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APPENDIX

LIST OF FREQUENTLY USED ACRONYMS

AD.....	Antidumping
AGOA.....	African Growth and Opportunity Act
APEC.....	Asia Pacific Economic Cooperation
ASEAN.....	Association of Southeast Asian Nations
ATC.....	Agreement on Textiles and Clothing
ATPA.....	Andean Trade Preferences Act
ATPDEA.....	Andean Trade Promotion & Drug Eradication Act
BIA.....	Built-In Agenda
BIT.....	Bilateral Investment Treaty
BOP.....	Balance of Payments
CACM.....	Central American Common Market
CAFTA.....	Central American Free Trade Area
CARICOM.....	Caribbean Common Market
CBERA.....	Caribbean Basin Economic Recovery Act
CBI.....	Caribbean Basin Initiative
CFTA.....	Canada Free Trade Agreement
CITEL.....	Telecommunications Division of the OAS
COMESA.....	Common Market for Eastern & Southern Africa
CTE.....	Committee on Trade and the Environment
CTG.....	Council for Trade in Goods
CVD.....	Countervailing Duty
DSB.....	Dispute Settlement Body
DSU.....	Dispute Settlement Understanding
EU.....	European Union
EFTA.....	European Free Trade Association
FTAA.....	Free Trade Area of the Americas
FOIA.....	Freedom of Information Act
GATT.....	General Agreement on Tariffs and Trade
GATS.....	General Agreements on Trade in Services
GDP.....	Gross Domestic Product
GEC.....	Global Electronic Commerce
GSP.....	Generalized System of Preferences
GPA.....	Government Procurement Agreement
IFI.....	International Financial Institution
IPR.....	Intellectual Property Rights
ITA.....	Information Technology Agreement
LDBDC.....	Least Developed Beneficiary Developing Country
MAI.....	Multilateral Agreement on Investment
MERCOSUL/MERCOSUR.....	Southern Common Market
MFA.....	Multifiber Arrangement
MFN.....	Most Favored Nation
MOSS.....	Market-Oriented, Sector-Selective
MOU.....	Memorandum of Understanding
MRA.....	Mutual Recognition Agreement
NAFTA.....	North American Free Trade Agreement

NEC.....	National Economic Council
NIS.....	Newly Independent States
NSC.....	National Security Council
NTR.....	Normal Trade Relations
OAS.....	Organization of American States
OECD.....	Organization for Economic Cooperation and Development
OPIC.....	Overseas Private Investment Corporation
PNTR.....	Permanent Normal Trade Relations
ROU.....	Record of Understanding
SACU.....	Southern African Customs Union
SADC.....	Southern African Development Community
SPS.....	Sanitary and Phytosanitary Measures
SRM.....	Specified Risk Material
TAA.....	Trade Adjustment Assistance
TABD.....	Trans-Atlantic Business Dialogue
TACD.....	Trans-Atlantic Consumer Dialogue
TAEVD.....	Trans-Atlantic Environment Dialogue
TALD.....	Trans-Atlantic Labor Dialogue
TBT.....	Technical Barriers to Trade
TEP.....	Transatlantic Economic Partnership
TIFA.....	Trade & Investment Framework Agreement
TPRG.....	Trade Policy Review Group
TPSC.....	Trade Policy Staff Committee
TRIMS.....	Trade Related Investment Measures
TRIPS.....	Trade Related Intellectual Property Rights
UNCTAD.....	United Nations Conference on Trade & Development
URAA.....	Uruguay Round Agreements Act
USDA.....	U.S. Department of Agriculture
USITC.....	U.S. International Trade Commission
USTR.....	United States Trade Representative
VRA.....	Voluntary Restraint Agreement
WAEMU.....	West African Economic & Monetary Union
WTO.....	World Trade Organization

FOREWORD

The 2006 National Trade Estimate Report on Foreign Trade Barriers (NTE) is the twenty-first in an annual series that surveys significant foreign barriers to U.S. exports.

In accordance with section 181 of the Trade Act of 1974 (the 1974 Trade Act), as amended by section 303 of the Trade and Tariff Act of 1984 (the 1984 Trade Act), section 1304 of the Omnibus Trade and Competitiveness Act of 1988 (the 1988 Trade Act), section 311 of the Uruguay Round Trade Agreements Act (1994 Trade Act), and section 1202 of the Internet Tax Freedom Act, the Office of the U.S. Trade Representative is required to submit to the President, the Senate Finance Committee, and appropriate committees in the House of Representatives, an annual report on significant foreign trade barriers.

The statute requires an inventory of the most important foreign barriers affecting U.S. exports of goods and services, foreign direct investment by U.S. persons, and protection of intellectual property rights. Such an inventory facilitates negotiations aimed at reducing or eliminating these barriers. The report also provides a valuable tool in enforcing U.S. trade laws, with the goal of expanding global trade, which benefits all nations, and U.S. producers and consumers in particular.

The report provides, where feasible, quantitative estimates of the impact of these foreign practices on the value of U.S. exports. Information is also included on some of the actions taken to eliminate foreign trade barriers. Opening markets for American goods and services either through negotiating trade agreements or through results-oriented enforcement actions is this Administration's top trade priority. This report is an important tool for identifying such trade barriers.

SCOPE AND COVERAGE

This report is based upon information compiled within USTR, the U.S. Departments of Commerce and Agriculture, and other U.S. Government agencies, and supplemented with information provided in response to a notice in the *Federal Register*, and by members of the private sector trade advisory committees and U.S. Embassies abroad.

Trade barriers elude fixed definitions, but may be broadly defined as government laws, regulations, policies, or practices that either protect domestic products from foreign competition or artificially stimulate exports of particular domestic products. This report classifies foreign trade barriers into ten different categories. These categories cover government-imposed measures and policies that restrict, prevent, or impede the international exchange of goods and services. They include:

- Import policies (e.g., tariffs and other import charges, quantitative restrictions, import licensing, customs barriers);
- Standards, testing, labeling and certification (including unnecessarily restrictive

application of sanitary and phytosanitary standards and environmental measures, and refusal to accept U.S. manufacturers' self-certification of conformance to foreign product standards);

- Government procurement (e.g., buy national policies and closed bidding);
- Export subsidies (e.g., export financing on preferential terms and agricultural export subsidies that displace U.S. exports in third country markets);
- Lack of intellectual property protection (e.g., inadequate patent, copyright, and trademark regimes);
- Services barriers (e.g., limits on the range of financial services offered by foreign financial institutions,¹ regulation of international data flows, and restrictions on the use of foreign data processing);
- Investment barriers (e.g., limitations on foreign equity participation and on access to foreign government-funded research and development (R&D) programs, local content and export performance requirements, and restrictions on transferring earnings and capital);
- Anticompetitive practices with trade effects tolerated by foreign governments (including anticompetitive activities of both state-owned and private firms that apply to services or to goods and that restrict the sale of U.S. products to any firm, not just to foreign firms that perpetuate the practices);
- Trade restrictions affecting electronic commerce (e.g., tariff and nontariff measures, burdensome and discriminatory regulations and standards, and discriminatory taxation); and
- Other barriers (barriers that encompass more than one category, e.g., bribery and corruption,² or that affect a single sector).

The NTE covers significant barriers, whether they are consistent or inconsistent with international trading rules. Many barriers to U.S. exports are consistent with existing international trade agreements. Tariffs, for example, are an accepted method of protection under the General Agreement on Tariffs and Trade (GATT). Even a very high tariff does not violate international rules unless a country has made a bound commitment not to exceed a specified rate. On the other hand, where measures are not consistent with international rules, they are actionable under U.S. trade law and through the World Trade Organization (WTO).

This report discusses the largest export markets for the United States, including: 58 nations, the European Union, Taiwan, Hong Kong, the Southern African Customs Union and one regional body. Some countries were excluded from this report due primarily to the relatively small size of their markets or the absence of major trade complaints from representatives of U.S. goods and services sectors. However, the omission of particular countries and barriers does not imply that

they are not of concern to the United States. Based on an assessment of the evolving nature of U.S. trade and investment relationships in the various regions of the world, in particular the continued movement away from central planning toward a market orientation, Cambodia and Laos have been added to the report. This recognizes the impact of a number of factors as both countries rapidly increase their integration into the world trading system. Both countries are implementing trade agreements with the United States. Cambodia is also implementing its WTO accession obligations while Laos is negotiating WTO accession.

The merchandise trade data contained in the NTE report are based on total U.S. exports, free alongside (f.a.s.)³ value, and general U.S. imports, customs value, as reported by the Bureau of the Census, Department of Commerce. (NOTE: These data are ranked according to size of export market in the Appendix). The services data are from the October 2005 issue of the Survey of Current Business (collected from the Bureau of Economic Analysis, Department of Commerce). The direct investment data are from the September 2005 issue of the Survey of Current Business (collected from the Bureau of Economic Analysis, Department of Commerce).

TRADE IMPACT ESTIMATES AND FOREIGN BARRIERS

Wherever possible, this report presents estimates of the impact on U.S. exports of specific foreign trade barriers or other trade distorting practices. However, it must be understood that these estimates are only approximations. Also, where consultations related to specific foreign practices were proceeding at the time this report was published, estimates were excluded, in order to avoid prejudice to those consultations.

The estimates included in this report constitute an attempt to assess quantitatively the potential effect of removing certain foreign trade barriers on particular U.S. exports. However, the estimates cannot be used to determine the total effect upon U.S. exports to either the country in which a barrier has been identified or to the world in general. In other words, the estimates contained in this report cannot be aggregated in order to derive a total estimate of gain in U.S. exports to a given country or the world.

Trade barriers or other trade distorting practices affect U.S. exports to another country because these measures effectively impose costs on such exports that are not imposed on goods produced domestically in the importing country. In theory, estimating the impact of a foreign trade measure upon U.S. exports of goods requires knowledge of the (extra) cost the measure imposes upon them, as well as knowledge of market conditions in the United States, in the country imposing the measure, and in third countries. In practice, such information often is not available.

Where sufficient data exist, an approximate impact of tariffs upon U.S. exports can be derived by obtaining estimates of supply and demand price elasticities in the importing country and in the United States. Typically, the U.S. share of imports is assumed to be constant. When no calculated price elasticities are available, reasonable postulated values are used. The resulting estimate of lost U.S. exports is approximate, depends upon the assumed elasticities, and does not necessarily reflect changes in trade patterns with third countries. Similar procedures are followed to estimate the impact upon our exports of subsidies that displace U.S. exports in third country markets.

The task of estimating the impact of nontariff measures on U.S. exports is far more difficult, since there is no readily available estimate of the additional cost these restrictions impose upon imports. Quantitative restrictions or import licenses limit (or discourage) imports and thus raise domestic prices, much as a tariff does. However, without detailed information on price differences between countries and on relevant supply and demand conditions, it is difficult to derive the estimated effects of these measures upon U.S. exports. Similarly, it is difficult to quantify the impact upon U.S. exports (or commerce) of other foreign practices such as government procurement policies, nontransparent standards, or inadequate intellectual property rights protection.

In some cases, particular U.S. exports are restricted by both foreign tariff and nontariff barriers. For the reasons stated above, it may be difficult to estimate the impact of such nontariff barriers on U.S. exports. When the value of actual U.S. exports is reduced to an unknown extent by one or more than one nontariff measure, it then becomes derivatively difficult to estimate the effect of even the overlapping tariff barriers on U.S. exports.

The same limitations that affect the ability to estimate the impact of foreign barriers upon U.S. goods exports apply to U.S. services exports. Furthermore, the trade data on services exports are extremely limited and of questionable reliability. For these reasons, estimates of the impact of foreign barriers on trade in services also are difficult to compute.

With respect to investment barriers, there are no accepted techniques for estimating the impact of such barriers on U.S. investment flows. For this reason, no such estimates are given in this report. The NTE includes generic government regulations and practices which are not product-specific. These are among the most difficult types of foreign practices for which to estimate trade effects.

In the context of trade actions brought under U.S. law, estimations of the impact of foreign practices on U.S. commerce are substantially more feasible. Trade actions under U.S. law are generally product-specific and therefore more tractable for estimating trade effects. In addition, the process used when a specific trade action is brought will frequently make available non-U.S. Government data (U.S. company or foreign sources) otherwise not available in the preparation of a broad survey such as this report.

In some cases, industry valuations estimating the financial effects of barriers are contained in the report. The methods computing these valuations are sometimes uncertain. Hence, their inclusion in the NTE report should not be construed as a U.S. Government endorsement of the estimates they reflect.

March 2006

Endnotes

1. The current NTE report covers only those financial services-related market access issues brought to the attention of USTR by outside sources. For the reader interested in a more comprehensive discussion of financial services barriers, the Treasury Department publishes quadrennially the National Treatment Study. Prepared in collaboration with the Secretary of State, the Office of the Comptroller of the Currency, the Federal Reserve Board, the Federal Deposit Insurance Corporation, the Securities and Exchange Commission, and the Department of Commerce, the Study analyzes in detail treatment of U.S. commercial banks and securities firms in foreign markets. It is intended as an authoritative reference for assessing financial services regimes abroad.

2. Corruption is an impediment to trade, a serious barrier to development, and a direct threat to our collective security. Corruption takes many forms and affects trade and development in different ways. In many countries, it affects customs practices, licensing decisions, and the awarding of government procurement contracts. If left unchecked, bribery and corruption can negate market access gained through trade negotiations, undermine the foundations of the international trading system, and frustrate broader reforms and economic stabilization programs. Corruption also hinders development and contributes to the cycle of poverty.

Information on specific problems associated with bribery and corruption is difficult to obtain, particularly since perpetrators go to great lengths to conceal their activities. Nevertheless, a consistent complaint from U.S. firms is that they have experienced situations that suggest corruption has played a role in the award of billions of dollars of foreign contracts and delayed or prevented the efficient movement of goods. Since the United States enacted the Foreign Corrupt Practices Act (FCPA) in 1977, U.S. companies have been prohibited from bribing foreign public officials, and numerous other domestic laws discipline corruption of public officials at the state and federal levels. The United States is committed to the active enforcement of the FCPA.

The United States Government has taken a leading role in addressing bribery and corruption in international business transactions and has made real progress over the past quarter century building international coalitions to fight bribery and corruption. Bribery and corruption are now being addressed in a number of fora. Some of these initiatives are now yielding positive results.

The United States Government led efforts to launch the Organization for Economic Cooperation and Development (OECD) Convention on Combating Bribery of Foreign Public Officials in International Business Transactions (Antibribery Convention). In November 1997, the United States and 33 other nations adopted the Antibribery Convention, which currently is in force for 36 countries, including the United States. The Antibribery Convention obligates its parties to criminalize the bribery of foreign public officials in the conduct of international business. It is aimed at proscribing the activities of those who offer, promise, or pay a bribe. (For additional information, see www.export.gov/tcc and www.oecd.org).

The United States played a critical role in the successful conclusion of negotiations that produced the United Nations Convention Against Corruption, the first global anti-corruption instrument. The Convention was opened for signature in December 2003, and is pending entry into force. The Convention requires countries to adopt such measures as may be necessary to criminalize fundamental anticorruption offenses, including bribery of domestic as well as foreign public officials. As of early March 2006, one hundred forty-one countries, including the United States, have signed the Convention and forty-nine have ratified it.

In March 1996, countries in the Western Hemisphere concluded negotiation of the Inter-American Convention Against Corruption (Inter-American Convention). The Inter-American Convention, a direct result of the Summit of the Americas Plan of Action, requires that parties criminalize bribery throughout the region. The Inter-American Convention entered into force in March 1997. The United States signed the Inter-American Convention on June 2, 1996 and deposited its instrument of ratification with the Organization of American States (OAS) on September 29, 2000. Twenty-eight of the thirty-three parties to the Inter-American Convention, including the United States, participate in a Follow-up Mechanism conducted under the auspices of the OAS to monitor implementation of the

Convention. The Inter-American Convention addresses a broad range of corrupt acts including domestic corruption and transnational bribery. Signatories agree to enact legislation making it a crime for individuals to offer bribes to public officials and for public officials to solicit and accept bribes, and to implement various preventive measures.

The United States Government continues to push its anti-corruption agenda forward. Consistent with the Bipartisan Trade Promotion Authority Act of 2002 (TPA), the United States Government is seeking and obtaining binding commitments in free trade agreements (FTAs) that promote transparency and that specifically address corruption of public officials. Also consistent with TPA, the United States Government is seeking to secure a meaningful agreement on trade facilitation in the World Trade Organization and has been pressing for concrete commitments on customs operations and transparency of government procurement regimes of our FTA partners. The United States Government is also playing a leadership role on these issues in the G-8 Forum, the Asia Pacific Economic Cooperation (APEC) Forum, the Southeastern Europe Stability Pact and other fora.

3. Free alongside (f.a.s.): Under this term, the seller quotes a price, including delivery of the goods alongside and within the reach of the loading tackle (hoist) of the vessel bound overseas.

ANGOLA

TRADE SUMMARY

The U.S. goods trade deficit with Angola was \$7.6 billion in 2005, an increase of \$3.6 billion from \$3.9 billion in 2004. U.S. goods exports in 2005 were \$928 million, up 56.2 percent from the previous year. Corresponding U.S. imports from Angola were \$8.5 billion, up 87.7 percent. Angola is currently the 66th largest export market for U.S. goods.

The stock of U.S. foreign direct investment (FDI) in Angola in 2004 was \$1.1 billion, the same as in 2003.

IMPORT BARRIERS

Tariffs and Non-Tariff Measures

Angola is a member of the WTO, the Common Market for Eastern and Southern Africa (COMESA), and the Southern African Development Community (SADC). In March 2003, Angola agreed to adhere to the SADC Protocol on Trade that seeks to facilitate trade by harmonizing and reducing tariffs and by establishing regional policies on trade, customs, and methodology. However, Angola is delaying implementation of this protocol until the country can re-launch internal production of non-petroleum goods, which remains extremely low due to an infrastructure devastated by 27 years of civil war. The government is concerned that implementation of the SADC Protocol on Trade would lead to a flood of imports, particularly from South Africa.

The Angolan government implemented a new customs law with revised duty rates effective in January 2005. The new program reduced tariff barriers by eliminating duties on basic products such as rice, wheat flour and beans, and reduced other duties by between 5 percent and 10 percent. Customs duties fall into 6 categories ranging from as low as 2 percent, which applies to raw materials necessary for the nation's development, up to 30 percent. Additional fees include clearing costs (2 percent), VAT (2 percent to 30 percent depending on the good), revenue stamps (0.5 percent), port charges (\$500/20 foot container or \$850/40 foot container), and port storage fees (free for the first 15 days, then \$20/20 foot container or \$40/40 foot container). In December 2004, the government announced a new special customs regime for the port of Cabinda which eliminates import and export duties for Cabinda province. The new regime does not apply to the petroleum industry, passenger vehicles, alcoholic beverages, tobacco, or jewelry.

Tariff obligations for the oil industry are largely determined by individually negotiated contracts between international oil companies and the Angolan government. In December 2004, Angola promulgated a new Petroleum Customs Law, which aimed to standardize tariff and customs obligations for the petroleum industry while protecting existing oil company rights and exemptions negotiated under prior contracts. According to customs officials, the new law does not provide for duty exemptions on imports by oil companies that are not directly used as equipment in oil production, as had been the case previously. Oil companies are currently disputing the customs officials' interpretation of the new law. Because most U.S. exports to

FOREIGN TRADE BARRIERS

Angola consist of specialized oil industry equipment which is largely exempt from tariffs, the impact of tariff barriers on U.S. exports is relatively low, in the range of \$10-25 million.

Customs Barriers

Angola is a member of the World Customs Organization (WCO) and signed the Letter of Intent to implement the WCO Framework in October 2005. In September 2005, the government approved a new customs code with the objective of facilitating clearance of commodities and reducing costs to importers. It replaces an outdated customs code dating back to colonial times and is harmonized with the Istanbul, Kyoto, and SADC international conventions.

Administration of Angola's customs service has improved in the last few years but remains a barrier to economic growth. In 2002, the Angolan government contracted with a British company to improve its customs clearance practices and, as a result, the average port clearance time has fallen from several months to less than two weeks. As of October 2005, port clearance time averaged seven days including weekends. In November 2005, the government approved an extension of the contract for the customs clearance contractor for another three years.

The government announced in October 2005, that it will not renew the contract with another contractor responsible for pre-shipment inspections (PSI) of imported commodities into Angola. The contract will end in March 2006 and importers will no longer need to submit most imports to pre-shipment inspections. However, the government will soon announce a list of selected products that will be subject to pre-shipment inspection. These inspections will be supervised by the customs service under guidelines to be established by the Ministry of Finance.

The importation of certain goods into Angola requires an import license issued by the Ministry of Trade. The import license is renewable annually and covers any good imported by the licensed importer. The importation of certain goods also requires specific authorization from various government ministries, which can delay the customs clearance process. Goods that require ministerial authorization include: pharmaceutical substances and saccharine and derived products (Ministry of Health); radios, transmitters, receivers, and other devices (Ministry of Post and Telecommunications); weapons, ammunitions, fireworks, and explosives (Ministry of Interior); plants, roots, bulbs, microbial cultures, buds, fruits, seeds, and crates and other packages containing these products (Ministry of Agriculture); fiscal or postal stamps (Ministry of Post and Telecommunications); poisonous and toxic substances and drugs (Ministries of Agriculture, Industry, and Health); and samples or other goods imported to be given away (Customs). If companies operating in the oil and mining industries present a letter from the Minister of Petroleum or Mines, they may import, without duty, equipment to be used exclusively for oil and mineral exploration.

Required customs paperwork includes the "Documento Unico" (single document) for calculation of customs duties, proof of ownership of the good, bill of lading, commercial invoice, packing list, and specific shipment documents verifying the right to import or export the product. Any shipment of goods equal to or exceeding \$1000 requires a clearing agent.

Competition among clearing agents is limited as the government has only licensed between 50 and 55 clearing agents. This has resulted in high fees, which often range between one and two percent of the value of the declaration.

STANDARDS, TESTING, LABELING, AND CERTIFICATION

Angola has adopted SADC guidelines on biotechnology, which effectively prohibit imports of biotechnology grain or seed until regulatory systems governing biotechnology have been developed. In January 2005, the government announced the promulgation of a law banning the importation of biotechnology products based on an earlier ministerial decree issued by the Ministry of Agriculture in April 2004. The Ministry of Agriculture controls all agricultural imports, and importers must present documents certifying that their goods do not include biotechnology products. Biotechnology food aid is permitted, but must be milled or sterilized to render the grain incapable of germinating upon arrival in the country and before distribution to beneficiaries. Biotechnology imports for scientific research will be subject to regulations and controls to be established by the Ministry of Agriculture.

Three agencies in Angola assume responsibility for food safety controls: the National Consumer Institute (INADEC), Codex Angola, and the Ministry of Agriculture. The Ministry of Agriculture sets standards and issues regulations for agricultural products produced, imported, and traded in the country. INADEC works to defend consumers' rights by conducting laboratory tests for food safety and quality. Codex Angola coordinates government policy and strategy regarding food safety controls and is working to promote updated food safety and food quality legislation and to create a nationwide network of laboratories. Angola has one well-equipped testing laboratory used to test some imported foods.

Angola does not currently enforce any labeling law. In early 2003, the Ministry of Industry issued a decree that requires labeling in Portuguese, but the rule has not been implemented. In practice, many imports are admitted into the country with little reference to health, testing, or weight standards. Angolan standards, testing, labeling and certification requirements have little effect on U.S. agricultural exports to Angola.

GOVERNMENT PROCUREMENT

Angola is not a signatory to the WTO Agreement on Government Procurement. The government advertises tender notices in local and international publications 15 days to 90 days before the tenders are due. Tender documents are normally obtained from a specific government ministry, department, or agency for a non-refundable fee. Completed tenders, accompanied by a specified security deposit, are usually submitted directly to the procuring ministry. The tendering process often lacks transparency. Information about government projects and tenders is not often readily available from the appropriate authorities, and the interested parties must spend considerable time on research. Announcements for government tenders are sometimes published in the government newspaper "Jornal de Angola." Under the Promotion of Angolan Private Entrepreneurs Law, the government gives Angolan companies preferential treatment in tendering for goods, services and public works contracts.

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The Angolan government has greatly increased spending to rehabilitate infrastructure damaged by the war and for election preparations. Opportunities for U.S. companies include installation of Angola's telecommunications backbone network, air navigation and radar equipment, rail equipment and communications systems, and power transmission lines.

INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

Although Angola has basic intellectual property rights protection and is working to strengthen existing legislation and enforcement, current protection is weak due to a lack of enforcement capacity. Intellectual property rights are regulated by the Ministry of Industry (trademarks, patents, and designs), and by the Ministry of Culture (authorship, literary, and artistic rights). Intellectual property is protected by Law 3/92 for industrial property and Law 4/90 for the attribution and protection of copyrights.

Angola's legislature approved the Paris Convention for the Protection of Industrial Property in August 2005, including the 1979 text and the World Intellectual Property Organization (WIPO) Patent Cooperation Treaty concluded in 1970 and amended in 1979 and 1984. Each petition for a patent that is accepted is subject to a fee that varies by type of patent requested. No suits involving U.S. intellectual property are known to have been filed in Angola.

SERVICES BARRIERS

Foreign participation in the services sector is generally not restricted. The banking sector comprises the bulk of the services sector and has grown substantially over the past two years, with Portuguese banks and private Angolan banks leading the expansion and with South African banks not far behind. The underdeveloped banking sector collects most of its profits from service fees, largely in foreign exchange transactions. The central bank is working with the government to improve banking sector legislation and supervision, and a new financial sector law and money laundering law are awaiting promulgation. As a result of increasing competition and experience, banking services are improving. In addition to banks, Angola's financial sector has four licensed insurance companies, but only two are presently operating. A third is expected to begin operations by the beginning of 2006, partly in response to new laws requiring automotive, aviation, and worker safety insurance.

INVESTMENT BARRIERS

Angola is officially open to foreign investment, but its regulatory and legal infrastructure is not adequate to facilitate much direct investment or to provide sufficient protection to foreign investors. Smaller, non-extractive firms tend to have a more difficult time conducting business in Angola than larger multinational corporations engaged in extractive industries. Angola created a National Private Investment Agency (ANIP) in July 2003 to assist investors and facilitate new investment. In 2003, the Angolan government replaced the 1994 Foreign Investment Law with the Law on Private Investment (Law 11/03). The new law lays out the general parameters, benefits, and obligations for foreign investment in Angola. It seeks to encourage foreign investment by providing equal treatment for domestic and foreign investors, offering fiscal and customs incentives, and simplifying the investment application process.

FOREIGN TRADE BARRIERS

However, it is vague on profit repatriation and includes weak legal safeguards to protect foreign investors. In addition, many provisions of the law are subordinate to other sectoral legislation, which allows other government ministries to override some of the protections and incentives offered by the investment law.

Angolan law does not allow for international arbitration and requires that any investment dispute be resolved in Angolan courts. Angola has not ratified major international arbitration treaties. The World Bank's "Doing Business in 2006" survey estimates that commercial contract enforcement, measured by the amount of time elapsed between filing of a complaint and receipt of restitution generally takes more than 1000 days in Angola. A voluntary arbitration law that provides the legal framework for speedier, non-judicial resolution of disputes has been drafted but not yet approved.

Angola's previous foreign investment law expressly prohibited foreign investment in the areas of defense, internal public order, and state security; in banking activities relating to the operations of the Central Bank and the Mint; in the administration of ports and airports; and in other areas of the State's exclusive responsibility by law. Although Law 11/03 does not explicitly restate these prohibitions, these areas are assumed to remain off-limits to investors. Investments benefit from a more standardized set of incentives under the Law on Tax and Customs Incentives for Private Investment, approved by the National Assembly in July 2003. Companies must apply for these benefits when negotiating with ANIP.

Although the new investment law is part of an overall effort by the Angolan government to create a more investor-friendly environment, many laws governing the economy have vague provisions that permit wide interpretation and inconsistent application by the government across sectors. Investments in the petroleum, diamond, and financial sectors continue to be governed by specific legislation. Foreign investors can set up fully-owned subsidiaries in many sectors, but frequently are strongly encouraged, though not formally required, to take on local partners.

Obtaining the proper permits and business licenses to operate in Angola is time-consuming and adds to the cost of investment. The World Bank "Doing Business in 2006" report identified Angola as the most time-consuming country out of 155 countries surveyed to establish a business, requiring an average of 146 days to register a business compared to a regional average of 63 days. According to the new investment law, ANIP and the Council of Ministers should take no more than two months to approve a contract with an investor, but in practice this process normally takes two to three months. After contract approval, the company must register and file documentation with the relevant government ministries.

In August 2003, the government established a one-stop shop, or "Guiche Unico," aimed at simplifying the process of registering a company by unifying under one roof the procedures required by various government ministries. However, the "Guiche Unico" lacks authority over the government ministries that must approve licenses, permits, and other requirements, and thus has had little success in expediting company registration. The two most time-consuming steps are obtaining certification from the Notary Public and publication of the company name and statutes in the *Diário da República*, the national gazette managed by the National Press.

The government is gradually implementing local content legislation for the petroleum sector, originally promulgated in November 2003 (Order 127/03 of the Ministry of Petroleum). The legislation will require many foreign oil services companies currently supplying the petroleum sector to form joint-venture partnerships with local companies. For the provision of goods and services not requiring heavy capital investment and with a basic, medium, or higher level of non-specialized expertise, foreign companies may only participate as a contractor to Angolan companies. For activities requiring a medium level of capital investment and a higher level of expertise, not necessarily specialized, foreign companies may only participate in association with Angolan companies, i.e. through a joint venture.

ELECTRONIC COMMERCE

The country's basic telecommunications law governs information technology, but includes no specific regulations regarding electronic commerce.

OTHER BARRIERS

Corruption

Petty corruption is prevalent due to low civil service salaries, dependence on a centralized bureaucracy and antiquated regulations dating back to the colonial era. Procedures to register a company are complicated and may involve up to 14 steps with many different government ministries, thus giving rise to rent-seeking opportunities. Investors are often tempted to seek quicker service and approval by paying gratuities and other facilitation fees.

Angola's public and private companies have not traditionally used transparent accounting systems consistent with international norms, and few companies in Angola adhere to international audit standards. The government approved an audit law in 2002 that sought to require audits for all "large" companies, but it has not yet been possible to enforce this rule due to the lack of a professional accounting institute. The World Bank is pushing for this institute to be established.

Investors have at times experienced harassment, political interference, and pressure to sell their investments. In some cases, these practices have involved individuals with powerful positions within the government who exert pressure directly or through the established bureaucracy. As a result, some investors have experienced significant delays in payments for government contracts and delays in obtaining the proper permits or approval of projects. Investors report pressure to form joint ventures with powerful local interests.

FOREIGN TRADE BARRIERS

Recovering from War

Angola's badly damaged infrastructure substantially increases the cost of doing business. Transportation of goods and persons is particularly costly due to poor roads, destroyed bridges, and mined secondary routes. None of the country's three main railroads is yet functioning in its entirety. The country is in the process of rebuilding its communications, energy, transportation, and road infrastructure. Domestic and international communications, while improving, are difficult and costly. With 500 percent growth in cell phone users over the past three years, the cell phone network is oversubscribed and is occasionally busy and unavailable, but coverage is improving and has been available in all provincial capitals since the end of 2004. There are frequent interruptions in power and water supplies, and power surges can damage electronic equipment. As a result, investors face additional costs to support their businesses, such as paying for security services, back-up generators, and water reservoirs. However, rebuilding infrastructure is a major objective of Angola. The government announced that public investment will reach \$2.5 billion for 2005, and has proposed a 2006 budget that calls for a 20 percent increase in capital spending, to be financed from higher oil revenue.

ARAB LEAGUE

The impact of the Arab League boycott of Israel on U.S. trade and investment in the Middle East and North Africa varies from country to country. While it remains a serious barrier for U.S. firms attempting to export from Israel to some countries in the region, the boycott has virtually no effect on U.S. trade and investment in many other countries in the region. Arab League members include the Palestinian Authority and the following states: Algeria, Comoros, Djibouti, Egypt, Iraq, Jordan, Lebanon, Libya, Mauritania, Morocco, Somalia, Sudan, Syria, Tunisia, Yemen, and the Gulf Cooperation Council (GCC) countries (Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates). The United States continues to oppose the boycott, and U.S. government officials have urged Arab League members to end its enforcement. Toward that goal, U.S. embassies and government officials raise the boycott with host country officials, noting the persistence of illegal boycott requests and the impact on both U.S. firms and on the countries' ability to expand trade and investment. Under U.S. antiboycott legislation enacted in 1978, U.S. firms are prohibited from responding to any request for information that is designed to determine compliance with the boycott and are required to report receipt of any such request to the U.S. Department of Commerce's Office of Antiboycott Compliance (OAC).

The primary aspect of the boycott prohibits the importation of Israeli-origin goods and services into boycotting countries. This prohibition conflicts with the obligation of Arab League member states that are also members of the World Trade Organization to treat Israeli imports on a Most Favored Nation (MFN) basis. The secondary and tertiary aspects of the boycott discriminate against U.S. and other foreign firms that wish to do business with both Israel and boycotting countries. These constrain U.S. exports to the region. The secondary aspect of the boycott prohibits individuals – as well as private and public sector firms and organizations – in Arab League countries from engaging in business with U.S. and other foreign firms that contribute to Israel's military or economic development. Such firms are placed on a blacklist maintained by the Damascus-based Central Boycott Office (CBO), a specialized bureau of the Arab League. The tertiary aspect of the boycott prohibits business dealings with U.S. and other firms that do business with blacklisted companies.

While the legal structure of the boycott in the Arab League remains unchanged, enforcement of the boycott remains the responsibility of individual member states and enforcement efforts vary widely from country to country. Some member governments of the Arab League have consistently maintained that only the Arab League as a whole can revoke the boycott. Other member governments support the view that adherence to the boycott is a matter of national discretion, and a number of states have taken steps to dismantle some aspects of it.

Egypt has not enforced any aspect of the boycott since 1980, pursuant to its peace treaty with Israel, although U.S. firms occasionally find some government agencies using outdated forms containing boycott language. Jordan ended its enforcement of the boycott with the signing of its peace treaty with Israel in 1994. Algeria, Morocco, Tunisia, and the Palestinian Authority do not enforce the boycott.

In September 1994, the GCC countries announced an end to the secondary and tertiary aspects of the Arab League boycott of Israel, eliminating a significant trade barrier to U.S. firms. In December 1996, the GCC countries recognized the total dismantling of the boycott as a necessary step to advance peace and promote regional cooperation in the Middle East and North Africa. Although all GCC states are complying with these stated plans, some commercial documentation continues to contain boycott language.

Bahrain does not have any restrictions on trade with U.S. companies that have relations with Israeli companies. Outdated tender documents in Bahrain have occasionally referred to the secondary and tertiary aspects of the boycott, but such instances have typically been remedied quickly. Bahrain's Ministry of Finance circulated a memorandum to all Bahraini Ministries in September 2005, reminding them that the secondary and tertiary boycotts are no longer in place and to remove any boycott language from contracts. The Government of Bahrain has stated publicly that it recognizes the need to dismantle the primary boycott and is taking steps to do so. It recently closed down its boycott office, the only entity responsible for enforcing the boycott. The U.S. government has received assurances from the Government of Bahrain that it is committed to ending the boycott. Bahrain is fully committed to complying with WTO requirements on trade relations with other WTO members, and Bahrain has no restrictions on American companies trading with Bahrain or doing business in Bahrain, regardless of their ownership or relations with Israeli companies. Bahrain did not attend the November 2005 Arab League boycott meeting in Damascus. Israeli-labeled products are reported to be found occasionally in the Bahraini market. There are no entities present in Bahrain for the purpose of promoting trade with Israel.

In accordance with the 1994 GCC decision, Kuwait no longer applies a secondary or tertiary boycott of firms doing business with Israel, and has taken steps to eliminate all direct references to the boycott of Israel in its commercial documents. Although Kuwaiti law does not include any specific language referring to or mandating a boycott of Israeli goods, Kuwait still applies a primary boycott of goods and services produced in Israel. Kuwait maintains an open boycott office in its Customs department and regularly attends Arab League boycott meetings. There is no direct trade between Kuwait and Israel.

Oman does not apply any aspect of the boycott, whether primary, secondary or tertiary, and has no laws to that effect. Although outdated boycott language occasionally appears inadvertently in tender documents, Oman is working to ensure such language is removed from these documents. In January 1996, Oman and Israel signed an agreement to open trade missions in each country. However, in October 2000, following the outbreak of the second Intifada, Oman and Israel suspended these missions. Omani customs processes Israeli-origin shipments entering with Israeli customs documentation. However, Omani firms have recently reportedly avoided marketing any identifiably Israeli consumer products. Telecommunications links and mail flow normally between the two countries.

In April 1996, Qatar and Israel agreed to exchange trade representation offices. The Israeli trade office opened in May 1996 and remains open. Qatar does not have any boycott laws on the books, and does not enforce the Arab League boycott. Although Qataris have sometimes visited Israel to investigate business opportunities, effectively there is no trade between the two states.

FOREIGN TRADE BARRIERS

Some Qatari government tender documents still include outdated boycott language. U.S. embassy officials have discussed this matter with the Central Tenders Committee, who claim that a final decision regarding the presence of boycott language in government tender documents is pending with the Ministry of Finance. The U.S. Government is currently working with the Ministry of Finance on this issue.

In accordance with the 1994 GCC decision, Saudi Arabia terminated the secondary and tertiary boycotts, and they are no longer enforced in the Kingdom. In light of its accession to the WTO in 2005, the Saudi government has re-issued the original directive confirming that these two boycotts are not to be applied in Saudi Arabia. The Ministry of Commerce (MOC) also established an office to address any reports of boycott violations. The MOC met with the U.S. Department of Commerce's Office of Anti-Boycott Compliance (OAC) in September 2005 to discuss methods for ensuring Saudi commercial documents and tenders are in compliance with anti-boycott regulations. The OAC's list of reported boycott violations in Saudi Arabia over the last few years has decreased dramatically, and the reported violations appear to reflect out-of-date language in recycled commercial and tender documents. Saudi companies have been willing to void or revise that language when they are notified of its use. Saudi Arabia is obligated to apply WTO commitments to all current members, including Israel.

U.S. firms have faced boycott requests in the United Arab Emirates as a result of bureaucratic and administrative inefficiencies. The UAE continues to have a policy of not implementing the secondary and tertiary aspects of the boycott. The UAE is taking steps to eliminate these prohibited boycott requests, and over the last year, the UAE government has issued instructions reiterating its position on the boycott.

Yemen remains a full participant in annual meetings of the Arab League boycott committee. The Government of Yemen does not have an official boycott office, but the Ministry of Trade chooses a representative from its staff to attend the Arab League meetings on an annual basis. Yemen enforces the primary boycott of goods and services produced in Israel. There are no specific laws on the books in Yemen regarding the boycott.

ARGENTINA

TRADE SUMMARY

The U.S. goods trade deficit with Argentina was \$472 million in 2005, an increase of \$115 million from \$357 million in 2004. U.S. goods exports in 2005 were \$4.1 billion, up 21 percent from the previous year. Corresponding U.S. imports from Argentina were \$4.6 billion, up 22.1 percent. Argentina is currently the 32nd largest export market for U.S. goods.

U.S. exports of private commercial services (i.e., excluding military and government) to Argentina were \$1.7 billion in 2004, and U.S. imports were \$754 million. Sales of services in Argentina by majority U.S.-owned affiliates were \$3.5 billion in 2003 (latest data available), while sales of services in the United States by majority Australia-owned firms were not available in 2003 (\$5 million in 2001).

The stock of U.S. foreign direct investment (FDI) in Argentina in 2004 was \$11.6 billion, up from \$10.9 billion in 2003. U.S. FDI in Argentina is concentrated largely in the manufacturing, finance, and information sectors.

IMPORT POLICY

With the collapse of the currency board system in January 2002, there was a 70 percent devaluation of the peso, a 56 percent drop in imports, and a three percent decline in exports the latter due to general uncertainty and lack of finance. Argentina's exchange rate policy is based on a managed float that targets a nominal exchange rate close to ARP 3 per U.S. dollar. However, the peso appreciated a nominal 7.5 percent between January 2003 and mid-November 2005.

Imports of used clothing are prohibited except for donations to government or religious organizations. Argentina prohibits the importation and sale of used tires, used or refurbished medical equipment, such as imaging equipment, and used auto parts. Imports of a long list of used capital goods are totally prohibited. Some used machinery imports are allowed, but only after the machinery is rebuilt. Brazil and Argentina's common automotive policy (Bilateral Auto Pact) bans the import of used self-propelled agricultural machinery.

The Government of Argentina placed substantial restrictions on natural gas exports to Chile by ministerial resolutions. Restrictions were imposed during 2004 and 2005, when rapid growth in demand outstripped the growth of supply, threatening domestic industrial production and residential use. Supply to Chile was cut completely on several occasions during 2005. Several U.S. companies were affected by these restrictions resulting in the violation of their export contracts. In May 2005, the government imposed a 20 percent export tax on gas exports.

TARIFFS

Argentina's average applied tariff rate was 13 percent in 2005, and ranges from zero percent to 35 percent. A statistical fee of 0.5 percent is added to most products (90 percent of all harmonized system tariff lines). The average export tax is 10.2 percent.

Exporters may claim reimbursement for some domestically paid taxes apart from VAT reimbursements. The average non-VAT reimbursement for exporters is 4.0 percent. In November 2005, the government issued rebates eliminating tax reimbursements on approximately 200 food products, as well as instituting price caps in an effort to reduce domestic prices.

Argentina is a member of MERCOSUR, a customs union comprised of Argentina, Brazil, Paraguay and Uruguay. Full common external tariff (CET) product coverage schedule for implementation in 2006 may be delayed. CETs range from zero percent to 20 percent *ad valorem*, with a number of country-specific exceptions. Currently Argentina maintains exceptions on 1,899 products or 7 percent of the total harmonized system.

In 2005, the government imposed new non-automatic licenses on shoes and toys (Resolutions 485/05 and 486/05) and there is an automatic license requirement for most footwear imports. In 2004, Resolution 495/04 established minimum specific import duties on footwear imports to be in force for 180 days. In 2005, however, the Ministry of the Economy extended the 180-day period to December 31, 2007. These import duties do not apply to imports from MERCOSUR countries and cannot exceed 35 percent when calculated as an equivalent *ad valorem* tariff. Under Resolution 825/01, toys and textiles from China are taxed with high specific tariffs affecting U.S. firms established in Argentina that import from China. This resolution includes a phase-out program for all duties on these products to be equivalent to a maximum 35 percent *ad valorem* tariff by January 2007.

CUSTOMS PROCEDURES

Argentina subscribes to the WTO Agreement on Customs Valuation. Argentina has import monitoring mechanisms, similar to an import-licensing regime, which affect roughly one-fifth of its imports. Cumbersome requirements exist for certificates of origin, particularly in the electronics and textile sectors. There is a "Canal Morado" procedure when Customs finds that the declared price of an import is lower than its reference price. The importer must provide a guarantee for the duties on the difference that Customs may end up retaining. This customs verification procedure can take a long time and results in higher financial costs for importers.

In 2005, Federal Administration for Public Revenues (AFIP) Resolution 1811/05 modified the import-export regime applied to couriers. Previously, a simplified procedure for Customs clearance that applied to international operations up to \$3,000 expedited couriers' activities. Resolution 1811/05 reduced this maximum to \$1,000, resulting in a vast number of courier operations going through normal customs clearance procedures which take three times longer than that of the simplified procedure.

FOREIGN TRADE BARRIERS

Additionally, couriers must declare the tax identification codes of the sender and addressee, rendering the process troublesome and costly. This burdensome regulation increases the cost not only for the courier, but also for users of courier services.

STANDARDS, TESTING, LABELING AND CERTIFICATION

Agricultural Products: The government has banned sweetbreads (from thymus gland) since 2002, due to the perceived risk of BSE transmissibility. Additionally, the government requires all products related to beef to have a special sanitary certificate which is not required of U.S. beef under internationally recognized standards. INAL demands traceability and documents stamped/notarized by the Argentine Consulate for these products. Argentina continues to delay issuing the final authorization for imports of additional citrus fruit, pears, and cherries from the United States. Argentina prohibits the import of seed potatoes, claiming phytosanitary concerns.

Non-agricultural Products: Argentina's Standards Institute (IRAM) bases some of its voluntary standards on international standards. IRAM standards are in some cases compatible with U.S. or European standards. In general, Argentine buyers accept products that meet U.S. standards. Argentina began mandating compliance with new safety certifications on a wide range of products in early 1998, affecting U.S. exports of low voltage electrical products (household appliances, electronics products and electrical materials), toys, covers for dangerous products, gas products, construction steel, personal protective equipment, and elevators. Many businesses often find the procedures for compliance to be inconsistent, redundant, and non-transparent.

Regulations that require product testing can be cumbersome, costly and problematic for small and medium-sized U.S. companies. Argentina's certificate of origin regulations require separate certificates for each of the countries involved in manufacturing the various components of a final product. In the past, Argentina failed to fulfill the notification and comment requirements of the WTO Agreement on Technical Barriers to Trade (TBT) in its implementation of these measures.

Regulations require strict specifications for textile and footwear labels. Labels must have very specific characteristics and information, and importers must provide details about products and composition that result in delays.

INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

Patents: Argentina's lack of adequate and effective patent protection has been a long-standing irritant in the bilateral trade relationship. Argentina is on the Special 301 Priority Watch List. The National Intellectual Property Institute (INPI) started to grant pharmaceutical patents in October 2000. INPI has been slow since that time in issuing pharmaceutical patents to products with commercial value. INPI, however, has taken a number of steps, including the implementation of fast-track procedures, to reduce Argentina's large patent application backlog. In April 2002, negotiations between the governments of the United States and Argentina clarified aspects of Argentina's intellectual property system, such as provisions related to the patentability of microorganisms and its import restriction regime. Those negotiations did not resolve the dispute concerning the lack of protection for safety and efficacy data developed by pharmaceutical companies submitted to INPI for the approval of pharmaceutical products.

Argentina amended its patent law in December 2003, as required by the May 2002 agreement between the two governments.

The intention of the amendment was to provide protections for process patents and to ensure that preliminary injunctions were available in intellectual property court proceedings, among other steps. The United States retained its right to seek resolution on the outstanding issues, including data protection, under the WTO dispute settlement mechanism.

Copyrights: Argentina's copyright laws provide generally good protection. Argentina ratified the World Intellectual Property Organization (WIPO) Copyright Treaty and the WIPO Performances and Phonograms Treaty in 1999, though some implementation issues remain. In November 1998, Argentina promulgated legislation establishing software piracy as a criminal offense, but the government has yet to fully comply with an agreement with the private sector to eliminate unlicensed software used in government offices.

Enforcement of copyrights on recorded music, videos, books, and computer software remains inconsistent. Argentina customs and other government authorities generally cooperate with industry efforts to stop shipments of pirated merchandise, but inadequate resources and multiple and slow court procedures have hampered the effectiveness of enforcement efforts. A court order issued in 2004 resulted in Argentine customs inspecting all shipments of blank optical disks coming into the country. The legal framework regarding Internet piracy provides few incentives to investigate and punish those who post infringing materials. On November 20, 2005, local record companies announced that they had filed 20 civil cases against “upholders”, or Internet users that share music through the net, violating intellectual property laws. Local record companies produced a report showing that more than 412 million songs are downloaded from the Internet in Argentina each year. Inadequate border controls, particularly at the Paraguayan/Brazilian border, further contribute to the regional circulation of pirated goods. The U.S. copyright industries are increasingly concerned with widespread offering of “home delivery” for pirated products. End-user piracy of business software, motion picture piracy, and book piracy remain widespread.

Trademarks: Argentina’s trademark law, Law on Trademarks and Designations (No. 23,262), was issued in 1980. Similar to other Latin American countries, Argentina has a somewhat limited view of eligible subject matter for trademarks, not accepting applications for certification marks. Argentina does, however, provide protection for sound and scent marks. U.S. companies report that the process of registering trademarks generally takes over five months. The registering procedure was improved and made quicker with Presidential Decree 1141/03.

Overall, enforcement of copyrights and trademarks remains a serious concern. Border controls and the prosecution of intellectual property violations are ineffective, civil damages are non-deterrent, and in criminal cases, the judiciary is reluctant to impose deterrent penalties, including jail time.

The United States and Argentina are closely allied in the area of agricultural biotechnology as co-complainants in challenging the EU moratorium on transgenic crops and implementation of the Cartagena Protocol of Biosafety (CPB). However, the government needs to adopt and

enforce intellectual property regimes acceptable to foreign companies, in order to attract sufficient investment in agricultural biotechnology. Argentina has been attempting to negotiate a system for royalty payments to accommodate agricultural companies where the Argentine Supreme Court previously declined to approve patent rights. These negotiations have reached an impasse, and companies could be forced to seek additional legal recourse if negotiations cannot be restarted and a reasonable solution achieved. The government opposes a grain-based collection system, as they believe it would undermine the joint WTO case against the EU. Argentine soybean exports for marketing year 2005/06 are forecast at 9.7 million metric tons. About 99 percent are biotechnology U.S. soybeans and large portions are produced without the necessary royalty payments.

SERVICES BARRIERS

Argentina enacted broad liberalization in the service sector as part of its economic reform program in the 1990s, but some barriers continue to exist. For example, the Argentina government obliges cable/pay television operators to register their programming with a government body. This government body imposed restrictions on the frequency of advertisements on cable-TV providers. In addition, restrictions regarding the showing, printing and dubbing of films burden U.S. exports, as does the practice of charging *ad valorem* customs duties based on the previously estimated value of the authors' rights, rather than solely on the value of the physical materials being imported which is the WTO standard.

In the WTO, Argentina has committed to allow foreign suppliers of non-insurance financial services to establish all forms of commercial presence and has committed to provide substantially full market access and national treatment to foreign suppliers of non-insurance financial services. The only significant remaining issue is that lending limits for foreign bank branches are based on local paid-in capital, not the parent bank's capital.

In general, commercial presence of insurance firms is permitted under the same conditions required for local firms. Law 20091, however, establishes that the branches or agencies of foreign insurance firms will be authorized to perform insurance activities in Argentina if there is reciprocity in the respective countries' laws. There was a reform of minimum capital requirements for new insurance firms in 1998, which resulted in new firms having to fulfill higher minimum capital requirements, whereas older firms could still benefit from lower requirements. Therefore, firms that establish themselves in the Argentine market through the acquisition of another firm benefiting from lower standards will be in a better position than those firms that begin in the Argentine market as new companies and, therefore, are subject to the new standards. These measures affect both foreign and local firms. The localization of assets maintained by insurance firms is affected by regulations issued by the government entity that supervises the sector, the National Insurance Superintendency (SSN). Some 75 percent of capital and 90 percent of technical reserves are to be invested within the country. There are lists of authorized investments that become stricter in the case of firms that manage pension funds (AFJP). These lists apply to both foreign and local firms. Argentine residents cannot acquire life, medical, or patrimony insurance abroad. Foreign suppliers cannot publicize their services within Argentina. However, insurance for cargo is permitted and reinsurance engaged abroad is always permitted, for all types of insurance.

FOREIGN TRADE BARRIERS

There is also a restriction on insuring goods owned or used by the National, provincial or municipal governments, independent agencies and people or firms that were granted concessions. The insurance for such goods has to be engaged with local firms, as established by Law 12988.

INVESTMENT BARRIERS

In line with WTO rules, Argentina in 1995 notified measures inconsistent with its obligations under the WTO Agreement on Trade-Related Investment Measures (TRIMS). The notified measures dealt with local content and trade balancing in the automotive industry. Proper notification allowed developing country WTO members to maintain such measures for a five-year transitional period, ending January 1, 2000. In November 2001, the WTO granted an extension to the TRIMS transitional period allowing Argentina and several other countries to maintain TRIMS-inconsistent measures until December 31, 2003. Article 23 of the September 2002 bilateral auto pact between Argentina and Brazil allowed Argentina to maintain minimum domestic content requirements on vehicles manufactured in Argentina until 2005. Article 13 of the agreement established trade balancing measures that expire in 2006.

The government implemented an increasing variety of capital and exchange controls throughout 2002. These measures inhibited access to foreign exchange to pay for imports, which has created difficulties for U.S. investors in Argentina, among others. As of September 2002, the government retained strict controls on the release of foreign exchange to pay for imports of 2,700 products. During 2003, most of the exchange market controls for imports were relaxed or abolished. Imports can now be paid in advance regardless of the type of good involved. Importers, however, must show that imported products entered Argentina within 360 days of payment. There are no restrictions on payments for services imports (such as freight, insurance, technical assessment, professional fees, etc.).

Hard currency export earnings, both from goods and services, must be cleared in the local foreign exchange market (with exceptions) and there are time limits to fulfill this obligation. Those limits range from approximately 130 to 350 working days for goods (depending on the goods involved) and 135 working days for services. For certain capital goods and situations where exports receive long-term financing, exporters face more liberal time limits. The foreign exchange clearance requirement does not apply to exports of certain minerals or for exports to Argentine foreign trade zones, and is limited to 30 percent of total revenues for hydrocarbons exports. Foreign currency earned through exports may be used for some foreign debt payments.

Argentina imposed a registration requirement for the inflows and outflows of capital, and a 180-day minimum investment period, beginning in June 2003. In May 2005, the government issued Presidential Decree 616/05 and extended the minimum time period to 365 days. The Decree also expanded the registration requirement to include "all types of debt operations of residents that could imply a future foreign currency payment to non-residents" and requires that all foreign debt of Argentine private sector residents, with the exception of trade finance and initial debt offerings, that bring foreign exchange into the market must include provisions that the debt need not be repaid in less than 365 days.

FOREIGN TRADE BARRIERS

Decree 616/05 imposed more restrictive controls on three classes of inbound investments: inflows of foreign funds from private sector debt, excluding foreign trade and primary stock and bond issues; inflows of non-resident funds that are destined for the holding of Argentine pesos or the purchase of private sector financial instruments (excluding foreign direct investment and the primary issuance of stocks and bonds); and investments in public sector securities purchased in the secondary market. These three types of inflows are subject to three restrictions: (a) they may not be transferred out of the country for 365 days after their entry; (b) proceeds from foreign exchange transactions involving these investments must be paid into an account in the local financial system; and (c) 30 percent of the amount of such transactions must be deposited in a local financial entity for 365 days. The account must be denominated in dollars and pay no interest. Violations are subject to criminal prosecution.

Under the bilateral investment treaty (BIT) between Argentina and the United States, which entered into force in 1994, each country committed to provide investors of the other country treatment equal to what it offers its own investors or investors from any other country. The BIT also includes obligations relating to compensation for expropriation, the free movement of capital and other investment-related transfers, and the right to hire senior managers of any nationality. Several U.S. investors have submitted to binding investor-state arbitration under the BIT claims that measures imposed by Argentina during the financial crisis that began in 2001 breached BIT obligations.

ELECTRONIC COMMERCE

Argentina has an advanced legal framework for Digital Signature. The Digital Signature Law 25506 was passed in 2001, followed by the Presidential Decree 2628/02, providing the implementation procedures for the use of Digital Signature in Argentina. There are, however, a few pending security and technological issues that the Application Authority needs to define to complete the regulatory regime for the full implementation of Digital Signature in Argentina. Argentina does not allow the use of electronically produced air waybills, limiting their ability to speed up customs processing and the growth of electronic commerce transactions.

AUSTRALIA

TRADE SUMMARY

The U.S. goods trade surplus with Australia was \$8.4 billion in 2005, an increase of \$1.7 billion from \$6.7 billion in 2004. U.S. goods exports in 2005 were \$15.8 billion, up 10.9 percent from the previous year. Corresponding U.S. imports from Australia were \$7.3 billion, down 2.7 percent. Australia is currently the 14th largest export market for U.S. goods.

U.S. exports of private commercial services (i.e., excluding military and government) to Australia were \$6.9 billion in 2004, and U.S. imports were \$3.9 billion. Sales of services in Australia by majority U.S.-owned affiliates were \$18.7 billion in 2003 (latest data available), while sales of services in the United States by majority Australia-owned firms were \$11.0 billion.

The stock of U.S. foreign direct investment (FDI) in Australia in 2004 was not available, \$48.9 billion in 2003. U.S. FDI in Australia is concentrated largely in the manufacturing, finance, and wholesale sectors.

FREE TRADE AGREEMENT (FTA)

The Governments of the United States and Australia concluded a free trade agreement (FTA) on February 8, 2004, that entered into force on January 1, 2005. The FTA already addressed many of the issues raised in the 2005 National Trade Estimate report. Under the FTA, more than 99 percent of U.S. exports of manufactured goods to Australia are now duty-free and all U.S. agricultural exports to Australia, totaling nearly \$700 million, receive duty-free access as of January 1, 2005.

IMPORT POLICIES

Tariffs

Eighty-six percent of Australia's tariffs are between zero percent and five percent, with more than 99 percent of tariff rates applied on an *ad valorem* basis. Ninety-seven percent of Australia's tariff lines are bound in the World Trade Organization (WTO). Australia's simple average bound tariff rate is 9.9 percent and its average applied normal trade relations (NTR), also known as most favored nation (MFN), tariff is 4.2 percent. The average applied NTR/MFN rate for industrial products is 4.6 percent, with most bound rates set between zero percent and 55 percent. The average applied NTR/MFN tariff for agricultural products is less than one percent, with bound rates generally set between zero percent and 29 percent. Tariff-rate quotas are in place for five cheese items and non-manufactured tobacco. Australia retains high tariffs peaks on textiles, clothing, and footwear (TCF) (maximum 25 percent) and passenger motor vehicles (maximum 15 percent).

FOREIGN TRADE BARRIERS

With the FTA in effect, 99 percent of U.S. manufactured goods and 100 percent of U.S. food and agricultural goods exports to Australia are now duty-free. The FTA will also eliminate tariffs within four years in the automotive sector and within 10 years in the textiles sector. U.S. industry estimates the removal of tariffs affecting trade in textiles, automobiles, and automotive components will lead to increases in U.S. exports to Australia of \$100 million to \$500 million in textiles, and raise exports of automobiles and components by \$100 million to \$500 million.

STANDARDS, TESTING, LABELING AND CERTIFICATION

Sanitary and Phytosanitary Measures

The Australian government maintains an extremely stringent regime for the application of sanitary and phytosanitary (SPS) measures, resulting in restrictions and prohibitions on imports of many agricultural products. Key U.S. products currently prohibited under Australia's SPS regime include Florida citrus, stone fruit, poultry (fresh, cooked, and frozen), and apples. In 2004, Australia issued new import rules for pork. Under these new rules, the United States gained access to the Australian market and is now shipping processed pork to Australia. Australia is deviating from the international standard on wood packing materials by requiring that they be free of bark as well as treated. The FTA created a new mechanism for scientific cooperation between U.S. and Australian SPS authorities to resolve specific bilateral, animal, and plant health matters. This new mechanism will facilitate engagement at the earliest appropriate point in each country's regulatory process to cooperate in the development of science-based measures that affect trade between the two countries.

Biotechnology

Commercial Release

The Gene Technology Act 2000 is the Commonwealth government component of a national regulatory scheme for gene technology and products produced through modern agricultural biotechnology. The Act regulates the use of all agricultural biotechnology products in Australia and requires that the Office of the Gene Technology Regulator license all biotechnology activities involving the intentional release of biotechnology products into the environment. Issues related to the marketability and trade implications of the commercialization of biotechnology crops do not fall within the scope of the evaluations provided in the Act. The Commonwealth, State, and Territorial governments consider these matters both individually and through joint forums. Most of Australia's States and Territories restrict biotechnology products through planting moratoria or bans on plantings of food-related biotechnology products licensed by the Commonwealth Office of the Gene Technology Regulator. The United States has objected to these actions as they appear to be based on marketing and trade concerns rather than science. Such actions have held up the commercialization of canola biotechnology. While the Government of Australia has invested in biotechnology research and widely supported the use of biotechnology for its farming community, the country experienced a setback in

2004 when the states of New South Wales, Victoria, South Australia and Western Australia all placed moratoria on new plantings of biotechnology crops. It should be noted that biotechnology cotton, a non-food-related biotechnology product, has been successfully introduced and planting of this product now dominates the cotton industry in Australia.

Biotechnology Food Approvals

Imported foods using biotechnology can be offered for sale and consumption in Australia only after being assessed and approved by Food Standards Australia New Zealand (FSANZ) and being listed in the Food Standards Code. As of November 2005, there were 24 products on the FSANZ-approved list of “food produced using gene technology.”

Biotechnology Food Labeling

The joint Australia-New Zealand regulatory regime for food, which includes mandatory labeling requirements for certain foods produced using biotechnology, became effective in December 2001. Biotechnology labeling is required if a food in its final form contains detectable DNA or protein resulting from the application of biotechnology, with a few exceptions. The law allows for a maximum of one percent of adventitious presence. Meeting these biotechnology food labeling regulations can be burdensome for manufacturers, packers, importers, and retailers, particularly involving U.S. agricultural exports, a large share of which is processed food.

GOVERNMENT PROCUREMENT

Australia is the only major industrialized country that is not a signatory to the plurilateral WTO Government Procurement Agreement (GPA). As such, Australia is not bound by the GPA's rules on open and non-discriminatory policies in government procurement. Under the FTA, the Australian Government has opened its government procurement market to U.S. suppliers and eliminated discriminatory preferences for domestic suppliers. The FTA permits some Australian State governments to maintain their discriminatory preference schemes until 2008.

INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

Australia is a member of the World Intellectual Property Organization (WIPO) and is a party to most multilateral IPR agreements, including: the Paris Convention for the Protection of Industrial Property; the Berne Convention for the Protection of Literary and Artistic Works; the Universal Copyright Convention; the Geneva Phonogram Convention; the Rome Convention for the Protection of Performers, Producers of Phonograms, and Broadcasting Organizations; and the Patent Cooperation Treaty. Under the FTA, Australia is obligated to accede and become a party to the 1996 WIPO Copyright Treaty and Performances and Phonograms Treaty. Australia is currently reviewing the steps necessary for accession.

FOREIGN TRADE BARRIERS

Australia permits the parallel importation of computer software, electronic versions of books, periodicals, sheet music, sound recordings, branded goods (clothing, footwear, toys, and packaged food), and some electronic games. The Australian government continues to prohibit the parallel importation of films. An estimated 20 percent of the digital video discs (DVDs) in Australia are illegal parallel imports. Locally replicated DVD-Rs, videocassettes copied from video compact discs (VCDs) and DVDs, illegally parallel-imported DVDs, and pirated VCDs continue to be the major threat to Australia's otherwise low rate of piracy of audio-visual materials. Pirate DVDs imported from Asia also are an emerging problem. U.S. copyright holders remain concerned over past decisions by the Australian Competition and Consumer Commission (ACCC) that equate the holding of a copyright with "market power." A 2005 decision by the High Court of Australia regarding the sale of devices to circumvent Technological Protection Measures (TPMs) raises some concerns regarding access controls. The decision held that the sale of the circumvention devices did not breach the anti-circumvention provisions of the Copyright Act. The Australian government is currently conducting a review of its TPM-related legislation, in accordance with its obligations under the FTA.

Due to the FTA, Australia now provides copyright protection for the life of the author plus 70 years (for works measured by a person's life), or 70 years (for corporate works). The FTA also clarifies that the right to reproduce literary and artistic works, recordings, and performances encompasses temporary copies, an important principle in the digital realm. Australia also agreed to obligations with respect to the liability of Internet Service Providers in connection with copyright infringements that take place over their networks.

Under the patent provisions of the FTA, Australia confirms that its law makes patents available for any invention, subject to limited exclusions, and confirms the availability of patents for new uses or methods of using a known product. To guard against arbitrary revocation, Australia will limit the grounds for revoking a patent to the grounds that would have justified a refusal to grant the patent; fraud is also grounds for revocation. Under the FTA, Australia also will make patent term adjustments to compensate if there are unreasonable delays that occur while granting the patent, or if there is an unreasonable curtailment of the effective patent term as a result of the marketing approval process for pharmaceutical products. The FTA protects test data that a company submits in seeking marketing approval for pharmaceutical and agricultural chemical products by precluding other firms from relying on the data. It also requires measures to prevent the marketing of pharmaceutical products that infringe patents.

The trademark and geographical indication provisions of the FTA establish that trademarks must include marks in respect of goods and services, collective marks, and certification marks, and that geographical indications are eligible for protection as marks. Australia also will provide protection for marks and geographical indications, as well as efficient and transparent procedures governing the application for protection of marks and geographical indications. The FTA also provides for rules on domain name management that require a dispute resolution procedure to prevent trademark cyber-piracy.

The FTA establishes strong penalties for piracy and counterfeiting. The Agreement criminalizes end-user piracy and requires Australia to authorize the seizure, forfeiture, and destruction of counterfeit and pirated goods and the equipment used to produce them. Australia also must empower its law enforcement agencies to take enforcement action at the border against pirated or counterfeit goods without waiting for a formal complaint.

The United States Government raised concerns that Australia's FTA implementing legislation, which Australia's parliament approved in August 2004, did not fully implement a number of the FTA commitments on intellectual property. The United States and Australia subsequently addressed these concerns in an exchange of letters in November 2004, through which Australia agreed to take steps, including making legislative and regulatory changes, to implement several commitments. Australia's parliament approved related legislation in December 2004. In accordance with the exchange of letters, the Australian government announced in June 2005 that it will submit legislation to Parliament that would apply criminal penalties for wrongfully accessing pay-TV services. Concerns remain, however, about the Australian government's implementation of its FTA commitments with respect to pharmaceutical patent protection.

SERVICES BARRIERS

Telecommunications

U.S. industry remains concerned about the ability of the majority government-owned telecommunications firm, Telstra, to abuse its monopoly power. This has included delays in making an acceptable public offer for access to its network, and the inflated pricing of its wholesale services such as leased lines and interconnection with its mobile network. Australia's government has made significant progress in addressing some of these issues by approving a reference interconnection offer and proposing a schedule of mobile termination rates that would introduce significant price reductions (termination rates in Australia are among the highest in Asia). Telstra has provided evidence that its leased-line rates are now comparable with other competitive markets, and companies seeking to challenge these rates have the opportunity to do so under Australia's rules. The Australian Parliament has passed legislation to permit the sale of the remaining 51 percent share of Telstra held by the Australian government. The Australian government has not, however, addressed the issue of foreign equity limits in Telstra, now limited to 35 percent. The FTA includes several important new obligations for major suppliers, including for the resale and provisioning of leased circuits and co-location, and ensuring access for U.S. firms.

Audiovisual Trade Barriers

The Australian Communications and Media Authority Content Standards require that 55 percent of all free-to-air television programming broadcast between 6:00 a.m. and midnight be of Australian origin with specific minimum annual sub-quotas for Australian drama aimed at adults, documentary and children's programs.

FOREIGN TRADE BARRIERS

In addition, the television advertising quota stipulates that at least 80 percent of total commercial television advertising during that same period must be Australian-produced. Australia's Broadcasting Services Amendment Act requires pay television channels with significant drama programming to spend 10 percent (with a requirement of up to 20 percent allowed under the FTA) of their programming budget on new Australian drama programs. Australian radio industry quotas require that up to 25 percent of all music broadcast between 6:00 a.m. and midnight be "predominantly" Australian in origin/performance. The FTA allows existing restrictions to remain, but limits or prohibits their extension to other media or means of transmission.

INVESTMENT BARRIERS

Pursuant to Australia's foreign investment law, the government's Foreign Investment Review Board (FIRB) screens in advance potential foreign investments in Australia above a threshold value of \$50 million. The FIRB may deny approval of particular investments above that threshold on "national interest" grounds. The FTA, however, exempts all new "greenfield" U.S. investments from FIRB screening entirely. The FTA also raised the threshold for screening of most U.S. acquisitions of existing investments in Australia from A\$50 million to A\$800 million (indexed annually). The FTA does not provide for binding international investor-state arbitration.

OTHER BARRIERS

Commodity Boards and Agricultural Support

The export of almost all wheat, barley, rice, and sugar remains under the monopoly control of commodity boards. The privatization of the Australian Wheat Board, Ltd., (AWB) in July 1999, saw its export controls transferred to the Wheat Export Authority (WEA), and the AWB retained veto rights over containerized export requests. After a review during 2000, the Australian government extended the WEA's export monopoly until 2004. In 2000, the Australian government launched an eight-year adjustment assistance package for the dairy industry, following deregulation of that industry. In 2002, it initiated a four-year, \$150 million sugar industry package; this package was increased by \$444 million in 2004. These programs support regional adjustment, diversification and industry restructuring. Depending on the program, assistance includes sustainability grants, income support, crisis counseling, interest rate subsidies, and short-term income support.

Automotive and Textile, Clothing, and Footwear (TCF) Sector Support Programs

Automotive producers benefit from import duty credits designed to promote production, investment, and research and development. In 2002, the program was extended to 2015 with declining benefits to compensate for planned additional tariff reductions. The TCF industry receives grants under the Australian government's Strategic Investment Program for research and development, restructuring, and investment to assist firms with restructuring prior to legislated tariff cuts in 2005.

FOREIGN TRADE BARRIERS

In November 2003, the Australian government announced a tariff reduction schedule and a reduced and final assistance scheme for the period of 2005 through 2015.

Pharmaceuticals

The U.S. pharmaceutical industry has raised concerns that the Australian government's policies regarding the pharmaceutical sector do not appropriately value innovation and diminish Australia's contribution to research and development of innovative pharmaceutical products. The FTA addresses some transparency concerns and requires establishment of an independent review process, which is awaiting the appointment of a full-time convenor. The FTA also established a Medicines Working Group to provide for continued dialogue between the two governments on emerging health care policy issues.

In early 2005, the pharmaceutical industry also raised concerns about the Australian government's proposed policy that would have required a 12.5 percent cut in the reimbursement price of pharmaceuticals in a therapeutic drug class each time a generic drug in that class came onto the market. After consultation with stakeholders, the Australian government implemented this policy by ensuring that innovative medicines are not subject to cumulative price reductions. In late 2005, the industry raised concerns that the Australian government was undertaking reform of pharmaceutical pricing issues without allowing for consultation with stakeholders.

Blood Plasma Products

Foreign companies face substantial barriers to the provision of blood plasma products in the Australian market. Hospitals are reimbursed only for blood plasma products produced by an Australian company under a monopoly contract granted by the government. While foreign blood products may be approved for sale in Australia, the exclusive contract makes it virtually impossible for foreign firms to sell their products in Australia except to fill shortages or provide products not otherwise available in Australia. The FTA commits Australia to review its arrangements for the supply of blood fractionation services by no later than January 1, 2007. The Australian government provided funds in its 2005-2006 budgets to begin this review. Under the FTA, the Australian government must recommend to Australia's states and territories that future arrangements for the supply of blood plasma products be conducted through an open tender process.

BAHRAIN

TRADE SUMMARY

The U.S. goods trade deficit with Bahrain was \$81 million in 2005, a decrease of \$22.6 million from \$103 million in 2004. U.S. exports in 2005 were \$351 million, up 16.2 percent from the previous year. Corresponding U.S. imports from Bahrain were \$432 million, up 6.5 percent. Bahrain is currently the 88th largest export market for U.S. goods.

The stock of U.S. foreign direct investment (FDI) in Bahrain in 2004 was \$176 million, up from \$141 million in 2003.

IMPORT POLICIES

As a member of the Gulf Cooperation Council (GCC), Bahrain applies the GCC common external tariff of five percent for most products, with a limited number of GCC-approved country-specific exceptions. Bahrain's exceptions to the common external tariff include alcohol (125 percent) and tobacco (100 percent). Four hundred seventeen food and medical items are exempted from customs duties entirely.

Upon entry into force of the U.S.-Bahrain Free Trade Agreement (FTA), 100 percent of bilateral trade in consumer and industrial products will become duty-free immediately. Bahrain will phase out tariffs on the remaining handful of products within ten years. On agricultural products, Bahrain will provide immediate duty-free access for U.S. agricultural exports in 98 percent of agricultural tariff lines. Bahrain will phase out tariffs on the remaining products within ten years.

STANDARDS, TESTING, LABELING AND CERTIFICATION

As part of the GCC Customs Union, member countries are working toward unifying their standards and conformity assessment systems and have progressed considerably toward the goal of a unified food standard – originally targeted for adoption by 2006. However, each country currently applies either its own standard or a GCC standard, which can cause confusion for U.S. exporters.

Bahrain generally uses international or GCC standards, and the development of standards in Bahrain is based on the following principles: (a) no unique Bahraini standard is to be developed if there is an identical draft GCC standard in the process of being developed; and (b) developing new Bahraini standards must not create trade barriers. The total number of GCC standards adopted as Bahraini standards currently stands at 1020, out of which 320 are mandatory and 700 are voluntary. There are also approximately 434 draft GCC standards under development.

FOREIGN TRADE BARRIERS

Bahrain has replaced its product shelf-life requirements; a major impediment to U.S. processed food exports to the Gulf region, with international (Codex) standards.

GOVERNMENT PROCUREMENT

In October 2002, Bahrain implemented a new government procurement law to ensure transparency and reduce bureaucracy and corruption in government tenders and purchases. Under the new law, specified procurements are eligible for bid by international suppliers. A Tender Board is chaired by a Minister of State who oversees all tenders and purchases with a value of BD10, 000 (\$26,525) or more.

The Tender Board is an important measure toward ensuring a transparent bidding process, which the Government of Bahrain recognizes as vital to attracting foreign investment. The Tender Board awarded tenders worth \$453.6 million in 2004. When the U.S.-Bahrain FTA enters into effect, Bahrain will be required to conduct procurement covered by the FTA in a fair, transparent, and non-discriminatory manner.

INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

The U.S.-Bahrain FTA commits Bahrain to enforce world-class IPR protection. Bahrain has finalized the process of joining the World Intellectual Property Organization (WIPO) Copyright Treaty and the WIPO Performances and Phonograms Treaty. The agreements became effective on December 15, 2005. A significant public awareness campaign was launched in March 2005, equating piracy with theft. Islamic religious officials were enlisted to educate the public on the intellectual property rights concept. However, the Motion Picture Association of America (MPAA) complains that the Government of Bahrain has failed to act to curb a growing trend of cable television piracy. The MPAA alleges that unlicensed operators are tapping into cable television feeds and illegally selling access to the diverted signal, thereby depriving U.S. motion picture studios of royalty payments.

The Government of Bahrain is preparing to submit several key pieces of draft IPR legislation to Parliament to comply with its obligations under the FTA. Bahrain's new legislation will improve protections and criminalize various IPR violations, including copyright, trademark and patent infringement.

SERVICES BARRIERS

Financial Sector

In March 2004, as part of an effort to stimulate the insurance industry and reinforce Bahrain's position as a major insurance center in the Middle East, the Bahrain Monetary Authority (BMA) lifted the requirement that foreign insurance brokers and loss adjusters have a local partner to

FOREIGN TRADE BARRIERS

operate in Bahrain. These firms, which were previously required to have at least 51 percent Bahraini ownership, are now permitted to operate with 100 percent foreign ownership. The BMA is holding consultations on further reform in areas such as captive insurance, solvency, business conduct, risk management and financial crime, enforcement, central bank reporting and public disclosure, intermediaries, and Islamic insurance.

As a result of the FTA, Bahrain will lift the moratorium on the issuance of new insurance licenses for life and medical insurance upon entry into force of the agreement and will lift the moratorium for non-life insurance licenses 6 months after entry into force.

Telecommunications

The telecommunications sector in Bahrain has been liberalized since July 2004. There are currently two mobile providers in Bahrain: Batelco and Vodafone. The TRA does not plan to award any additional mobile licenses in the near future.

In August 2005, the TRA issued a resolution declaring that any party interested in operating a WiFi hotspot must obtain a temporary frequency license, available for a period of three months (all other telecommunications licenses in Bahrain are valid for 15 years). As of December 2005, only three such licenses had been issued.

INVESTMENT BARRIERS

The U.S.-Bahrain Bilateral Investment Treaty (BIT) provides benefits and protection to U.S. investors in Bahrain, such as most-favored-nation treatment and national treatment, the right to make financial transfers freely and without delay, international law standards for expropriation and compensation cases, and access to international arbitration. The BIT provides national and most favored nation treatment for U.S. investments across all sectors, with exceptions for ownership or control of television, radio or other forms of media, fisheries, initial privatization, air transportation, and the purchase or ownership of land. As of January 1, 2005, U.S. investors can purchase or own shares traded on the Bahrain Stock Exchange.

Bahrain permits 100 percent foreign ownership of new industrial entities and the establishment of representative offices or branches of foreign companies without local sponsors. Wholly foreign-owned companies may be set up for regional distribution services and may operate within the domestic market as long as they do not exclusively pursue domestic commercial sales. Foreign companies established before 1975 may be exempt from this rule under special circumstances.

Since January 2001, foreign firms and GCC nationals may own land in Bahrain. Non-GCC nationals may now own high-rise commercial and residential properties, as well as property in tourism, banking, financial and health projects, and training centers, in specific geographic areas.

FOREIGN TRADE BARRIERS

In an attempt to streamline licensing and approval procedures, the Ministry of Commerce opened the Bahrain Investors Center (BIC) in October 2004 for both local and foreign companies seeking to register in Bahrain. According to Ministry of Commerce officials, 80 percent of all licenses can be processed and verified within approximately twenty-four hours, an additional 10 percent within five working days and the remaining 10 percent, involved in environmental, power, health and other important utilities and services, are processed separately and issued on a case-by-case basis.

BOLIVIA

TRADE SUMMARY

The U.S. goods trade deficit with Bolivia was \$75 million in 2005, an increase of \$9 million from \$67 million in 2004. U.S. goods exports in 2005 were \$218 million, up 12.6 percent from the previous year. Corresponding U.S. imports from Bolivia were \$293 million, up 12.6 percent. Bolivia is currently the 100th largest export market for U.S. goods.

The stock of U.S. foreign direct investment (FDI) in Bolivia in 2004 was \$221 million, down from \$360 million in 2003.

FREE TRADE NEGOTIATIONS

In May 2004, the United States initiated free trade negotiations with Colombia, Ecuador, and Peru. To date, the United States has concluded free trade agreements with Peru and Colombia. Negotiations with Ecuador will resume in late March 2006. Bolivia has participated as an observer and could become part of the agreement at a later stage. The United States has significant economic ties to the region. Total two-way goods trade with the Andean countries of Peru, Colombia, and Ecuador was approximately \$24 billion in 2004. The stock of U.S. foreign direct investment in these countries in 2004 was \$7.7 billion.

IMPORT POLICIES

Tariffs

Bolivia has a three-tier tariff structure. Capital goods designated for industrial development may enter duty-free; non-essential capital goods are subject to a 5 percent tariff; and most other goods are subject to a 10 percent tariff.

Non-Tariff Measures

Supreme Decree 27340, dated January 31, 2004, banned the importation of certain types of used clothing, including old, destroyed, or useless articles of apparel; used bedding and intimate apparel; used shoes; and certain destroyed or useless textile articles (rags, cords, string, and rope). U.S. industry reports that imports of other types of used clothing, while not banned from import into Bolivia, may be subject to other non-tariff trade barriers. According to industry, Bolivian customs often does not agree with official invoices that are presented. In those instances, importers are typically expected to pay whatever valuation the local customs authority deems to be 'fair value' for the shipment. U.S. officials are continuing to monitor the situation to determine what, if any, barriers exist.

FOREIGN TRADE BARRIERS

STANDARDS, TESTING, LABELING AND CERTIFICATION

The Bolivian government imposes no specific import standards. The National Certification and Standardization Organization (IBNORCA) is charged with developing Bolivian product standards. In the future, products for use in the oil and gas industry may have to comply with certain specific requirements.

Food product labeling requirements were established in 2003 by Supreme Decree 26510. Products normally retain their original labels, but they must also have complementary labeling showing the importer's or distributor's taxpayer identification number (RUC), sanitary registration number, and ingredient translations.

GOVERNMENT PROCUREMENT

Since 1999, private (mostly foreign) firms have controlled the most significant of former state-owned enterprises, but government expenditures still account for a significant portion of Bolivia's GDP. The central government, sub-central governments (state and municipal levels), and other public entities remain important buyers of machinery, equipment, materials, and other goods and services.

In an effort to encourage local production, the Bolivian government changed its purchasing rules in March 2004 (Supreme Decree 27328, dated January 31, 2004). Government purchases (except insurance contracts) under \$20,000 may be made through direct invitation and price comparisons, with a minimum of three quotes. The government is legally required to issue tenders for purchases between \$20,000 and \$1,000,000. Importers of foreign goods can participate in these procurements only when locally manufactured products and service providers are unavailable or when the Bolivian government fails to award a contract. The government can call for international bids only when purchases are between \$1,000,000 and \$5,000,000. Suppliers submitting bids for purchases over \$5,000,000 must comply with specified prerequisites, which are established in bidding documents exclusive to each purchase.

Bolivia is not a party to the World Trade Organization (WTO) Agreement on Government Procurement.

INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

Bolivia belongs to the World Trade Organization (WTO) and the World Intellectual Property Organization (WIPO) and is a signatory to the Paris Convention for the Protection of Industrial Property, the Berne Convention for the Protection of Literary and Artistic Works, the Nice Agreement, the Geneva Phonograms Convention, and the Convention for the Protection of New Varieties of Plants.

In 1999, the Bolivian government established the National Intellectual Property Rights Service (SENAPI) to oversee IPR issues. The organization initiated a USAID-supported restructuring process in early 2003, but as of October 2005, that process was not yet complete.

The 1992 Copyright Law recognizes copyright infringement as a public offense and the 2001 Bolivian Criminal Procedures Code provides for the criminal prosecution of IPR violations, respectively. However, IPR protection remains insufficient. Despite the prosecution of a criminal case in 2003, enforcement efforts are sporadic and largely ineffective. As a result, Bolivia remains on the U.S. Trade Representative's Special 301 Watch List. Video, music, and software piracy rates are among the highest in Latin America, and the International Intellectual Property Alliance estimates that piracy levels have reached 100 percent for motion pictures and 90 percent for recorded music.

Copyrights

The 1992 Copyright Law protects literary, artistic, and scientific works for the lifetime of the author plus 50 years. It protects the rights of Bolivian authors, foreign authors domiciled in Bolivia, and foreign authors published for the first time in Bolivia. Foreigners not domiciled in Bolivia enjoy protection under the Copyright Law to the extent provided in international conventions and treaties to which Bolivia is a party. Bolivian copyright protection includes the exclusive right to copy or reproduce works; to revise, adapt, or prepare derivative works; to distribute copies of works; and to communicate the work publicly.

Patents and Trademarks

Patent registrations are reviewed for form and substance. A notice of the proposed patent registration is published in the Official Gazette, and if there are no objections within 30 working days, a patent is granted for a period of 20 years.

The registration of trademarks parallels that of patents. Once obtained, a trademark is valid for a 10-year renewable period, but can be cancelled if not used within three years.

Enforcement

Although the exclusive right to translate works is not explicitly granted, the law does prevent unauthorized adaptation, transformation, modification, and editing. The law also provides protection for software and databases.

INVESTMENT BARRIERS

Together with other legislation, the 1990 Investment Law opened Bolivia's economy to foreign investment. The law provides for equal treatment of foreign firms and guarantees the unimpeded repatriation of profits, the free convertibility of currency, and the right to international arbitration (limited to contractual rights) in all sectors.

FOREIGN TRADE BARRIERS

In-kind transfers are not allowed. Companies must follow the Bolivian commercial code to close down operations and repatriate their capital. The Bolivian government is still discussing a bankruptcy law.

In the mid-1990s, the Bolivian government implemented its “capitalization” (privatization) program. The program differed from traditional privatizations in that the funds committed by foreign investors: (a) could only be used to acquire a 50 percent maximum equity share in former state-owned companies; and (b) were directed not to the Bolivian Treasury but to investment funds meant to support the national pension system.

Bolivia has signed bilateral investment treaties with several countries, including the United States. The U.S.–Bolivia Bilateral Investment Treaty (BIT) entered into force in June 2001. The treaty guarantees recourse to international arbitration, which may permit U.S. companies to obtain damages in disputes that cannot be adequately addressed in the Bolivian legal system, where judicial processes can be prolonged, non-transparent, and occasionally corrupt.

Article 139 of the Bolivian Constitution stipulates that all hydrocarbon deposits, whatever their state or form, belong to the Government of Bolivia. No concessions or contracts may transfer ownership of hydrocarbon deposits to private or other interests. The Bolivian government exercises its right to explore and exploit hydrocarbon reserves and trade related products through the state-owned firm Yacimientos Petrolíferos Fiscales Bolivianos (YPFB). The law allows YPFB to enter into joint venture contracts for limited periods of time with national or foreign individuals or companies wishing to exploit or trade hydrocarbons or their derivatives.

Under the 1996 Hydrocarbons Law, the Government of Bolivia reduced royalties paid to the Bolivian Treasury and local governments under these joint venture contracts and attracted \$4.6 billion in new investment, eventually signing 72 shared risk contracts.

In May 2005, the Government of Bolivia adopted Hydrocarbons Law 3058, which required investors to migrate to new contracts within 180 days, imposed an additional 32 percent tax on revenues, and required producers to relinquish all hydrocarbons to the state, losing ownership of production at the wellhead and greatly reducing the value of company assets. Companies are no longer free to commercialize their own products. Instead, they must sell all hydrocarbons through YPFB, which charges a service fee. Companies must satisfy the domestic market before exporting, and they must contend with artificially low domestic prices set by the Bolivian hydrocarbons regulator. As of October 2005, seven hydrocarbons companies, including three U.S. firms, have threatened to pursue international arbitration under their countries’ bilateral investment treaties with Bolivia. However, they are paying, for the time being, the higher taxes and fees, but have not agreed to the new contracts. Companies are also being forced to sell gas locally at below-market prices, with the companies absorbing the losses.

BRAZIL

TRADE SUMMARY

The U.S. goods trade deficit with Brazil was \$9.1 billion in 2005, an increase of \$1.8 billion from \$7.3 billion in 2004. U.S. goods exports in 2005 were \$15.3 billion, up 10.4 percent from the previous year. Corresponding U.S. imports from Brazil were \$24.4 billion, up 15.5 percent. Brazil is currently the 15th largest export market for U.S. goods.

U.S. exports of private commercial services (i.e., excluding military and government) to Brazil were \$5.0 billion in 2004, and U.S. imports were \$1.9 billion. Sales of services in Brazil by majority U.S.-owned affiliates were \$12.3 billion in 2003 (latest data available), while sales of services in the United States by majority Brazil-owned firms were \$384 million.

The stock of U.S. foreign direct investment (FDI) in Brazil in 2004 was \$33.3 billion, up from \$31.7 billion in 2003. U.S. FDI in Brazil is concentrated largely in the manufacturing, finance, and banking sectors.

IMPORT POLICIES

Brazil's average applied tariff rate was 10.73 percent in 2005. Brazil is a member of MERCOSUL, a customs union comprised of Argentina, Brazil, Paraguay, and Uruguay. Full common external tariff (CET) product coverage scheduled for implementation in 2006 may be delayed. CETs range from zero percent to 35 percent *ad valorem*, with a number of country-specific exceptions. Currently, Brazil maintains 100 exceptions to the CET, with tariffs reaching as high as 55 percent on peaches.

High CETs significantly impede increased imports of U.S. agricultural products, distilled spirits, and computer and telecommunications equipment. Brazil applies additional import taxes and charges that can effectively double the actual cost of importing products into Brazil. High tariffs on information technology products and components as well as high taxes have led to a large gray market in personal computers. One safeguard measure is in place against toy imports. A number of imports are prohibited, including foreign blood products, all used consumer goods such as machinery, automobiles, clothing, refurbished medical equipment, and other consumer goods. A 25 percent merchant marine tax on freight at certain ports puts U.S. agricultural products at a competitive disadvantage to MERCOSUL products. Brazil applies a 60 percent flat import tax on most manufactured retail goods imported by individuals that go through a simplified customs clearance procedure called RTS (simplified tax regime).

Import Licensing/Customs Valuation

All importers must register with the Secretariat of Foreign Trade (SECEX) to access the SISCOMEX computerized trade documentation system. SISCOMEX registration requirements are onerous, including a minimum capital requirement. In addition, fees are assessed for each import statement submitted through SISCOMEX. Most imports into Brazil are covered by an "automatic import license" regime. Brazil's non-automatic import licensing system includes imports of products that require authorization from specific ministries or agencies such as beverages (Ministry of Agriculture), pharmaceuticals (Ministry of Health), and arms and munitions (National Defense Ministry). Although a list of products subject to non-automatic import licensing procedures is published on the Brazilian Ministry of Development, Industry and Trade website, specific information related to non-automatic import license requirements and explanations for rejections of non-automatic import license applications are lacking. These measures have made importing into Brazil less transparent and more cumbersome for U.S. exporters.

U.S. companies continue to complain that Brazil employs a variety of customs-related non-tariff barriers including onerous and burdensome documentation requirements and inconsistent interpretations of the law. Also, the Ministry of Health's regulatory agency, ANVISA, must approve product registrations for imported processed food products and food supplement products. Currently, the registration process at ANVISA takes about 90 days for new products. On March 1, 2000, the term of validity for such a registration was shortened. Registration fees for these imports, as well as for medical and pharmaceutical products, have increased significantly. Implementation of such import measures continues to have a negative impact on U.S. exports, especially given the high tariffs on medical equipment.

The United States has raised a concern with Brazil that the state of Rio de Janeiro administers the ICMS tax (a value-added tax collected by individual states) in a way that provides a preferential tax advantage to a Brazilian soda ash supplier located within the state. Similarly, some U.S. companies have raised concerns about the arbitrary application of various quotas and non-automatic import licensing procedures, such as authorizations from the Federal Police and the Nuclear Regulatory Agency. For example, Brazil maintains extremely restrictive import quotas and requires non-automatic import license approval for imports of lithium compounds, including lithium carbonate and lithium hydroxide, citing the potential nuclear applications of these products. These products, however, are widely available without restriction in global markets. The United States has raised this issue with Brazil on several occasions, both bilaterally and in the WTO.

STANDARDS, TESTING, LABELING AND CERTIFICATION

Sanitary and Phytosanitary Measures

While some progress has been made in the area of sanitary and phytosanitary measures, significant issues remain that restrict U.S. agricultural and food exports. For example, due to concerns about bovine spongiform encephalopathy (BSE), Brazil restricts U.S. exports of low-risk beef without scientific justification and contrary to international standards. Brazil continues to prohibit the import of poultry and poultry products from the entire United States. Brazil has indicated that these restrictions are based, in part, on an alleged lack of reciprocity. Brazil's ban on durum and white wheat from the states of Washington, Oregon, Idaho, California, Nevada, and Arizona due to phytosanitary concerns remains in place. While the United States understands that some of these SPS measures are being rewritten, the ban continues to adversely affect U.S. agricultural exports.

Biotechnology

Brazil's National Congress approved on March 2, 2005 the so-called Biosafety Bill, which replaced the previous legal framework in use since 1995 under which agricultural biotechnology was developed in Brazil. Brazil's President signed the Biosafety Bill, converting it into Law 11,105, on March 24, 2005. This law, which also includes provisions for stem cell research, became effective on March 28, 2005 after its publication in Brazil's official registry (Diario Oficial). Implementing regulations for the law were issued by presidential decree on November 23, 2005.

Although Law 11,105 has improved the quality of public debate on biotechnology in Brazil and provided a frame of reference for judicial proceedings, there are still some outstanding issues. For instance, other concerns include the application of the labeling regulations for biotech products, marketing and transportation restrictions in some states, widespread use of pirated (biotech) soybean and cotton seeds, and a pending court case between Monsanto and environmental and consumer NGOs. Also, on June 22, 2005, the Federal Public Prosecutor filed a lawsuit in Brazil's Supreme Court called Direct Action of Unconstitutionality (ADIN) against the new Biosafety Law. ADIN is a legal instrument based on Brazil's constitution that allows a challenge in the highest court of any law that is considered to be unconstitutional.

GOVERNMENT PROCUREMENT

Brazil is not a signatory to the WTO Agreement on Government Procurement, and transparency in Brazil's procurement processes is at times lacking. The United States government has received complaints concerning lack of transparency and preferences for Brazilian products in tenders for government and hospitals, including for domestically produced medical equipment. Limitations on foreign capital participation in procurement bids reportedly impair access for potential service providers in the energy, construction, security and defense sectors. Brazilian federal, state and municipal governments, as well as related agencies and companies, in general follow a "buy national" policy.

Law 8,666 (1993), which covers most government procurement other than informatics and telecommunications, requires non-discriminatory treatment for all bidders regardless of the nationality or origin of the product or service. However, the law's implementing regulations allow consideration of non-price factors, giving preferences to certain goods produced in Brazil and stipulating local content requirements for eligibility for fiscal benefits.

Decree 1,070 (1994), which regulates the procurement of information technology goods and services, requires federal agencies and parastatal entities to give preferences to locally produced computer products based on a complicated and nontransparent price/technology matrix. However, Brazil permits foreign companies to compete in any procurement-related multilateral development bank loans and opens selected procurements to international tenders.

EXPORT SUBSIDIES

The Government of Brazil offers a variety of tax, tariff, and financing incentives to encourage production for export and the use of Brazilian-made inputs in domestic production. For example, Brazil's National Bank for Economic and Social Development (BNDES) provides long-term financing to Brazilian industries through several different programs. The interest rates charged on this financing are customarily lower than the prevailing market interest rates for domestic financing. One BNDES program, FINAME, provides capital financing to Brazilian companies for, among other things, expansion and modernization projects as well as acquisition or leasing of new machinery and equipment. One goal of this program is to support the purchase of domestic over imported equipment and machinery. These programs can be used for financing capacity expansions and equipment purchases in industries such as steel and agriculture.

On November 21, 2005, Brazil's President signed Law 11,196 which contains provisions originally included in Provisional Measures (MP) 255/2005 and 252/2005 (commonly referred to as MP do Bem) that provide tax benefits to qualifying exporters. The law's Special Regime for the Information Technology Exportation Platform (REPES) suspends PIS/PASEP and COFINS taxes on goods and services imported by companies that commit to export software and information technology services to the extent that those exports account for over 80 percent of annual gross income. The MP's Special Regime for the Acquisition of Capital Goods by Exporting Enterprises (RECAP) suspends these same taxes on new machines, instruments and equipment imported by companies that commit for a period of at least three years to exports goods and services such that they account for at least 80 percent of overall gross income.

INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

Patents and Trademarks

Brazil's industrial property law (Law 9,279/1996) became effective in May 1997. Concerns continue about a provision in Brazil's industrial property law that prohibits importation as a means of satisfying the requirement that a patent be "worked" in Brazil. This issue was the subject of a U.S. dispute settlement proceeding at the WTO, which was terminated without prejudice in June 2001.

FOREIGN TRADE BARRIERS

The dispute was terminated based on Brazil's commitment to provide advance notice to, and hold consultations with, the United States should it deem it necessary in the future to grant a compulsory license for failure to work a patent.

Invoking TRIPS provisions, Brazil has at times threatened to issue compulsory licenses for anti-retrovirals used in treating HIV/AIDS if satisfactory supply agreements, including a reduction in prices, could not be reached with patent-holders. To date, Brazil has not issued such a license. Negotiations were successfully completed with one U.S. pharmaceutical company in 2005 and are on-going with two others.

Law 10,196 (2001) includes some problematic provisions, including a requirement that Health Ministry (ANVISA) approval be obtained prior to the issuance of a pharmaceutical patent. This raises a concern with respect to Article 27 of the TRIPS Agreement, which U.S. officials have communicated to Brazilian counterparts, and has contributed, to a backlog in patent issuance.

Although Brazil's National Institute for Industrial Property (INPI) received a \$10 million increase in its budget in 2004 and authorization to hire an additional 450 people over the next several years, including 300 patent examiners, INPI was unable to significantly expand its staff in 2005 due to bureaucratic delays. INPI is projecting that it will take another five to six years to work through patent and trademark application backlogs. Industry estimates the backlog to be 70,000 patents of which 21,000 are for pharmaceutical products and 600,000 trademark applications.

The United States government has also received complaints that unauthorized copies of pharmaceutical products have received sanitary registrations that rely on undisclosed tests and other confidential data, raising concerns of consistency with TRIPS Article 39.3.

Law 10,603 (2002) on data confidentiality covers pharmaceuticals for veterinary use, fertilizers, agROTOXINS, and their components and related products. The law does not cover pharmaceuticals for human use. If the product is not commercialized within two years of the date of sanitary registration, third parties may request use of the data for registration purposes.

Copyrights

Brazil's Law 9,610 (1998) on copyrights included changes intended to bring Brazil into compliance with the Berne Convention and TRIPS. A 1998 software law protects computer programs for 50 years as "literary works," and makes software infringement a fiscal and an intellectual property crime. Brazil is not a party to the World Intellectual Property Organization Treaties on Copyright, and Performances and Phonograms.

Piracy remains a serious problem. The International Intellectual Property Alliance (IIPA) estimated losses due to piracy of copyrighted materials in Brazil totaled at least \$ 858.5 million in 2005. The U.S. government has engaged intensively with the Brazilian government on copyright enforcement as a result of the review of Brazil's benefits under the Generalized System of Preferences (GSP) trade program, which was prompted by an IIPA petition charging that Brazil had failed to offer adequate protection to copyrighted materials.

Positive initiatives taken by the Brazilian government, in particular formation of a public-private National Anti-Piracy Council, development of a national action plan to combat piracy, and increased police actions, led to closure of the GSP Review in early January 2006. While the recent progress was significant in improving Brazil's institutional capacity to combat piracy, the Administration will continue to seek further improvements to reduce the piracy rate.

SERVICES BARRIERS

Telecommunications

The telecommunications sector was privatized following the passage of the 1997 General Telecommunications Law, but has presented some regulatory challenges. In the fixed-line sector, for example, interconnection charges and other incumbency advantages have provided strong barriers to entry, and the companies created during a transitional duopoly stage have not fared well.

Brazil has not yet ratified its original WTO basic telecommunications commitments. In 2001, Brazil withdrew its schedule of commitments because of concerns raised by certain WTO Members that it maintained the legal prerogative of the Executive Branch to limit foreign participation in this sector, thereby creating significant uncertainty for investors. This legal prerogative is contained in Brazil's 1997 General Law on Telecommunications and is inscribed in Brazil's constitution. While Brazil has not pursued the constitutional change required to allow a revision of its offer to open up this sector, the current regulatory environment generally reflects the obligations contained in the WTO Basic Telecommunications Reference Paper.

Audio Visual Services

Brazil limits foreign ownership of cable and media companies, and has some restrictions on foreign programming contents. Foreign ownership of cable companies is limited to 49 percent, and the foreign owner must have a headquarters in Brazil and have had a presence in the country for the prior 10 years. Foreign cable and satellite television programmers are subject to an 11 percent remittance tax. The tax, however, can be avoided if the programmer invests 3 percent of its remittances in co-production of Brazilian audio-visual services. National cable and satellite operators are subject to a fixed title levy on foreign content and foreign advertising released on their channels. Law 10,610 (2002) limits foreign ownership in media outlets to 30 percent, including the print and "open broadcast" (non-cable) television sectors. Brazil's legislature is considering extension of this restriction to cover Internet Service Providers, pay TV channels and operators, and content producers and distributors. Such a change would pose a serious threat to a number of U.S. companies operating in Brazil as content producers/distributors. Open television companies are also subject to a regulation requiring that 80 percent of their programming content be domestic in origin.

Law 10,454 (2002) aims to promote the national film industry through creation of the National Film Agency (ANCINE) and through various regulatory measures. The law imposes a fixed title levy on the release of foreign films in theaters, foreign home entertainment products, and foreign programming for broadcast television.

FOREIGN TRADE BARRIERS

Remittances to foreign producers of audiovisual works are subject to a 25 percent income withholding tax. Brazilian distributors of foreign films are subject to a levy equal to 11 percent of their withholding taxes. This tax, called the CONDECINE (Contribution to the Development of a National Film Industry), is waived for the Brazilian distributor if the producer of the foreign audiovisual work agrees to invest an amount equal to 70 percent of the income withholding tax on their remittances in co-productions with Brazilian film companies. The CONDECINE tax is also levied on any foreign cinematographic or video phonographic advertisement. The fee may vary according to the advertising content and the transmission segment.

Brazil also requires that 100 percent of all films and television shows be printed locally. Importation of color prints for the theatrical and television markets is prohibited. Theatrical screen quotas for local films exist. Quotas on domestic titles for home video distributors, while not currently enforced, present another potential hindrance to commerce.

Express Delivery Services

A bill (PL 1491/99) that would reorganize the National Postal System remains under discussion in the Brazilian Congress. The current proposal would create a regulatory agency for postal services as well as a new Postal Company of Brazil, owned and operated by the federal government. Although the bill would end the government monopoly over postal services after a ten-year period, it would also create a monopoly on the delivery of certain types of correspondence and parcels that are not now subject to regulation, such as express delivery packages, thereby significantly inhibiting market access by U.S. firms. Brazil also applies a 60 percent flat import tax on most manufactured retail goods imported by individuals that go through a simplified customs clearance procedure called RTS (simplified tax regime) that is used by express delivery services.

Financial Services

Brazil has not yet ratified its commitments from the 1997 Financial Services negotiations (known as the Fifth Protocol) or taken the necessary steps to make them binding under the General Agreement on Trade in Services (GATS). Brazil is South America's largest insurance market and earnings from premiums have grown rapidly in recent years. In 1996, Brazil eliminated the distinction between foreign and domestic capital, and many major U.S. firms have since entered the market mainly via joint ventures with established companies. Foreign participation, however, is limited to 50 percent of the capital of a company and to one third of its voting stock. Brazil maintains a government-owned reinsurance monopoly through the Brazil Reinsurance Institute (IRB). While a 1996 constitutional reform allowed for the abolishment of the monopoly, private reinsurance companies have been precluded from operating in Brazil pending passage of implementing legislation necessary to open the sector to private competition. The Brazilian government eventually dropped plans to privatize the IRB as part of the opening of the sector and opted instead to submit to Congress, in May 2005, a bill to allow private companies, including foreign ones, to offer reinsurance in the Brazilian market. The government would retain ownership of the IRB, which would continue to offer reinsurance on the domestic market. The IRB's regulatory functions would pass to the insurance regulator.

If Brazilian shipping companies wish to obtain foreign hull insurance, they must submit information to IRB demonstrating that the foreign insurance policy is less expensive than that offered by Brazilian insurers. Brazilian importers must obtain cargo insurance from insurance firm's resident in Brazil, although the firms may be foreign-owned.

Service trade opportunities in some sectors have been affected by limitations on foreign capital participation. Brazil's constitution precludes the expansion of foreign-owned banks until new financial sector legislation is issued. For practical reasons, the required legislation has not been issued, but Brazil's President has the authority to authorize new foreign participants on a case-by-case basis. In practice, Brazil has approved most plans by Foreign Service suppliers to enter the market or expand existing operations. United States financial service suppliers have established significant operations in Brazil. As of June 2005, foreign-owned or controlled assets accounted for 27.8 percent of Brazil's total banking sector equity.

INVESTMENT BARRIERS

In addition to restrictions discussed above, foreign investment is restricted in internal transportation, public utilities, media and other "strategic industries." Foreign ownership of land adjacent to national borders remains prohibited under Brazilian law, unless approved by Brazil's National Security Council. Despite investment restrictions, U.S. and other foreign firms have major investments in Brazil, with the U.S. accounting for more than one-third of total foreign investment. There is neither a bilateral investment treaty nor a treaty on the avoidance of double taxation between the United States and Brazil.

Energy

In 2004, Brazil implemented new energy legislation to restructure the power generation and distribution sector. The new legislation gives the state a leading role in determining, for example, how much new power capacity is needed based on forecasts by a newly created independent Energy Research Institute (IPE). The new model separates into two different competition groups power generators that have not yet amortized their investments (new energy) and those that have (old energy), based on whether a facility had been built by a certain cut-off date. This dual-pool structure has disadvantaged some U.S. companies that invested in the sector during privatization in the late 1990s and whose investments have not been amortized, but which are nevertheless included in the old energy pool. The Brazilian government is still in the midst of implementing the new model.

BULGARIA

TRADE SUMMARY

The U.S. goods trade deficit with Bulgaria was \$185 million in 2005, a decrease of \$150 million from \$335 million in 2004. U.S. goods exports in 2005 were \$268 million, up 56 percent from the previous year. Corresponding U.S. imports from Bulgaria were \$454 million, down 10.5 percent. Bulgaria is currently the 91st largest export market for U.S. goods.

The stock of U.S. foreign direct investment (FDI) in Bulgaria in 2004 was \$191 million, up from \$186 million in 2003.

IMPORT POLICIES

Tariffs

Bulgaria's trade policies are shaped primarily by its World Trade Organization (WTO) membership and by its status as a candidate for EU membership. Bulgaria has a preferential trade agreement with the European Union (EU) under its Europe Agreement, and free trade agreements with the European Free Trade Area (EFTA) countries. It also has free trade agreements with its Central European neighbors, Turkey, Macedonia, Albania, Serbia and Montenegro, Bosnia and Herzegovina, Israel and Moldova.

As a result of a petition filed by the Distilled Spirits Council of the United States, the U.S. Government is reviewing Bulgaria's continued eligibility for the U.S. Generalized System of Preferences (GSP) program in view of the preferential tariff treatment it affords to the EU. The U.S. has urged the Bulgarian government to lower most-favored-nation (MFN) tariffs on a range of items to reduce the tariff differential and its negative effect on U.S. commerce.

Upon accession to the EU, Bulgaria will align its external tariffs with those of the EU. The average MFN tariff rate, for example, would come down from its current level of 11.55 percent to an average of 6.5 percent. For 2005, Bulgaria's average import tariff for industrial goods is 8.6 percent and the average level for agricultural goods is 22.9 percent. The maximum *ad valorem* level for agricultural goods, which is applied on 0.38 percent of tariff lines, is 75 percent. Bulgaria has eliminated all tariffs on industrial imports from the EU under its Association Agreement with the European Union.

Bulgaria's agricultural trade regime is characterized by high MFN tariffs, particularly for red meat and poultry, and by preferential agreements with the EU and Central Europe. High *ad valorem* duties serve as incentives for smuggling and fraud. Cargoes are often improperly identified and falsely labeled and declared in an effort to avoid customs charges. The Bulgarian customs service also uses minimum import prices, which appear to be applied arbitrarily, to calculate customs duties, particularly on poultry shipments.

Bulgaria provides the EU with preferential tariff rates and reciprocal duty elimination on numerous agricultural products, as well as on wine. These preferences hurt U.S. agricultural exporters who face higher MFN rates. Import tariffs on U.S. chicken are 68 percent, with frozen cut parts subject to a 74 percent tariff.

Non-tariff Barriers

In general, customs regulations and policies are reported to be cumbersome, arbitrary and inconsistent. Problems cited by U.S. companies include excessive documentation requirements, slow processing of shipments, and corruption.

The Bulgarian government's drug supply mechanism constitutes a major market access barrier to U.S. pharmaceutical exports. Under the new drug legislation, pharmaceutical companies are required to commit to pay damages when a distributor fails to supply the right medicine. Thus, the burden of responsibility for distributors is being shifted from the government to the pharmaceutical industry.

STANDARDS, TESTING, LABELING AND CERTIFICATION

The registration processes for pharmaceutical products and for drug pricing and reimbursement, including the process by which the National Health Insurance Fund classifies drugs, are cumbersome and non-transparent. Newer drugs are often arbitrarily classified with their older, generic versions for pricing purposes, thereby limiting companies' ability to recover their research and development costs.

GOVERNMENT PROCUREMENT

Bulgaria is an observer in the WTO Committee on Government Procurement, but not a signatory to the WTO Agreement on Government Procurement (GPA). In its accession to the WTO, Bulgaria committed to accede to the GPA and to submit an offer by June 1997 and complete negotiations by December 1997. The Bulgarian government, however, did not initiate the process for GPA accession until 2000, and has not yet submitted an offer. Upon its accession to the European Union (EU), Bulgaria automatically will become subject to the GPA as a Member State of the European Communities.

Although Bulgaria's government procurement law underwent a substantial reform in 2004 to align the system with WTO and EU rules, bidders still complain that tendering processes are unclear and subject to irregularities and corrupt practices, and that court appeals are long and cumbersome. The Bulgarian government has prepared amendments

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to the 2004 Public Procurement Law in order to incorporate new European public procurement directives and further streamline the national procurement process. The law, however, offers little reform in the area of court appeals and has yet to be approved.

Defense procurement activities lack transparency, are subject to corrupt influences, and do not comply with international standards. The purchasing, pricing, and reimbursement processes for drugs under Bulgaria's national health system are not transparent. The government can use the price-approval mechanism to regulate the market for any product, and bureaucratic barriers can limit patients' access to new products.

Government procurement practices in the energy sector appear to disadvantage foreign insurance companies. According to U.S. industry, procedures for awarding insurance contracts for companies within the energy sector are not transparent.

INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

In 2004, Bulgaria was placed on the Special 301 "Watch List" for the first time in five years and remained on the "Watch List" in 2005 due to a steady resurgence of piracy, mainly in the sale of pirated optical disc (OD) media. Today, the level of open and massive music piracy and copyright crime on Bulgaria's domestic market is unacceptably high and enforcement at all levels is inadequate. Although forensic evidence collected by the copyright industry indicates that pirate facilities are operating once again in Bulgaria, Bulgarian authorities have not adequately recognized or addressed the possibility of piracy production. Furthermore, Bulgaria is still widely used for the transshipment of pirated compact discs (CDs) from Russia to the Balkans, Greece, and Turkey. CD piracy has been increasing significantly, and the local music business in particular is feeling the brunt of this phenomenon.

In September 2005, Parliament approved the long awaited Law on Administrative Control over the Manufacture and Distribution of Optical Disc Media, which now requires source identification code on blank optical discs produced in Bulgaria and strengthens the import/export regime for raw materials and equipment involved in OD production. The new law, however, does not allow the rights holders' organizations and their representatives to participate in the inspections and excludes from the registration regime goods in transit, setting the stage to transform Bulgaria into a transit and dispatch center of pirated production from manufacturing countries (e.g. Russia, and other countries) to other territories.

The new law further weakens enforcement by restricting the authority of state officials. State control bodies are not allowed to require inspection of the manufacturing facilities in operation or to seize documents, samples, raw materials, manufacturing equipment, or matrices for the purpose of establishing facts and circumstances related to the inspection.

Despite some successes by individual agencies, enforcement greatly suffers because of the lack of overall coordination between agencies, inadequate resources, and legal loopholes. The government lacks sufficient institutional capacity and will to address major enforcement problems effectively, especially in combating and prosecuting

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organized crime groups. The Council of Intellectual Property Protection (a recently formed high-level, interagency group) may help the government strengthen its efforts.

The Bulgarian government included in its 2003 drug law a provision to provide protection for confidential test data submitted for marketing approval by pharmaceutical products companies. The law, however, links data protection to the good being covered by a valid patent, even though confidential test data is itself a separate, protected form of intellectual property. Bulgaria joined the European Patent Convention on July 1, 2002 and has obtained observer status in the Administrative Council of the European Patent Organization.

The U.S. pharmaceutical industry has reported that Bulgaria is effectively shortening the patent life of innovative products, creating a barrier to U.S. industry's exports to Bulgaria and their investments. The industry is concerned that generic copies of the original drugs have been granted marketing authorizations, a registered retail price and applied for (or received access to) reimbursement prior to expiration of the patent of the original pharmaceutical product.

U.S. companies report that the Bulgarian government's inability to protect trademarks is a significant barrier to investment and legitimate domestic economic development. U.S. businesses have noted significant difficulties in obtaining relief against trademark infringement and noted that, even with court orders, the entities charged with enforcement often cannot be relied upon to carry out the court judgment.

There is evidence of significant counterfeit production in Bulgaria and illegal importation of counterfeit U.S. brand distilled alcoholic spirits. Some spirits companies have estimated that almost 10 percent of the products sold in the Bulgarian market may be counterfeit.

SERVICES BARRIERS

As in other EU candidate countries, Bulgaria's 1998 Radio and Television Law requires a "predominant portion" of certain programming to be drawn from European-produced works and sets quotas for Bulgarian works within that portion. This requirement, however, is only to be applied to the extent "practicable." Foreign broadcasters transmitting into Bulgaria must have a local representative, and broadcasters are prohibited from entering into barter agreements with television program suppliers.

INVESTMENT BARRIERS

The U.S.-Bulgaria Bilateral Investment Treaty (BIT), which entered into force in 1994, includes obligations that protect U.S. investors, such as national treatment and MFN treatment, the right to make financial transfers freely and without delay, international law standards for expropriation and compensation, and access to binding international arbitration. In 2003, to address potential incompatibilities between BIT obligations and EU law, the United States and eight prospective EU members agreed to make several narrow amendments to the texts of the relevant BITs. Both the United States and Bulgaria

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have ratified the BIT amendments, but the amendments will not enter into force until Bulgaria joins the EU.

The 2005 property rights constitutional amendment will come into effect on January 1, 2007. The amendment will lift the existing prohibition on the purchase of Bulgarian land by foreigners and favors EU over U.S. investors. While EU citizens and entities will be allowed to acquire property directly by virtue of Bulgaria's accession treaty, all other foreigners will be able to do so only on the basis of international agreements ratified by the Bulgarian Parliament. In the meantime, the constitutional prohibition against ownership of land by foreign individuals remains in force. Foreign-owned companies registered in Bulgaria, however, are considered to be Bulgarian persons. U.S.-owned companies that register in Bulgaria therefore may acquire land in Bulgaria.

Local companies in which foreign partners have controlling interests must obtain prior approval (licenses) to engage in certain activities, including: production and export of arms/ammunition; banking and insurance; exploration, development, and exploitation of natural resources; and acquisition of property in certain geographic areas. There are neither specific export performance requirements nor specific restrictions on hiring expatriate personnel, although residence permits are often difficult to obtain.

A recent Bulgarian law eliminated the withholding tax on dividends for European investors, but U.S. investors face a withholding tax of 15 percent.

New insolvency rules in Bulgaria's Commercial Code and its Law on Public Offering of Securities have greatly improved the legislative protection for minority shareholders. But enforcement of the law's provisions is inadequate and corporate governance remains weak.

In 2003, Parliament approved a new Telecommunications Law that increases institutional and regulatory liberalization of the Bulgarian telecommunications sector but focuses more on institutional issues and the protection of state interests than on greater market liberalization. The new Telecommunication Act extended until December 2005 the Bulgarian Telecommunications Company's (BTC) control over the sole telecommunication network.

A June 1999 law regulating the gaming industry imposes additional requirements on foreigners organizing games of chance. Foreigners can receive a license to establish a casino in a hotel only if they satisfy one of the following conditions: (1) purchase or construction of a hotel rated four-star or higher; or (2) investment of at least \$10 million and employment of at least 500 workers in economic activities unrelated to gambling.

According to U.S. businesses, other steps needed to improve the environment for foreign investment include improved creditor rights through improvements to bankruptcy law and procedures; reform of the judicial system; improved accounting standards and risk assessment; reform of the energy sector; and transparency and accountability in public policy to reduce the perception of corruption.

FOREIGN TRADE BARRIERS

OTHER BARRIERS

Selective enforcement

Foreign investors complain that tax evasion by private domestic firms combined with the failure of the authorities to enforce collection from large, often financially-precarious, state-owned enterprises places the foreign investor at a disadvantage. The multiplicity of Bulgarian licensing and regulatory regimes, their arbitrary interpretation and enforcement by the bureaucracy, and the incentives this creates for corruption have long been seen as an impediment to investment, private business development and market entry.

CAMBODIA

TRADE SUMMARY

The U.S. goods trade deficit with Cambodia was \$1.7 billion in 2005, an increase of \$259 million from \$1.4 billion in 2004. U.S. goods exports in 2005 were \$69 million, up 17.9 percent from the previous year. Corresponding U.S. imports from Cambodia were \$1.8 billion, up 18.0 percent. Cambodia is currently the 141st largest export market for U.S. Goods.

The stock of U.S. foreign direct investment (FDI) in Cambodia in 2004 was \$1 million, the same as in 2003.

IMPORT POLICIES

Tariffs

Cambodia's tariff schedule was first rationalized in 1993 and simplified in 2001, following the country's accession to the ASEAN Free Trade Area (AFTA). The 2001 tariff restructuring resulted in simplification of customs duties from 12 tariff bands to four tariff bands (0 percent, 7 percent, 15 percent and 35 percent), and reduction of the maximum duty rate from 120 percent to 35 percent and the simple average rate to below 15 percent.

In January 2004, Cambodia launched a new customs tariff schedule that implements both the Harmonized System of Commodities Description and Coding System (HS) and ASEAN Harmonized Tariff Nomenclature (AHTN). Under the Common Effective Preferential Tariff (CEPT) scheme of the ASEAN Free Trade Agreement (AFTA), Cambodia will reduce or eliminate customs import duties on most AFTA-origin products by January 2015.

Cambodia and the United States signed a bilateral trade agreement (BTA) in October 1996; the agreement provides for reciprocal NTR tariff treatment. Cambodia acceded to the WTO in October, 2004.

Non-Tariff Barriers

Import prohibition: Cambodia currently prohibits the commercial importation of the following products: narcotics, psychotropic substances and their precursors, toxic wastes and poisonous chemicals and substances, and pesticides. In an effort to curb the spread of avian influenza, Cambodia has also issued a regulation banning the import of poultry products.

FOREIGN TRADE BARRIERS

Quantitative restrictions and non-automatic licensing: Importation of some goods is subject to restriction and importers are required to have approval from relevant government agencies depending upon the nature of goods. Imports of pharmaceutical products are subject to prior permit from the Ministry of Health. Importers also need to secure import licenses from the Ministry of Agriculture, Forestry and Fishery for imports of agricultural inputs such as fertilizer, and live animals and meat. Imports of weapons, explosives and ammunition require a license from the Ministry of Defense, while the National Bank of Cambodia approves imports of precious stones.

Foreign Exchange System: Although the Riel is the official currency of Cambodia, the economy is heavily dollarized. Most commercial transactions are conducted in dollars. Under the Exchange Law of 1997, foreign direct investment (FDI) investors are allowed to purchase foreign currencies freely through the banking system. The law specifically states that there shall be no restrictions on foreign-exchange operations, but the transactions must be conducted by authorized intermediaries; i.e., lawfully established banks in Cambodia. These banks are required to report to the National Bank of Cambodia all transactions in excess of \$10,000.

Customs: Cambodia is in the process of reforming its customs regime through a five-year (2003–2008) reform and modernization program to streamline and improve the effectiveness of customs operations and to facilitate trade. With assistance from the International Monetary Fund (IMF), a revised Law on Customs has been drafted and is awaiting National Assembly approval. As part of its WTO accession commitments, Cambodia will implement the WTO Customs Valuation Agreement by January 2009.

Although Cambodia has made some progress in reform efforts, customs procedures remain complicated. Both local and foreign businesses have complained that the Customs and Excise Department generally engages in practices that are non-transparent and that often appear arbitrary and irregular. Importers frequently cite problems with undue processing delays, excessive paperwork and formalities driven by excessive discretionary practices.

Taxation: Cambodia levies a 10 percent VAT on goods and services. In theory, VAT is to be applied to all goods and services, but in practice the government began implementing the VAT with major companies. It is now expanding the base to which VAT is applied.

The corporate tax rate is within the range of 20 percent to 30 percent depending on the nature of business. A concessional, as low as zero percent, tax rate will be applied if the government has granted a firm a tax-exempt period. Resident branches of overseas companies or banks are taxed at 20 percent. The government also applies a withholding tax of 14 percent on dividends, royalties, rents and interests.

STANDARDS, TESTING, LABELLING AND CERTIFICATION

Standardization is at an early stage in Cambodia and only partially regulated. The country currently has no body of law governing standards for imported and exported goods. The Sub-decree on Industrial Standards, passed in 2001, provided the basis for rules and procedures for adopting a new standard, technical regulations and conformity assessment procedures. The Law on Industrial Standards is in draft form.

Cambodia is currently working on the establishment of standards and other technical measures based on international standards, guidelines and recommendations. The United Nations Industrial Development Organization (UNIDO) is presently providing assistance to the Department of Industrial Standards of Cambodia (ISC) of the Ministry of Industry, Mines, and Energy (MIME) in creating a new product certification scheme conforming to the requirement of ISO/IEC Guide 65.

Quality control is under the Department of Inspection and Fraud Repression (CamControl) of the Ministry of Commerce. CamControl is the national contact point for Codex Alimentarius. Its primary responsibility is the enforcement of quality and safety of products and services through the establishment of standards and labeling requirements.

The responsibility for establishing industrial standards and certifications resides with the ISC of the Ministry of Industry, Mines, and Energy. The ISC has been assigned as the enquiry point for technical barriers to trade (TBT) and as the agency responsible for notifications and publications required by the WTO TBT Agreement. The Ministry of Health is charged with prescribing standards, quality control, distribution and labeling requirement for medicines.

The Ministerial Regulation on Measures Against Food Products Devoid of Appropriate Label requires detailed labeling of food products circulated in Cambodia. For many products, it is mandatory to have labeling, instructions or warnings in Khmer language. In practice, however, this regulation is often ignored.

Cambodia maintains a pre-shipment inspection system. Société Generale de Surveillance (SGS) may inspect the quality of any goods shipped into the country. In practice, imports are admitted into Cambodia with little reference to standards or rigorous inspection.

Cambodia is obligated to fully implement the WTO TBT Agreement by January 2007 and SPS Agreement by January 2008. Cambodia has committed to implementing a “Risk Management Strategy” for inspection of imported and exported goods in 2006.

Cambodia joined the International Organization for Standardization (ISO) in 1995 and is also a member of the ASEAN Consultative Committee on Standards and Quality (ACCSQ). Cambodia has ratified the ASEAN Framework Agreement on Mutual Recognition Arrangements.

FOREIGN TRADE BARRIERS

GOVERNMENT PROCUREMENT

Cambodia's government procurement regime is governed by a sub-decree issued in 1995. Under the sub-decree, Cambodia's procurement policies are open and well-defined. The sub-decree requires that all international purchases over 200 million riel (\$50,000) for civil work and 100 million riel for goods be made through public tender. The public tender will also be applied to domestic purchases below 200 million riel for civil works projects and 100 million riel for goods. Both international and domestic bidding is open to all interested bidders through public advertisement.

While Cambodia has clear regulations pertaining to government procurement, the conduct of procurement is often non-transparent and irregular. To eliminate some potential bidders, the public announcement of the tenders is often either subject to a short deadline or not widely publicized. These tactics provide an advantage to a limited number of bidders often connected with government officials.

Cambodia is not a signatory to the WTO Government Procurement Agreement.

EXPORT SUBSIDIES

The Cambodian government does not grant direct export subsidies, but does use preferential tax incentives to attract investment and promote exports. Currently, Cambodia has no agricultural subsidies. The 1994 Law on Investment, amended in 2003, grants incentives and privileges including the exemption, in whole or in part, of customs duties and taxes to qualified investment projects (QIP), which refers to investment projects that have received a Final Registration Certificate issued by the Council for the Development of Cambodia.

The investment law provides an import duty exemption for construction materials, production equipment and production inputs used by export QIPs and domestic QIPs. Supporting QIPs are also entitled to the exemption, but the QIPs are required to pay customs duties and taxes on the production inputs for the quantity that has not been supplied to the export industry or directly exported after review.

INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

Cambodia has adopted legislation concerning the protection of intellectual property rights including the Law on Copyrights and Related Rights and Patent and Industrial Designs. Cambodia is a member of the World Intellectual Property Organization (WIPO) and the Paris Convention for the Protection of Industrial Designs.

Cambodia is implementing the WTO TRIPS Agreement, but, comprehensive enforcement remains problematic. The 1996 BTA contained a broad range of IPR protection, which given the limited experience with IPR, will be phased in by the Cambodian government.

FOREIGN TRADE BARRIERS

The Cambodian government has taken law enforcement action against the piracy of domestically produced music or video products. There has been no enforcement effort, however, against piracy of foreign optical media. Cambodian copyright law allows the owners of IPR to file a complaint with the authorities to take action. However, owners requesting crackdowns on IPR pirating operations must pay support costs to the authorities for conducting the operations.

Trademarks

In 2002, the National Assembly passed a trademark law to implement Cambodia's TRIPS obligations. The law outlines specific penalties for trademark violations, including jail sentences and fines for counterfeiting registered trademarks. It also contains detailed procedures for registering trademarks, invalidation and removal, licensing of trademarks, and infringement and remedies.

Before a trademark law was in force in Cambodia, owners of trademarks were unable to seek relief from infringement in court. The relatively few complaints received were directed to the Ministry of Commerce, which has responsibility for registering trademarks, but does not have clear legal authority to conduct enforcement activities. Nevertheless, the Ministry has taken effective action against trademark infringement in several cases since 1998. The Ministry has ordered local firms to stop using well-known U.S. trademarks. The Ministry of Commerce maintains an effective trademark registration system, registering more than 10,000 trademarks (over 2,900 for U.S. companies) under the terms of a 1991 sub-decree, and has proven cooperative in preventing unauthorized individuals from registering U.S. trademarks in Cambodia.

At least one U.S. company has brought legal action to protect its trademarks in Cambodia. The case reached the Supreme Court in Phnom Penh, which issued a mixed decision that, unfortunately, did not cancel the other party's registrations. The Phnom Penh Municipal Court, however, handed down Cambodia's first trademark conviction in March 2006.

Patents and Industrial Designs

Cambodia has a very small industrial base, and infringement of patents and industrial designs is not yet commercially significant. With assistance from WIPO, the Ministry of Industry, Mines and Energy (MIME) prepared a draft of a comprehensive law on the protection of patents and industrial designs in April 1999. The National Assembly adopted the law and it entered into force in January 2003. The law provides for the filing, registration, and protection of patents, utility model certificates and industrial designs. The MIME has also issued a sub-decree on granting patents and registering industrial designs.

Cambodia has not yet made significant progress toward enacting required legislation in the area of encrypted satellite signals, semiconductor layout designs, and trade secrets.

Copyrights

A copyright law was enacted in January 2003. Responsibility for copyrights is shared between the Ministry of Culture, which handles phonograms, compact discs (CDs), and other recordings; and the Ministry of Information, which deals with printed materials. Although Cambodia is not a major center for the production or export of pirated CDs, videos, and other copyrighted materials, these products are widely available in Cambodian markets. Pirated computer programs, digital video discs (DVDs), and music CDs are widely used throughout the country.

SERVICES BARRIERS

Foreign participation in the services sector is generally not restricted. Cambodia's legislation regarding the services sector has generally complied with the principles and provisions of the General Agreements on Trade in Services (GATS). Cambodia provides market access or national treatment for the cross-border supply, consumption abroad, and commercial presence of almost all services.

Accounting, Consulting and Tax Services: Cambodia provides market access and national treatment to foreign firms providing accounting, auditing and taxation services. Major international accounting and consulting firms operate in Cambodia.

Legal Services: According to the Cambodian Law on the Bar adopted in 1995, foreign lawyers cannot represent clients, conduct activities to attract clients, or publish commercial advertisements. However, they are permitted to work in commercial association with Cambodian lawyers. The commercial association requirement does not apply when legal services are provided in the area of foreign and international law.

Architectural and Engineering Services: Cross-border supply for architectural services is not restricted and national treatment is granted. Foreign citizens can provide engineering and integrated engineering services.

Telecommunications Services: For the most part, access to Cambodia's telecommunications services market is not restricted. Private participation in mobile services, e-mail, electronic data interchange and code and protocol conversion are allowed and national treatment is accorded. In addition, Cambodia is committed to permitting licensed suppliers of mobile communications services to choose which technology to use for such services.

Cross-border supply for voice telephone services, circuit-switched data transmission and private leased circuit services are allowed only over circuits leased from Telecom Cambodia. This restriction will be eliminated by January 2009 and foreign participation of up to 49 percent equity will be allowed. Cambodia is making preparations to create an independent regulatory body.

Audiovisual Services: Cambodia does not prohibit foreign firms from distributing foreign films and videotapes. However, given poor enforcement of the IPR regime, legitimate foreign and domestic products are scarce and expensive whereas pirated products are abundant and cheap.

Distribution Services: No limitation on market access or national treatment is imposed on foreign firms wishing to engage in distribution services; i.e., wholesale trade and retailing services. Like other business activity, foreign firms are required to register with the Ministry of Commerce to obtain a business license.

Educational Services: Cambodia faces a shortage of qualified teachers and is in need of international-quality educators and education. Foreign participation in educational services is not restricted. Currently there are several foreign-owned schools in Phnom Penh.

Insurance Services: Licensed insurance companies including foreign companies can provide all types of insurance products. Cambodia's insurance sector is governed by the Law on Insurance of 2000. A few foreign insurance companies operate in Cambodia.

Banking services: Cambodia allows foreign firms to operate as either 100 percent-owned subsidiaries or as branches. The 1999 Law on Banking and Financial Institutions and subsequent regulations guarantee foreign banks rights and obligations equal to local banks. The law imposes no restrictions on foreign ownership of banks. There are a few foreign bank subsidiaries operating in Phnom Penh.

Health-Related Services: Cambodia permits cross-border of hospital services. For commercial presence, foreign ownership and management of private hospitals and clinics is permitted as long as at least one director for technical matters is Cambodian. Foreign firms are allowed to provide dental services through joint ventures with Cambodian legal entities.

Tourism and Travel-Related Services: Tourism is one of the most important sectors of the country's economy. Cambodia does not restrict foreigners' participation in this sector. Foreign companies may establish a commercial presence to operate hotels, restaurants, travel agencies, and tour operator services, provided that they register with the Ministry of Commerce for business licenses.

INVESTMENT BARRIERS

Cambodia's investment climate is poor. The World Economic Forum's 2005 competitiveness survey ranked Cambodia 112 out of 117 countries surveyed. The World Bank also ranked Cambodia near the bottom of the list on business climate. Foreign direct investment (FDI) has declined over recent years. Approved investment fell to \$61 million in 2004 from \$129 million in 2003. The stock of U.S. investment in Cambodia was estimated to be \$1 million in 2004.

The Cambodian government actively solicits foreign private investment to boost its economic development. Cambodia's 1994 Investment Law, amended in 2003, is liberal and accords national treatment to all foreign investors, but the Constitution restricts foreign ownership of land. Foreign investors may use land through concessions, unlimited long-term land leases and renewable limited short-term leases.

Cambodia has one of the most liberal and competitive investment laws in the region, but potential investors are often deterred by excessive bureaucracy and corruption. Cambodia has the potential for business investment in almost all sectors. The government particularly encourages investment in agriculture and agro-processing industries, environmental protection, export-oriented industries, tourism and infrastructure. Nonetheless, in practice, local and foreign businesses often complain of complex and burdensome bureaucracy and corruption.

Cambodia has attempted to reverse the decline in foreign investment through reforms intended to improve the investment climate. Through its biannual Government-Private Sector Forum, Cambodia has managed to reduce business registration fees from \$635 to \$177 and decrease the registration period from 30 days to 10.5 days. Other reforms are under way to improve the business environment, including a World Bank-funded trade facilitation reform program.

ELECTRONIC COMMERCE

E-commerce is a new concept in Cambodia. Online commercial transactions are extremely limited, and Internet access is still in its infancy. No legislation exists to govern these sectors, but no specific restrictions on products or services traded via e-commerce have been imposed.

The exclusive right to operate a Voice over Internet Protocol (VoIP) service has been granted to one local company.

FOREIGN TRADE BARRIERS

OTHER BARRIERS

Corruption and Governance

Corruption is pervasive throughout the government and business sector. In 2005, Transparency International ranked Cambodia 139 out of 159 countries surveyed for graft. Both foreign and local businesses have identified corruption or malfeasance in Cambodia as a major obstacle to business and a deterrent to foreign direct investment.

Prime Minister Hun Sen has publicly emphasized the need to fight corruption, and has said that corruption takes a toll on economic performance and poverty alleviation. During the National Conference on Good Governance in December 2004, he described bad governance as “a landmine buried in Cambodia’s path towards reform”. In the December 2004 Consultative Group (CG) meeting of development assistance agencies, donors established a benchmark of having a new anti-corruption law adopted by the Council of Ministers and submitted to the National Assembly before the next CG meeting, which was held March 2-3, 2006. The anti-corruption law has yet to be completed. In January 2005, the Prime Minister instructed the Ministry of National Assembly to resurrect a decade-old draft anti-corruption law. An informal donor working group including the United States is working closely with the government to produce a revised draft law that meets international best practices.

Judicial and Legal Framework: Cambodia’s legal framework is incomplete and unevenly enforced. Many business-related draft laws are still pending. The judicial system is often arbitrary and subject to corruption. Many Cambodian and foreign business representatives perceive the court system to be unreliable and susceptible to external political and commercial influence, which constitutes one of the most serious legal risks that investors face.

Smuggling: Widespread smuggling of commodities such as vehicles, fuel, soft drinks and cigarettes has undermined fair competition, legitimate investment, and government revenue. The government has issued numerous orders to suppress smuggling and created various anti-smuggling units within the governmental agencies, particularly the Department of Customs and Excise.

In the latest drive to curb smuggling, Cambodia targeted high revenue commodities such as fuel, vehicles and electronic goods. Prime Minister Hun Sen issued another order to prevent and crackdown on smuggling. To encourage implementation, incentives are given to authorities or officials who have confiscated smuggled goods. Despite these efforts, smuggling remains a problem in Cambodia. Crackdowns are often perfunctory and most intense immediately after the onset of anti-smuggling campaigns.

CAMEROON

TRADE SUMMARY

The U.S. goods trade deficit with Cameroon was \$41 million in 2005, a decrease of \$168 million from \$209 million in 2004. U.S. goods exports in 2005 were \$117 million, up 17.5 percent from the previous year. Corresponding U.S. imports from Cameroon were \$158 million, down 48.9 percent. Cameroon is currently the 121st largest export market for U.S. goods.

The stock of U.S. foreign direct investment (FDI) in Cameroon in 2004 was \$283 million, up from \$242 million in 2003.

IMPORT POLICIES

Tariffs

Cameroon is a member of the WTO and the Central African Economic and Monetary Community (in French, CEMAC), which includes Gabon, the Central African Republic, the Republic of Congo, Chad, and Equatorial Guinea. CEMAC countries have a common currency managed by a regional Central Bank, share a common financial, regulatory, and legal structure, and maintain a common external tariff on imports from non-CEMAC countries. In theory, tariffs have been eliminated within CEMAC, and only a value-added tax should be applied to goods traded among CEMAC members. There has been some delay, however, in fully achieving this goal, and currently both customs duties and the value-added tax are being assessed on imports within CEMAC. Trade levels between Cameroon and its neighbors are small compared to the trade flows between Cameroon and its principal trading partners in Europe.

The simple average of CEMAC's common external tariff (CET) is 18.4 percent. The CET is assessed through four tiers of tariff rates: 5 percent for essential goods, 10 percent for raw materials and capital goods, 20 percent for intermediate goods, and 30 percent for consumer goods. In addition, there are other taxes assessed on imports, which can vary according to the nature of the item, the quantity of the particular item in the shipment, and even the mode of transport. As a result, average customs charges are in reality much higher. To improve customs revenue collection, the Cameroonian government has contracted with a Swiss company to assess and collect customs duties.

FOREIGN TRADE BARRIERS

Non-Tariff Measures

Prospective importers are required to register with the local Ministry of Trade and notify the customs collection contractor of all imports. Special import permits are granted to individuals who import items for personal use. Export-import companies must secure a commerce register and a taxpayer's card from the Ministry of Economy and Finance prior to registering with the Ministry of Trade. Contractors importing equipment and supplies related to public contracts may obtain a duty exemption from the Ministry of Economy and Finance only when the duties would count as part of the government investment in the project. CEMAC has no regional licensing system. Agents and distributors must register with the government, and their contracts with suppliers must be notarized and published in the local press.

Cameroon requires a commercial invoice and a bill of lading for all imported goods. Ship registration marks and numbers must match exactly those on the invoices and the goods. Three copies of the invoice are necessary for surface shipments and four copies are needed for air shipments. The importer must also present a written approval certificate acknowledging that the business operator is an exporter or an importer and/or an exemption, if appropriate. Documentation of bank transactions is required if the value of the imported goods exceeds FCFA 2 million (approximately \$4,000). This is also true for pre-shipment inspection certificates, which require a "clean report of findings" from the customs collection contractor. For certain imports, such as used clothing, certificates of non-infestation are also required. A service fee of FCFA 25,000 (approx. \$50) is required for imported second-hand automobiles. All documents must be submitted within 48 hours of a shipment's arrival.

Cameroon is a party to the WTO Agreement on Customs Valuation. Cameroon assesses duties on its own estimated cost of production, rather than the actual purchase price, for three commonly subsidized goods -- beet sugar, flour, and metal rebar. Although the government has tried to speed customs clearance, customs fraud is still a major problem, and protracted negotiations with customs officers over the value of imported goods are common.

STANDARDS, TESTING, LABELING AND CERTIFICATION

The Department of Price Control, Weights and Measures is officially responsible for the administration of standards. Labels must be written in both French and English and must include the country of origin as well as the name and address of the manufacturer. The pre-shipment inspection contractor may inspect the quality of any goods shipped into the country. In the absence of any specified domestic norm or standard, international norms and standards apply. In practice, most imports are admitted into the country without the need to meet specific standards.

GOVERNMENT PROCUREMENT

Cameroon is an observer, but not yet a member of the WTO Agreement on Government Procurement. The Government Procurement Regulatory Board administers public sector procurement. Local companies are gradually losing their preferential price margins and other preferential treatment with regards to government procurement and development projects. As part of its economic reform program, the government has established more open tender announcements, set up independent monitors for large government contract awards, and instituted more frequent audits of tender awards. In September 2004, the government enacted a decree to further enhance transparency and competitiveness in the award of public contracts. Cameroon's tight budgetary constraints require that most direct purchases by the government have pre-identified sources of financing.

INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

Cameroon is a member of the World Intellectual Property Organization and is a party to the Paris Convention for the Protection of Industrial Property and the Universal Copyright Convention. IPR enforcement is problematic due to the cost of enforcement and the rudimentary understanding of IPR among government officials and the populace. A few firms, including some from the United States, have complained of piracy, but have found little practical legal recourse to enforce their intellectual property rights. Although the government of Cameroon has been making some efforts in this regard, it is piecemeal at best. Yaounde, the capital of Cameroon, is also the headquarters for the 14-nation Africa Intellectual Property Organization (known by its French acronym OAPI) which offers patent and trademark registration.

SERVICES BARRIERS

Telecommunications

Cameroon has eliminated many restrictions on foreign trade in services and is gradually privatizing its telecommunications sector. In 1999, the government sold the state-owned mobile telephone company Camtel Mobil to a South African firm and gave a second mobile phone license to a French company. Efforts to privatize the main state-owned telephone operator, CAMTEL, collapsed when the two top bidders withdrew their offers. In 2004, the government – with the consent of the World Bank, which is monitoring the government's privatization program – authorized CAMTEL to resume investments in the sector that had previously been frozen for more than seven years. CAMTEL is to operate as a private company with no government support through 2006, while the government and the World Bank work to identify further privatization options. CAMTEL has taken advantage of this opportunity and launched a new wireless program. A number of companies are now moving into local Very Small Aperture Terminal (VSAT) systems for data transmission, international telephone service and Internet access. In September 2005, wireless provider MTN Cameroon bought a leading Internet service provider, although the regulatory board has yet to approve the deal. The Cameroon

FOREIGN TRADE BARRIERS

Telecommunications Regulator – Telecommunications Regulatory Board (ART) – regulates the sector and issues licenses for new companies to operate.

Insurance

Foreign firms can operate in Cameroon, but they must have local partners. There are several foreign insurance companies (including one U.S. firm) operating in Cameroon with Cameroonian partners.

INVESTMENT BARRIERS

The government states that it welcomes foreign investment and there has been significant improvement in the process of obtaining approvals for investment projects. In March 2002, the Parliament approved an investment charter that established a new framework for investments and integrated recent laws relating to the forestry, mining and petroleum codes. In September 2005, the President enacted a decree creating an investment promotion agency.

However, Cameroon’s investment climate remains challenging. The World Bank’s “Doing Business in 2006” survey found that it takes 444 days to comply with licensing and permit requirements for ongoing business operations in Cameroon, compared with 70 days in the United States, and also found that enforcing contracts can be particularly difficult.

Capital movements within CEMAC are completely free. Capital movements between CEMAC and third countries are permitted, provided that proper supporting documentation is available and prior notification is given to the exchange control authority. With respect to inward or outward foreign direct investment, investors are required to declare to the Ministry of Economy and Finance transactions above CFA 100 million (approximately \$200,000), and they must provide such notification within 30 days of the realization of the investment. The Bank of Central African States’ decision to continue monitoring outward transfers, combined with its cumbersome payment system, has led many to conclude that controls on transfers remain in force.

Local and foreign investors, including some U.S. firms, have found Cameroonian courts too complicated and costly to resolve their contract or property rights disputes. The United States-Cameroon Bilateral Investment Treaty provides access to international arbitration.

OTHER BARRIERS

Problems with energy supply have been a major concern of the government and international financial institutions. The IMF and the World Bank, in particular, feel that the lack of a dependable supply of energy has limited FDI, so they are pushing stakeholders in the sector to improve capacity as quickly as possible.

FOREIGN TRADE BARRIERS

Corruption is pervasive throughout the public and business sectors. The judicial system, characterized by long delays and under-staffing in the areas of financial and commercial law, has imposed major expenses on some American companies operating in Cameroon. Court decisions are often arbitrary and subject to corruption. Cameroon ratified the UN Convention Against Corruption in February 2006.

CANADA

TRADE SUMMARY

The U.S. goods trade deficit with Canada was \$76.4 billion in 2005, an increase of \$10.0 billion from \$66.5 billion in 2004. U.S. goods exports in 2005 were \$211.3 billion, up 11.3 percent from the previous year. Corresponding U.S. imports from Canada were \$287.9 billion, up 12.3 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 \$29.7 billion in 2004 (latest data available), and U.S. imports were \$20.0 billion. Sales of services in Canada by majority U.S.-owned affiliates were \$41.7 billion in 2003 (latest data available), while sales of services in the United States by majority Canada-owned firms were \$40.5 billion.

The stock of U.S. foreign direct investment (FDI) in Canada in 2004 was \$216.6 billion, up from \$189.8 billion in 2003. U.S. FDI in Canada is concentrated largely in the manufacturing, finance, and mining sectors.

A Trading Relationship Based on Free Trade

The North American Free Trade Agreement (NAFTA) came into force on January 1, 1994 and replaced the U.S.-Canada free trade agreement, which was implemented in 1989. The phase-out of tariffs between Canada and the United States was completed on January 1, 1998, except for tariff-rate quotas (TRQ) that Canada retains on certain supply-managed agricultural products. However, Canada still maintains some non-tariff barriers of concern at both the federal and provincial levels, impeding access to the Canadian market for U.S. goods and services.

IMPORT POLICIES

Supply-Managed Products

Canada closely restricts imports of certain domestic "supply-managed" agricultural products such as dairy products, eggs, and poultry through the use of TRQs. This practice severely limits the ability of U.S. producers to increase exports to Canada above the TRQ levels.

Margarine: The Province of Quebec applies coloring restrictions on margarine. In addition, provincial restrictions on the marketing of butter/margarine blends and imitation dairy products limits and, in certain cases, prohibits the sales of these products in many provinces. The provinces of Ontario, Manitoba, and Saskatchewan are challenging Quebec's provincial coloring regulations. An inter-provincial trade dispute panel ordered Quebec to remove its ban on yellow-colored margarine in June 2005, but the province has yet to comply with the ruling, which was supposed to go into effect in September 2005.

FOREIGN TRADE BARRIERS

Cheese snack foods: Canada is unwilling to resume duty-free trade in cheese snack foods between the United States and Canada. Prior to 1999, cheese snack foods were traded duty-free between the United States and Canada. Canada ceased issuing duty-free import permits on September 1, 2001, and started to apply a tariff of 245 percent on U.S. exports of breaded cheese sticks to Canada. Canada acted in response to a 1999 U.S. Customs Service reclassification of cheese sticks, which subjected U.S. imports to a U.S. TRQ and over-quota tariff. On November 7, 2001, USTR stated that it was prepared to request that the President issue a Proclamation to return duty- and quota-free treatment to Canadian cheese sticks, provided Canada commits to providing the same tariff treatment for imports of similar U.S. cheese snack foods. In early January 2002, the Department of Foreign Affairs and International Trade informed the United States that Canada had no intention of reducing its duties on cheese snack foods or entering into negotiations with the United States.

Processed egg products: The Canadian Egg Marketing Agency operates a dual pricing scheme for processed egg products. Under the regime, the domestic Canadian price for shell eggs is maintained at a level substantially above the world price. Producers are also assessed a levy on all eggs sold, a portion of which is used to subsidize egg exports. This practice artificially increases Canadian exports of egg products at the expense of U.S. exporters.

Fresh Fruits and Vegetables: Canada prohibits imports of fresh or processed fruits and vegetables in packages exceeding certain standard package sizes unless the Government of Canada grants a ministerial easement or exemption. To obtain an exemption, Canadian importers must demonstrate that there is an insufficient supply of a product in the domestic market. The restrictions on bulk goods do not apply to intra-provincial shipments. The import restrictions apply to all fresh and processed produce in bulk containers if there are standardized container sizes stipulated in the regulations for that commodity. For those horticultural products without prescribed container sizes, there is no restriction on bulk imports. The restriction has negative impact on U.S. potatoes, apples, and blueberries. In addition, Canadian regulations on fresh fruit and vegetable imports prohibit consignment sales of fresh fruit and vegetables in the absence of a pre-arranged buyer.

Restrictions on U.S. Grain Exports

U.S. access to the Canadian grain market has been limited partially by Canadian varietal controls. Canada requires that each variety of grain be registered and be visually distinguishable. Because U.S. varieties may not be visually distinct, they are not registered in Canada. As a result, U.S. wheat is sold in Canada as "feed" wheat at sharp price discounts compared to the Canadian varieties. The Canadian Grain Commission (CGC) is currently in the process of introducing a new system called Variety Eligibility Declaration, or VED, which is designed to monitor and control the type of grain that enters the grain handling and transportation system. After extensive consultations on the operational details of the VED system, the CGC is close to making its proposals public.

On September 16, 2005, the Canadian International Trade Tribunal (CITT) and the Canada Border Services Agency (CBSA) launched an official investigation into alleged dumping and subsidization of U.S. grain corn imports into Canada, following a petition filed by the Canadian Corn Growers. On November 15, 2005, the CITT found that imports of unprocessed corn into Canada are injuring Canadian growers.

CBSA must make a final determination on March 15, 2006. The final Canadian International Trade Tribunal injury determination is due April 18, 2006.

Personal Duty Exemption

The United States has urged Canada to facilitate cross border trade for border residents by relaxing its taxation of goods purchased in the United States by Canadian tourists. While U.S. and Canadian personal exemption regimes are not directly comparable, the United States allows an \$800 per person exemption every 30 days, while Canada has an allowance linked to the length of the tourist's absence and allows only C\$50 for tourists absent for at least 24 hours and C\$200 for visits exceeding 48 hours. This practice discourages shopping visits to the United States by border residents.

Wine and Spirits

Market access barriers in several provinces hamper exports of U.S. wine and spirits to Canada. These include "cost of service" mark-ups, listings, reference prices and discounting, and distribution and warehousing policies.

The Canadian Wheat Board and State Trading Enterprises

The U.S. government has concerns about the monopolistic marketing practices of the Canadian Wheat Board. Announced in 2002, USTR's approach to level the playing field for American farmers is producing important results. Most notably, in WTO dispute settlement proceedings against the Canadian Wheat Board and the Government of Canada, a WTO panel found in favor of the United States on claims related to Canada's grain handling and transportation systems. Canada now must comply with those findings. In order to comply with the WTO panel's findings, the Government of Canada introduced and passed Bill C-40, which amended the Canada Grain Act and Canada Transportation Act in May 2005.

In addition, the United States is seeking reforms to state trading enterprises (STEs) as part of the WTO agricultural negotiations. The U.S. proposal calls for the end of exclusive STE export rights to ensure private sector competition in markets currently controlled by single desk exporters; the establishment of WTO requirements to notify acquisition costs, export pricing, and other sales information for single desk exporters; and the elimination of the use of government funds or guarantees to support or ensure the financial viability of single desk exporters.

The United States gained WTO support for the elimination of trade-distorting practices of agricultural state trading enterprises.

In October 2003 the U.S. Department of Commerce (DOC) imposed 8.87 percent antidumping and 5.29 percent countervailing duties on Canadian hard red spring wheat (HRS). Following a June 2005 NAFTA panel remand decision, the U.S. International Trade Commission made a negative determination that HRS imports from Canada materially injured the U.S. industry. On January 30, the NAFTA secretariat issued a notice pursuant to rule 80 that the panel review was completed

STANDARDS, TESTING, LABELING AND CERTIFICATION

Restrictions on Fortification of Foods

Canadian requirements for foods fortified with vitamins and minerals have created a costly burden for American food manufacturers who export to Canada. Health Canada restricts marketing of breakfast cereals and other products, such as orange juice, that are fortified with vitamins and/or minerals at certain levels. Canada's regulatory regime requires that products such as calcium-enhanced orange juice be treated as a drug. This forces manufacturers to label vitamin and mineral fortified breakfast cereals as "meal replacements." These standards impose costs on manufacturers who must make separate production runs for the U.S. and Canadian markets.

In March 2005, the Government of Canada released for public consideration a draft policy on supplemental fortification of food and beverages that reflects the study on Dietary Reference Intakes (DRIs) undertaken by the U.S. Institute of Medicine (IOM). Industry welcomed the draft policy as it may offer more latitude to manufacturers for discretionary fortification of foods and beverages than the current regulatory regime. The new policy may reduce the cross-border discrepancy in fortification rules; however, Canada's policy is still under review and the final regulations based on it have not yet been drafted or submitted for public review. Draft regulations are now expected to be made public in mid-2006 and come into force in late 2006. They may still present barriers to efficient cross-border trade.

Restrictions on Container Sizes

Canada's Processed Products Regulations (Canada Agricultural Products Act) prescribe standard container sizes for a wide range of processed fruit and vegetable products. No other NAFTA country imposes such mandatory container size restrictions. The Processed Products Regulations require manufacturers of baby food to sell in only two standardized container sizes: 4.5 ounces (128 ml) and 7.5 ounces (213 ml). The requirement to sell in container sizes that exist only in Canada creates an unnecessary obstacle to trade in baby food between Canada and the United States. Canada claims that the regulations are being rewritten and suggests that U.S. concerns will be addressed. However, it appears that the effort to revise the regulations has stalled, as there has been no progress for the past several years.

EXPORT AND DOMESTIC SUBSIDIES

Softwood Lumber

The United States and Canada have been involved in a dispute over trade in softwood lumber for more than two decades. The current dispute began when the Softwood Lumber Agreement expired in 2001. After the Agreement expired, the U.S. industry filed antidumping (AD) and countervailing duty (CVD) petitions. The U.S. International Trade Commission (ITC) determined that the U.S. lumber industry was threatened with material injury by imports of dumped and subsidized Canadian softwood lumber, and the Department of Commerce (“Commerce”) found company-specific antidumping rates ranging from 2.18 percent to 12.44 percent and a country-wide subsidy rate of 18.79 percent. On December 14, 2004, Commerce announced the results of its first administrative review of the AD and CVD orders, in which it calculated AD rates ranging from 0.192 percent to 9.10 percent, and a CVD duty rate of 17.18 percent. On December 6, 2005, Commerce announced the results of its second administrative review of the AD and CVD orders, with AD rates ranging from 0.51 percent to 4.43 percent, and a CVD rate of 8.70 percent.

To date, Canadian interests have filed more than two dozen cases challenging the orders in various fora, including under the NAFTA, at the WTO, and in the U.S. Court of International Trade. Most of the litigation is still ongoing. The United States continues to believe that it is in the interests of both the United States and Canada to reach a negotiated solution to their longstanding differences over softwood lumber. This view is shared by stakeholders on both sides of the border. The United States is committed to seeking a resolution to this dispute and remains hopeful that we will be able to resume negotiations with Canada in the near future. In the meantime, the litigation will continue, and the United States will vigorously enforce its trade remedy laws to ensure a level playing field for U.S. industry.

Technology Partnerships Canada/Transformative Technologies Program

In September 2005, the Canadian federal government announced plans to launch its new Transformative Technologies Program (TTP), replacing the former Technology Partnerships Canada (TPC) program. TPC is a Canadian government program that supports the research and development activities of select industries. Established in 1996, TPC provided loan funding for so-called “pre-competitive” research and development activities for companies incorporated in Canada. Although TPC was targeted at a number of industries, a disproportionate amount of funding has been provided to aerospace and defense companies. To date, C\$2.7 billion in TPC funding commitments have been made for over 600 projects, of which about 70 percent has been disbursed. According to the Canadian government, about three percent of TPC funds have been repaid. The Canadian government restructured the TPC program in 1999 after a WTO Dispute Panel requested by Brazil determined that it provided an illegal subsidy.

The Canadian government announced plans to phase out the TPC program by April 1, 2006, after which time TPC would be operational. During the phase-out period, no new proposals for TPC funding will be accepted, except for those related to the aerospace and defense industries.

The Canadian government announced that TTP funding for aerospace and defense will continue at the same levels as under the TPC program, even though the TTP apparently will be aimed at reaching a broader range of industries than has been the case for the TPC program. It appears that the Canadian government may not expect full repayment of TP funds. An Industry Canada announcement of the TTP states “Its measure of success will not be cost recovery but sharing the risks of innovation.”

According to the Canadian Taxpayers Federation, Bombardier has been the largest recipient of Canadian federal subsidies, including funding such as the TPC program. The Canadian government has committed to provide Bombardier \$262.5 million for the purpose of developing the 110-130 seat “C series” civil transport aircraft, according to a May 2005 press report.

An Industry Canada spokesman is reported to have said that the funding would operate along the lines of the TPC program. As of early 2006, it appeared that no decision had been made to launch the C series aircraft.

Pharmaceuticals

The U.S. pharmaceutical industry has raised concerns about the pricing of patented medicines in Canada and encourages Canada and the Patented Medicine Prices Review Board (PMPRB) to move towards a more market-based review system.

The United States is monitoring Canadian policies on patent and data protections. Canada’s compliance with its TRIPS and NAFTA obligations remains a matter of concern. Although Canada has instituted statutory data protection, several judicial rulings have cast doubt on how well these protections are being enforced, as required by TRIPS Article 39.3 and NAFTA Article 1711. Regulations proposed in 2004, to extend the duration of data protection to eight years, have not progressed and it is unclear whether they will be reopened for comment. Canada is also apparently failing to apply its “linkage regulations” effectively. Such regulations require Health Canada to determine whether the marketing of generic pharmaceuticals infringes on existing name-brand patents.

The U.S. pharmaceutical industry estimates that Canadian trade barriers, including insufficient intellectual property protection, cost their companies between \$100 million and \$500 million annually.

INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

Canada is a member of the World Intellectual Property Organization (WIPO) and adheres to several international agreements, including the Paris Convention for the Protection of Industrial Property (1971), the Berne Convention for the Protection of Literary and Artistic Works (1971), and the 1952 Universal Copyright Convention (UCC). Canada is also a signatory of the WIPO Copyright Treaty and the WIPO Performances and Phonograms Treaty (together the WIPO Treaties), which set standards for intellectual property protection in the digital environment. Canada has not yet ratified either treaty, however. Ratification legislation was introduced into Canada's Parliament in 2005, but will have to be reintroduced following the election of a new government, and will not pass until 2006 at the earliest.

Canada's Copyright Act contains two provisions under which the country applies reciprocal rather than national treatment. The first provision is for the payment of a neighboring rights royalty to be made by broadcasters to producers and artists. Under Canadian law, those payments are only guaranteed to producers and artists from countries that are signatories of the 1961 Rome Convention. The United States is not a signatory of the Convention, and Canadian authorities have not granted U.S. producers and artists' national treatment in the distribution of these royalties. The second provision is for the payment of a levy, dubbed the private copy levy, by manufacturers and importers of blank audio recording media to producers and artists from countries that provide an equivalent payment to Canadian artists. The levy covers analog and digital tapes and discs, and was expanded in December 2003 to include MP3 players (although coverage of MP3 players was struck down by a court decision in December 2004).

Canada's copyright law stipulates this reciprocity criterion in the distribution of the private copy levy to foreign producers and artists. The United States does not impose a levy on analog tape, but does impose a levy on digital audio recording media and devices, with proceeds being distributed to applicable producers and artists on a non-discriminatory basis, including to Canadians.

The United States regards Canada's reciprocity requirement for both the neighboring rights royalty and the blank media levy as detrimental to U.S. copyright holders. For this reason (and other reasons including Canada's delay in implementing the WIPO treaties) USTR has placed Canada on its Special 301 "Watch List" for the past four years. Canada is authorized under its statute to grant some or all of the benefits of the two regimes to other countries if it considers that such countries grant or have undertaken to grant substantially equivalent rights to Canadians, but it has not granted these benefits to the United States. A growing coalition of technology and retail companies advocating the elimination of the private copy levy have added the levy to the list of copyright issues that will be examined as a part of the ongoing Parliamentary review of the Copyright Act.

U.S. intellectual property owners are concerned about Canada's lax and deteriorating border measures and general enforcement. The lack of *ex officio* authority for Canadian Customs officers makes it difficult for Customs to seize shipments of counterfeit goods. To perform a civil seizure of a shipment under the Customs Act, the right holder must obtain a court order, which requires detailed information on the shipment. However, Canada's Criminal Code allows for a public officer in the course of duty to seize any item discovered to be in violation of the law. For example, Customs can detain suspected counterfeit shipments and contact the Royal Canadian Mounted Police (RCMP), which can then proceed with investigation under criminal law.

Pirated and counterfeit goods include software, CDs, shampoo, and toys, which are often openly displayed in Canadian malls, department stores and chain stores. Of particular concern is the growing number of counterfeit electrical products that pose a significant health and safety risk, potentially compromising the reputation of the rights holder.

The price differential between pirated and legitimate goods, especially software, is significant. The majority of the pirated products are high quality, factory produced products from Asia. Aside from pirated software, many stores sell and install circumvention devices, also made in Asia, that allow pirated products to be played in a legitimate console. Once pirated and counterfeit products clear Canadian Customs, enforcement is the responsibility of the RCMP and the local police. The RCMP lacks adequate resources, training, and staff. Because Canadian laws are inadequate to address IPR issues, few prosecutors are willing or trained to take on the few cases that come up. Where an infringement case has gone to trial, the penalties imposed can be too weak to act as a deterrent, and jail time is rarely imposed. Border enforcement concerns were a major factor in keeping Canada on the Special 301 "Watch List" in 2005.

U.S. anti-piracy analysts have estimated that Canadian IPR protection weaknesses cost the U.S. economy between \$100 million and 500 million annually.

Music File-Sharing

In March 2004, Canada's Federal Court ruled that downloading music from the Internet using peer-to-peer (P2P) software does not constitute copyright infringement. The court denied a motion to compel Internet service providers (ISPs) to disclose the identities of clients who were alleged to be sharing copyrighted music files. The recording industry appealed the decision and although the appeals court upheld the denial of disclosure of client identities, the denial was without prejudice to file a new application, and the appeals judge clearly stated that the 2004 decision was incorrect to state that P2P file-sharing is legal. The question of whether P2P file-sharing is legal in Canada remains unclear. Canadian ratification of the WIPO treaties would help remedy this problem.

SERVICES BARRIERS

Audiovisual and Communications Services

In 2003, the Government of Canada amended the Copyright Act to ensure that Internet retransmitters are ineligible for the compulsory retransmission license until the Canadian Radio-television and Telecommunications Commission (CRTC) licenses them as distribution undertakings. Internet "broadcasters" are currently exempt from licensing. In 2003, the CRTC confirmed its intention to leave this exemption unchanged.

The Broadcasting Act lists among its objectives, "to safeguard, enrich and strengthen the cultural, political, social and economic fabric of Canada." The federal broadcasting regulator, the CRTC, implements this policy. The CRTC requires that for Canadian conventional, over-the-air broadcasters, Canadian programs must make up 60 percent of television broadcast time overall and 50 percent during evening hours (6 p.m. to midnight). It also requires that 35 percent of popular musical selections broadcast on radio should qualify as "Canadian" under a Canadian government-determined point system. For cable television and direct to home (DTH) broadcast services, a preponderance (more than 50 percent) of the channels received by subscribers must be Canadian programming services.

Non-Canadian channels must be pre-approved ("listed") by the CRTC. For other services, such as specialty television and satellite radio services, the required percentage of Canadian content varies according to the nature of the service.

The CRTC also requires that the English and French television networks operated by the Canadian Broadcasting Corporation (CBC) not show popular foreign feature movies between 7 been released in theaters at least two years earlier and not be listed in the top 100 of Variety Magazine's top grossing films for at least the past ten years.

Under previous CRTC policy, in cases where a Canadian service was licensed in a format competing with that of an authorized non-Canadian service, the CRTC could revoke the license of the non-Canadian service, if the new Canadian applicant so requested. This policy led to one "de-listing" in 1995 and has deterred potential new entrants from entering the Canadian market.

In July 1997, the CRTC announced that it would no longer be "disposed" to take such action. Nonetheless, Canadian licensees may still appeal the listing of a non-Canadian service which is thought to compete with a Canadian pay or specialty service, and the CRTC will consider removing existing non-Canadian services from the list, or shifting them into a less competitive location on the channel dial, if they change format to compete with a Canadian pay or specialty service.

Radiocommunication Act

A principal concern of the Canadian Cable Telecommunications Association (CCTA) is the spread of unauthorized use of satellite television services. Industry findings, extrapolated on a national basis, estimated that 520,000 to 700,000 households within cabled areas use unauthorized satellite services. Any survey of the incidence of satellite signal theft outside cabled areas would add to these numbers.

This survey, combined with information obtained through Canadian film producers' investigations and related Internet newsgroups, supports the conclusion that there may be 1 million illegal users of U.S. satellite television systems in Canada, resulting in a significant annual loss to the legitimate satellite television industry. Of this number of illegal users, it is estimated that over 90 percent are involved in the "black market" (i.e., signal theft without any payment to U.S. satellite companies), with the remainder subscribing via "gray market" where the unauthorized user does in fact purchase the signal from a U.S. satellite company for the signal, but only by pretending to be a U.S. resident. Annual losses to the U.S. motion picture industry due to audiovisual piracy in Canada were estimated at \$122 million in 2002.

Late in 2003, the Government of Canada (GOC) introduced amendments to the Radiocommunication Act to significantly increase penalties for signal theft and for the sale of unauthorized hardware. This draft legislation expired at the end of the Parliamentary session in November 2003, but was reintroduced in substantially the same form in the past session, which ended in November 2005 with no action.

A Quebec court ruled in October 2004 that the Canadian government's measures to prevent Canadians from subscribing directly to U.S.-origin satellite television services are unconstitutional. The GOC appealed this ruling and it was overturned by a higher court in April 2005.

Basic Telecommunications Services

Under the terms of the WTO Agreement on Basic Telecommunications Services, Canada permits foreign firms to provide local, long distance, and international services through any means of technology, on a facilities or resale basis. However, Canada retained a 46.7 percent limit on foreign ownership for all services except fixed satellite services and submarine cables. In addition to the equity limitations, Canada also retained a requirement for "Canadian control" of basic telecommunications facilities, which stipulates that at least 80 percent of the members of a board of directors must be Canadian citizens. These restrictions prevent global telecommunications service providers from managing and operating much of their own telecommunications facilities in Canada. In addition, these restrictions deny foreign providers certain regulatory advantages only available to facilities-based carriers (e.g., access to unbundled network elements and certain bottleneck facilities). In April 2003, the House of Commons Committee on Industry recommended the complete removal of these restrictions.

Canada has revised its universal service system. Previously, contributions to universal service funds were based upon on a per-minute assessment. This system potentially over-compensated incumbent local suppliers, who also competed in the long distance sector. The Canadian regulator, CRTC, established rules for a more competition-neutral collection system as of January 1, 2001. On May 30, 2002, the CRTC released its price caps decision, which cut contribution rates by 10 to 20 percent. This new regime extends through 2006.

As a consequence of foreign ownership restrictions, U.S. firms' presence in the Canadian market as wholly U.S.-owned operators is limited to that of a reseller, dependent on Canadian facilities-based operators for critical services and component parts. This limits those U.S. companies' options for providing high quality end-to-end telecommunications services as they cannot own or operate their own telecommunications transmission facilities.

Barriers to Film Exports

The classification of theatrical and home video product distributed in Canada is within the exclusive jurisdiction of the provinces. There are six different provincial or regional classification boards to which MPA members must submit product destined for theatrical release. Most of these boards also classify product intended for home video distribution.

As a control device, and to display a video's Quebec classification, the Quebec Cinema Act requires that a sticker be acquired from the Régie du Cinéma and attached to each pre-recorded video cassette and DVD at a cost of C\$0.40 per unit. The Québec government proposes to reduce the sticker cost to C\$0.30 for English and French versions of films dubbed into French in Quebec.

In addition to the direct cost of acquiring the stickers, there are the administrative costs of attaching stickers to each unit and removing them from all returns, plus the per-title, per-distributor administrative fee of C\$55.00 charged by the Régie.

In an effort to create a uniform, consumer-friendly classification system that more readily comports with national advertising campaigns and other practical concerns of the industry, the Canadian video distribution industry has initiated a voluntary national classification system for works distributed on videocassette and DVD. Under this system, a film's national rating is determined by averaging its provincial ratings and is displayed on the packaging. While some provinces accept the average national classification for the purpose of providing consumer information on pre-recorded video material, three of the provincial/regional boards, Manitoba, Quebec, and the Maritime Provinces (New Brunswick, Nova Scotia and Prince Edward Island), also require that their own classification be displayed.

The lack of unanimous acceptance of the voluntary national classification and the negative precedent established by the Quebec stickering regime continue to create significant consumer confusion and expense.

INVESTMENT BARRIERS

General Establishment Restrictions

Under the Investment Canada Act, the Broadcasting Act, the Telecommunications Act and standing Canadian regulatory policy, Canada maintains restrictions that inhibit new or expanded foreign investment in the energy and mining, banking, fishing, publishing, telecommunications, transportation, film, music, broadcasting, cable television, and real estate sectors.

Investment Canada Act

The Investment Canada Act (ICA) has regulated foreign investment in Canada since 1985. Foreign investors must notify the Government of Canada prior to the direct or indirect acquisition of an existing Canadian business of substantial size (as defined below). The Canadian government also reviews acquisitions by non-Canadians of existing Canadian businesses or establishments or of new Canadian businesses in designated types of business activity relating to Canada's culture, heritage or national identity where the federal government has authorized such review as being in the public interest. The Government of Canada must be notified of any investment by a non-Canadian to:

- Establish a new Canadian business (regardless of size); or
- Acquire direct control of any existing Canadian business which either has assets of C\$5 million or more; is in a business that is identified by regulation to be culturally sensitive; or is in uranium production, financial services, or transportation services; or
- Acquire indirect control over any existing Canadian business, the assets of which exceed C\$50 million in value in a non-cultural business or between C\$5 million and C\$50 million in a cultural business.

In 2005, the C\$5 million threshold for investment in sensitive sectors was increased to C\$250 million for non-Canadian investors from World Trade Organization (WTO) member countries. The WTO exemption does not include investments in production of uranium, financial services, transportation services, or a cultural business. The dollar threshold varies year-to-year and is a function of Canadian GDP. In 2006, the review threshold for WTO members is expected to be C\$265 million, rather than the C\$5 million level applicable to non-WTO investors. There is no review process for indirect acquisition of a Canadian business by any member of the WTO, with the exception of foreign acquisitions of any size in "cultural industries" (publishing, film, music, etc.).

Industry Canada is the reviewing authority for most investments, except for those related to cultural industries which come under the jurisdiction of Heritage Canada. The ICA sets time limits within which the reviewing authority must complete its analysis. In practice, Canada allows most transactions to proceed, though in some instances only after prospective investors have agreed to fulfill certain conditions.

FOREIGN TRADE BARRIERS

Publishing Policy

Foreign investors may directly acquire Canadian book firms only under certain circumstances. Under an agreement on periodicals reached with the United States in May 1999, Canada permits 100 percent foreign ownership of businesses to publish, distribute and sell periodicals. However, direct acquisition by foreign investors of existing Canadian-owned businesses continues to be prohibited.

Film Industry Investment

Canadian policies prohibit foreign acquisitions of Canadian-owned film distribution firms. A new distribution firm established with foreign investment may only market its own proprietary products. Indirect or direct acquisition of a foreign distribution firm operating in Canada is only allowed if the investor undertakes to reinvest a portion of its Canadian earnings in a manner specified by the Canadian government.

GOVERNMENT PROCUREMENT

As a party to the WTO Government Procurement Agreement (GPA), Canada allows U.S. suppliers to compete on a non-discriminatory basis for its federal government contracts covered by the GPA. However, Canada has not yet opened "sub-central" government procurement markets (i.e., procurement by provincial governments), despite commitments in the GPA to do so no later than July 1997. Some Canadian provinces maintain "Buy Canada" price preferences and other discriminatory procurement policies that favor Canadian suppliers over U.S. and other foreign suppliers. Because Canada does not cover its provinces in its GPA commitment, Canadian suppliers do not benefit from the United States' GPA commitments with respect to 37 state governments' procurement markets. In recent years, several U.S. states and Canadian provinces have cooperated to make reciprocal changes in their government procurement systems that may enhance U.S. business access to the Canadian sub-federal government procurement market. However, the Administration and a number of U.S. states have expressed concern that Canadian provincial restrictions continue to result in an imbalance of commercial opportunities in bilateral government procurement markets.

ELECTRONIC COMMERCE

There are currently few barriers to U.S.-based electronic commerce in Canada. In the WTO context, Canada has consistently supported the U.S. initiative for duty-free cyberspace. The Canadian Radio-television and Telecommunications Commission announced in 1999 that it would not attempt to regulate the Internet, a decision which is subject to review after five years (i.e., in 2004) but that review has not yet begun. In 2004, the CRTC decided that telephone communication over the internet (VoIP) should be subject to the same regulatory regime as conventional telephone systems, although no regulations have yet been proposed.

Canada's Personal Information Protection and Electronic Documents Act, which took effect on January 1, 2001, requires persons or firms that collect personal information in the course of commercial activities to inform the subject of all purposes to which the data may be put and to obtain informed consent for its use.

CHILE

TRADE SUMMARY

The U.S. goods trade deficit with Chile was \$1.5 billion in 2005, an increase of \$342 million from \$1.1 billion in 2004. U.S. goods exports in 2005 were \$5.2 billion, up 44.1 percent from the previous year. Corresponding U.S. imports from Chile were \$6.7 billion, up 40.9 percent. Chile is currently the 29th largest export market for U.S. goods.

U.S. exports of private commercial services (i.e., excluding military and government) to Chile were \$1.1 billion in 2004 (latest data available), and U.S. imports were \$687 million. Sales of services in Chile by majority U.S.-owned affiliates were \$3.0 billion in 2003 (latest data available), while sales of services in the United States by majority Chile-owned firms were \$2 million.

The stock of U.S. foreign direct investment (FDI) in Chile in 2004 was \$10.2 billion, up from \$9.2 billion in 2003. U.S. FDI in Chile is concentrated largely in the finance, manufacturing, mining, and banking sectors.

IMPORT POLICIES

Tariffs

The U.S.-Chile Free Trade Agreement (FTA) entered into force on January 1, 2004. The FTA eliminates tariffs on 87 percent of bilateral trade immediately and will establish duty-free trade in all products within a maximum of twelve years. Approximately 75 percent of U.S. farm exports will enter Chile duty-free within four years.

Chile has a relatively open trade regime. The uniform applied tariff rate for virtually all goods is 6 percent. Importers also must pay a 19 percent value added tax (VAT) calculated on the customs value plus import tariff. In the case of duty free imports, the VAT is calculated on the customs value alone.

There are several exceptions to the uniform tariff. For example, higher effective tariffs will remain throughout the U.S.-Chile FTA's 12-year transition period for wheat, wheat flour, and sugar, which are still subject to an import price band system. In August 2001, Chile formally registered with the World Trade Organization (WTO) its new consolidated sugar import tariff which increased the tariff from 31.5 percent to 98 percent. In order to increase the import tariff, Chile was obligated to offer quotas as compensation to its three principal suppliers, Argentina, Guatemala and Brazil.

Under the U.S.-Chile FTA, a 50 percent surcharge on used goods has been eliminated for goods originating in the United States. The importation of used passenger and cargo transport vehicles is prohibited with few exceptions. Many computer products and books enter Chile duty-free. Used clothing and other used textiles articles classified under HS heading 63.09 became duty-free upon entry into force of the agreement.

Import Controls

Chile's trade regime provides for the free importation of goods, except for those goods that are prohibited under existing legislation. Sometimes a potential import to Chile, due to its nature, might be subject to special authorization or oversight by an enforcement agency such as the Agricultural and Livestock Service, National Health Service, General Directorate of National Mobilization, or the Directorate for Borders and Limits.

Customs authorities must approve and issue a report for all imports valued at more than \$3,000. Imported goods must generally be shipped within 30 days from the day of the report, but longer periods may be authorized. Commercial banks may authorize imports of less than \$3,000. Larger firms must report their import and export transactions to the Central Bank. Commercial banks may sell foreign currency to any importer to cover the price of the imported goods and related expenses, as well as to pay interest and other financing expenses that are authorized in the import report. There are virtually no restrictions on the types or amounts of goods that can be imported into Chile, nor any requirements to use the official foreign exchange market.

Non-Tariff Barriers

Chile maintains a complex price band system for wheat, wheat flour, and sugar that will be phased out under the U.S.-Chile FTA for imports from the United States by 2016. The price band system was created in 1985 and is intended to guarantee a minimum and maximum price for the covered commodities. When certain cost, insurance and freight (CIF) prices (as calculated by Chilean authorities) fall below the floor, a special tax is added to the uniform tariff rate to raise the price to the minimum floor level. Price bands effectively set a minimum import price that is normally higher than both international and Chilean domestic prices.

The WTO Dispute Settlement Body (DSB) ruled on October 23, 2002, that Chile's price band system was inconsistent with Article 4.2 of the Agreement on Agriculture. Following arbitration, Chile was given until December 23, 2003, to implement the rulings and recommendations of the DSB to bring the price band into compliance with its WTO obligations. The Lagos Government and the Chilean Parliament agreed on a compromise proposal on August 7, 2003, eliminating the price band system on vegetable oils and introducing a number of modifications for wheat, wheat flour and sugar. In the case of sugar, wheat, and wheat flour, the new values for the floor and ceiling prices came into effect in November 2003 and will remain until 2007.

Beginning in 2008, the floor will be adjusted downward by two percent a year, until 2014, when Chile's President will evaluate whether to continue the price band system or eliminate it. Mixtures (e.g., high fructose corn syrup) containing more than 65 percent sugar content are now subject to the sugar price band system. On January 20, 2006, the DSB established a panel with regard to a claim by Argentina that Chile's 2003 modifications to the price band are also WTO-inconsistent.

STANDARDS, TESTING, LABELING AND CERTIFICATION

Prior to the U.S.-Chile FTA, many of Chile's trade-restrictive sanitary and phytosanitary (SPS) requirements prevented the entry of a number of U.S. agricultural and food exports. However, during the FTA negotiations, an ad hoc SPS working group was established to address a limited number of issues of concern to both the United States and Chile. Through this working group, important progress was made, including obtaining new market access for U.S. beef and processed beef products. In December 2003, Chile closed market access due to the detection of a single case of bovine spongiform encephalopathy (BSE) in the United States. In July 2005, Chile agreed to re-open the market for U.S. boneless beef, but access for offal and other select bovine products remains closed, contrary to international standards set by the World Animal Health Organization (OIE).

Currently, Chile has approved the planting of agricultural biotechnology products only for export seed propagation. A Presidential Commission was created to review all aspects of agricultural biotechnology and issued its report in June 2003. While the Commission's report supported the increased use of biotechnology crops in Chile for both export and domestic consumption, to date no biotechnology crops have been approved for commercialization domestically.

Under existing Chilean requirements, all imported food products must file a request for a "Certificate of Use and Disposal" and provide microbiological, dietetic, chemical and physical analyses and samples, regardless of whether the product has been reviewed and approved previously for another applicant. The requirement for repeated reviews and sampling of previously approved imported products does not achieve a good balance between cost and effectiveness. With risk-based testing system, or even random testing, it would be possible to achieve nearly the same level of public health protection at a reduced cost. The introduction of such a testing system could lead to a rise in U.S. exports to Chile of less than \$10 million.

GOVERNMENT PROCUREMENT

Individual government entities in Chile usually conduct their own procurement. In general terms, Chilean law calls for public bids for large purchases, although procurement by negotiation is permitted in certain cases. Foreign and local bidders on government tenders must register with the Chilean Bureau of Government Procurement.

They must also post a bank and/or guaranteed bond, usually equivalent to 10 percent of the total bid, to assure compliance with specifications and delivery dates. Chile is not a member of the WTO Agreement on Government Procurement.

The Government of Chile created the Information System for Procurements and Public Contracts for the Public Sector (www.chilecompras.cl) in March 2000. Through this site, anyone can offer products or services and register in the system as a potential supplier for government procurement, free of charge.

The system also allows all public agencies to publish information concerning their public bidding processes and requirements for public viewing on the Internet. Public agencies also publish detailed reports on the results of procurement processes.

The U.S.-Chile FTA covers the procurement of most Chilean central government agencies, 13 regional governments, 11 ports and airports, and more than 340 municipalities in Chile. The FTA includes provisions aimed at preventing discrimination against U.S. firms when they are bidding on government procurement opportunities that are covered by the FTA.

EXPORT SUBSIDIES

Chile's Ministry of Foreign Affairs promotes the country's exports, including through grants to private companies or industries for export promotional activities. ProChile, the Export Promotion Bureau of Chile, promotes specific products to targeted exports markets. It provides matching funds of up to 50 percent to participating firms on approved market promotion activities.

Chile provides a simplified duty drawback program for nontraditional exports that reimburses firms a percentage of the value of the export. Companies purchasing capital equipment domestically or internationally can borrow up to 73 percent of the amount of the customs duties that would normally be paid on such equipment if it were not used exclusively for exporting. Such imported capital equipment must carry a minimum value of \$3,813. For imported vehicles to be used in an export business, such vehicles must have a minimum value of \$4,830. Another export-promotion measure lets all exporters defer import duties for up to seven years on imported capital equipment or receive an equivalent subsidy for domestically produced capital goods. Chile has announced that it will phase out the simplified drawback program, in accordance with its WTO commitments.

Under Chile's separate value added tax (VAT) reimbursement policy, exporters have the right to recoup the VAT they have paid when purchasing goods and using services intended for export activities. To be eligible for the VAT reimbursement policy, exporters must have annual sales of less than \$16.7 million.

Chile also offers the Guarantee Fund (*Fondo de Garantia*) for small and medium enterprises. Through this fund, the Government of Chile guarantees access to credit provided by financial institutions and technical cooperation agencies to small and medium businesses. This Guarantee Fund benefits all those non-agricultural entrepreneurs whose annual gross sales do not exceed \$8.2 million, and agricultural producers with annual gross sales less than \$460,000. The U.S.-Chile FTA's Chapter on Market Access eliminates, over a transition period, the use of duty drawback and duty deferral for imports that are incorporated into any goods exported to the United States or Chile. Full drawback rights are allowed for the first eight years from entry into force. Beginning with year nine, the amount of drawback allowed is reduced until it reaches zero by year twelve.

Export Controls

Chilean customs authorities must approve and issue export reports. Exported goods must generally be shipped within 90 days from the date of the export report, but this period may be extended under certain conditions. Exporters may freely dispose of hard currency derived from exports. As with imports, exporters may use the formal or informal exchange market. Large firms must report all exports to the Chilean Central Bank, except for copper exports, which are authorized by the Chilean Copper Commission. Duty-free import of materials used in products for export within 180 days is permitted with prior authorization. Free-zone imports are exempt from duties and value-added tax if re-exported.

The export/import process requires contracting the services of a specialized professional called a Customs Agent. The Customs Agent is the link between the exporter importer and the National Customs Service. The Agent's mission is to facilitate foreign trade operations and to act as the official representative of the exporter/importer in the country. Agent fees are not standardized.

INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

Chile was placed on the 2004 Special 301 Watch List and remained on the list during 2005 because of substantive deficiencies in IPR laws and regulations and overall inadequate IPR enforcement. The lack of adequate protection for intellectual property rights (IPR) is the most glaring trade barrier in Chile's otherwise excellent business climate. The two biggest areas of concern are the lack of IPR protection in the pharmaceutical sector, including both patent infringement and a failure to protect undisclosed data from unfair competition, and the piracy of copyrighted material such as movies, music and software. If Chile were to eliminate this barrier to trade through effective IPR protection, it could potentially lead to a rise of between \$10 million to \$25 million in U.S. exports to Chile.

Patents and Trademarks

Following the 2004 Special 301 Watch List designation, the United States and Chile have continued their discussions on Chile's obligations to protect intellectual property under the FTA. The most notable area of concern has involved pharmaceutical products and the safety and efficacy data submitted in support of those products. During 2005, Chile remained on the Watch List because of these failures to protect intellectual property rights.

Notably, the U.S. pharmaceutical industry reports that Chilean health authorities are issuing marketing approvals to generic versions of innovative products within five years of the latter's market approval in Chile, relying inappropriately on the safety and efficacy information submitted by the innovators.

Chile is reportedly not meeting its data protection obligations under the FTA in two ways. First, it is allowing third parties to inappropriately rely on the test data of innovative pharmaceutical drugs to get market approvals for generic versions of drugs during the data protection period. Second, it is granting sanitary approval to third parties that are requesting to market their generic drug during the term of a patent which covers that drug product – often referred to as “linkage.” Industry has reported several such cases which appear to be contrary to Chile's FTA obligations.

In December 2004, Chile's Congress approved legislation intended to bring the country into compliance with a number of its TRIPS commitments. The new law provides for, among others things, expedited court proceedings and the authority to seize illegal copies of patented products. It also is intended to implement certain FTA obligations, such as the extension of the term of protection for patents when there are unreasonable delays in the patent application process, as well as stronger protection for confidential test data submitted to obtain marketing approval for pharmaceutical products and agricultural chemical products. Chile's implementing regulations for the data protection provisions only recently entered into force (November 28, 2005). These obligations should have been in force since January 1, 2004. The regulations contain exceptions and limitations that may undermine the effective protection of undisclosed safety and efficacy information. The United States will continue to work with the Chilean government to ensure full implementation of its FTA obligations.

Chile's Trademark Law is generally in line with international standards. Some U.S. trademark holders have complained of inadequate enforcement of trademark rights in Chile. In relation to Internet domain names, the United States and Chile have committed to creating a system to resolve problems of cyber-infringement of trademarks, following international standards. The FTA also requires Chile to respect the principle of “first-in-time, first-in-right” with respect to trademarks and geographical indications.

Copyrights

Despite active enforcement efforts by the police, the piracy of computer software and video recordings in Chile remains significant. Attempts to enforce copyrights in Chile have met with considerable delays in the courts and weak punishment when sentences were issued. According to the International Intellectual Property Alliance (IIPA), estimated losses due to the piracy of copyrighted materials in Chile totaled \$106.7 million in 2004. Chile made two sets of amendments to its copyright law in 2003, one to implement TRIPS and one to implement FTA obligations. The FTA's provisions increased the period of protection for copyrights and related rights to "life of the author plus 70 years," established strong prohibitions against the circumvention of encryption technology attached to digital works, performances and phonograms; added protection for temporary copies; and established a legal framework to combat on-line piracy. The U.S.-Chile FTA also criminalized end-user piracy, mandated reimbursement for actual damages for IPR violations, and penalized tampering with anti-piracy technology.

The United States will continue to work with the Chilean government to improve enforcement and ensure full implementation of the FTA's enforcement obligations, which enter into force in 2008.

Chile ratified both the World Intellectual Property Organization (WIPO) Copyright Treaty and the WIPO Performances and Phonograms Treaty in April 2001.

SERVICES BARRIERS

Chile's relatively open services trade and investment regime stands in contrast to its relatively limited commitments under the General Agreement on Trade in Services (GATS). In particular, Chile maintains a "horizontal" limitation, applying to all sectors in Chile's GATS schedule, under which authorization for foreign investment in service industries may be contingent upon a number of factors, including employment generation, use of local inputs, and compensation. This restriction undermines the commercial value and predictability of Chile's GATS commitments.

Commitments in services under the U.S.-Chile FTA cover both cross-border supply of services and the right to invest. Market access commitments apply across a wide range of sectors, including computer and related services, telecommunications, audiovisual services, construction and engineering, tourism, advertising, express delivery, professional services, distribution services, adult education and training services, and environmental services.

Chile has made WTO commitments on most basic telecommunications services, adopting the WTO Reference Paper on Regulatory Commitments, and ratifying the GATS Fourth Protocol. Nonetheless, U.S. companies have complained of regulatory delays and a lack of transparency in regulatory decisions.

FOREIGN TRADE BARRIERS

Financial Services

During its WTO financial services negotiations, Chile made commitments in banking services and in most securities and other financial services. However, the Chilean WTO Commitment Schedule in the securities sector did not include asset fund management (mutual funds, investment funds, foreign capital investment funds, and pension funds). Chile also reserved the right to apply economic needs and national interest tests when licensing Foreign Service suppliers. In practice, Chile has allowed foreign banks to establish branches and to provide the same range of services as domestic banks. Foreign insurance companies established in Chile operate with unlimited access to the Chilean market, as long as their legal incorporations meet requirements established in the Chilean Corporate Law Code. Foreign-based insurance companies cannot offer or contract insurance policies in Chile directly or through intermediaries.

Under the U.S. Chile FTA, banks, insurance, securities, and related services operate in a more open, competitive, and transparent market than previously. The financial services chapter of the FTA included core obligations concerning non-discrimination and most-favored nation status, as well as additional market access obligations. U.S. insurance firms now have the right to establish subsidiaries or joint ventures in all insurance sectors with only limited exceptions. Chile also committed to phase in insurance branching rights and to modify its legislation to open up its market to key insurance sectors such as marine, aviation, and transport (MAT) insurance and the insurance brokerage of reinsurance. U.S. banks and securities firms are now also allowed to establish branches and subsidiaries and may invest in local firms without restriction, except under very limited circumstances. U.S. financial institutions are also able to offer financial services to citizens participating in Chile's privatized voluntary social saving plans. They have also gained increased market access through Chile's mandatory social security system. Chile now allows U.S.-based firms to offer cross-border services to Chileans in areas such as financial information, data processing, and financial advisory services, with limited exceptions. Chilean mutual funds are permitted to use foreign-based portfolio managers.

INVESTMENT BARRIERS

Chile welcomes foreign investment, but maintains some controls and restrictions. Foreign direct investment is subject to *pro forma* screening by the government. The Foreign Investment Committee (FIC) of the Ministry of Economy reviews all foreign investment and sets the terms and conditions for all contracts involving foreign direct investment. FIC approval is required for the following categories of investment projects: those whose total value exceeds \$5 million; those related to sectors or activities that are normally developed by the government and/or supplied by public services; those involving the mass media; and those made by foreign governments or foreign public entities. Foreign investment projects worth more than \$5 million are entitled to the benefits and guarantees of Decree Law (D.L.) 600. Under this law, the FIC signs a separate contract with each investor that stipulates the time period within which the

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investment will be implemented, which varies according to the type of investment. Under D.L. 600, profits from an investment may be repatriated immediately, but none of the original capital may be repatriated for one year.

Foreign investors in Chile may own up to 100 percent of an enterprise and there is no limit on the period during which they may own property. In the mining sector, a foreign investor might, for example, hold mining rights for an unlimited period but not own the land/mine itself in Chile. Foreign investors have access to all sectors of the economy with some limited exceptions in coastal trade, air transportation, and the mass media. Chile permits investment in the fishing sector to the extent that an investor's home country reciprocally permits Chilean nationals to invest in that sector. Most investment projects require additional permits and/or must fulfill other requirements aside from those set forth in D.L. 600 (e.g., pertaining to environmental protection). All investors, both local and foreign, must comply with sector-specific legislation at the national, regional and municipal levels.

Investors domiciled abroad may bring foreign currency into Chile under Chapter 14 of the Foreign Exchange Regulations of the Central Bank. Chapter 14 allows the investor to sell foreign currency freely through the formal or informal exchange market. In 2001, the Central Bank suspended its prior controls on capital flows, including the "encaje," a domestic deposit requirement that applied to short-term capital flows. The Central Bank also eliminated the one-year holding period for indirect investment. Outflows associated with capital returns, dividends, and other investments no longer require government approval. Restrictions on the issuance of American Depositary Receipts (ADRs) have also been lifted. Chilean companies are free to take out loans or issue bonds in a wide range of currencies.

The U.S.-Chile FTA further strengthened the legal framework for U.S. investors operating in Chile. All forms of investment are protected under the FTA, including enterprises, debt instruments, concessions, contracts, and intellectual property. The FTA also prohibits certain restrictions on investors, such as the requirement to buy domestic rather than imported inputs.

The U.S. and Chilean governments have been discussing a bilateral tax treaty, but were not able to conclude negotiations in 2005. Until such a treaty takes effect, profits of U.S. companies operating in Chile will continue to be subject to taxation by both governments.

OTHER BARRIERS

Luxury Tax

A luxury tax of 21.25 percent is applied to automobiles whose CIF value exceeds \$27,726.85. Under the terms of the FTA, the luxury tax on automobiles is to be phased out over four years by raising the threshold value and lowering the rate each year. The luxury tax is charged on the amount exceeding the threshold value. On January 1, 2007 the luxury tax will be eliminated completely.

Distilled Spirit Tax and Other Taxes

Chile collects an *ad valorem* tax of 27 percent on all liquor. Beer and wine are subject to a 15 percent *ad valorem* tax, while mineral water, soft drinks, and syrups face a 13 percent tax. Other merchandise subject to additional taxes are: gold articles, platinum, ivory, jewelry, natural and synthetic precious stones (15 percent), compressed air arms, their accessories and bullets (15 percent), fine carpets and upholstery (15 percent), motor homes and caviar (15 percent), caviar preserves and its substitutes (15 percent). Imports of tobacco are also subject to an *ad valorem* tax - 51 percent for cigars, 60.4 percent for cigarettes and 57.9 percent for elaborated tobacco.

CHINA

TRADE SUMMARY

The U.S. goods trade deficit with China was \$201.6 billion in 2005, an increase of \$40 billion from \$161.9 billion in 2004. U.S. goods exports in 2005 were \$41.8 billion, up 20 percent from the previous year. Corresponding U.S. imports from China were \$243.5 billion, up 24 percent. China is currently the 4th largest export market for U.S. goods.

U.S. exports of private commercial services (i.e., excluding military and government) to China were \$7.2 billion in 2004 (latest data available), and U.S. imports were \$5.6 billion. Sales of services in China by majority U.S.-owned affiliates were \$3.8 billion in 2003 (latest data available), while sales of services in the United States by majority China-owned firms were not available in 2003 (\$321 million in 2002).

The stock of U.S. foreign direct investment (FDI) in China in 2004 was \$15.4 billion, up from \$11.5 billion in 2003. U.S. FDI in China is concentrated largely in the manufacturing, wholesale, and mining sectors.

Since joining the WTO in December 2001, China has taken steps to implement its numerous WTO commitments. With most of China's key commitments scheduled to be phased in fully by December 2004, this past year provided a first critical glimpse at what to expect of China as a WTO member with its full range of commitments in place. At this point, however, China's implementation work is still incomplete. While China has made important progress in implementing specific commitments and in adhering to the ongoing obligations of a WTO member, there are still serious problems in some important areas, especially in the enforcement of intellectual property rights (IPR). Many of the shortfalls in China's WTO compliance efforts seem to stem from China's incomplete transition from being a state-planned economy. China has not yet fully embraced the key WTO principles of market access, non-discrimination and national treatment, nor has China fully institutionalized market mechanisms and made its trade regime predictable and transparent. Although China implemented some key reforms, it continued to use an array of industrial policy tools in 2005 to promote or protect favored sectors and industries, and these tools at times collide with China's WTO obligations.

The Administration utilized high-level engagement, expert-to-expert discussions and WTO mechanisms to address the problems that arose and, in particular, initiated a comprehensive new strategy for obtaining improvements in China's IPR enforcement. Many of these efforts culminated in a meeting of the Joint Commission on Commerce and Trade (JCCT) in July 2005, co-chaired by Vice Premier Wu Yi on the Chinese side and Secretary of Commerce Gutierrez and United States Trade Representative Portman on the U.S. side. That meeting achieved measured progress on a range of concerns, but it fell short of realizing the many win-win outcomes of the previous JCCT meeting, held in April 2004. Nevertheless, China did agree to take several specific actions in support of its WTO commitment to significantly reduce IPR infringement levels, to initiate technical consultations with WTO members to accelerate its

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efforts to join the WTO Government Procurement Agreement and to schedule telecommunications and insurance dialogues to discuss market access issues in those sectors. While U.S. stakeholders generally hold the view that China's economic reforms have improved the climate for U.S. exporters and investors, serious challenges remain, and many U.S. businesses are still not able to maximize their opportunities in the Chinese market. Areas that continue to generate significant problems include inadequate enforcement of laws, particularly in the IPR area, industrial policies, services, agriculture and an overall lack of transparency in the regulatory environment.

In the IPR area, while China has made noticeable improvements to its framework of laws and regulations, the lack of effective IPR enforcement remains a major challenge. Building on its engagement with China at the April 2004 JCCT meeting, the United States took several aggressive steps in 2005 in an effort to obtain meaningful progress. First, the United States conducted an out-of-cycle review under the Special 301 provisions of U.S. trade law. At the conclusion of this review in April 2005, the Administration elevated China to the Special 301 "Priority Watch" list and set forth a comprehensive strategy for addressing China's ineffective IPR enforcement regime, which included the possible use of WTO mechanisms, as appropriate. The United States immediately began to pursue this strategy during the run up to the July 2005 JCCT meeting, and China subsequently agreed to take a series of specific actions designed to increase criminal prosecutions of IPR violators, improve enforcement at the border, combat piracy of movies, audio visual products and software, address Internet-related piracy and assist small and medium-sized U.S. companies experiencing China-related IPR problems, among other things. Because lack of transparency on IPR infringement levels and enforcement activities in China has hampered the United States' ability to assess the effectiveness of China's efforts to improve IPR enforcement since the April 2004 JCCT meeting, the United States also submitted a transparency request to China under Article 63.3 of the TRIPS Agreement in October 2005. The U.S. request, made in conjunction with similar requests by Japan and Switzerland, seeks detailed information from China on its IPR enforcement efforts over the last four years.

China has also increasingly resorted to industrial policies that limit market access by non-Chinese origin goods or rely on substantial government resources to support increased exports. The objective of these policies seems to be to support the development of Chinese industries by effectively mandating local content of products that are higher up the economic value chain than the industries that make up China's current labor-intensive base, or simply to protect less-competitive domestic industries. In 2005, examples of these industrial policies are readily evident. They include the issuance of regulations on automotive parts tariffs that discourage the use of imported parts, the telecommunications regulator's interference in commercial negotiations over royalty payments to intellectual property rights holders in the area of 3G standards, the pursuit of unique national standards in many areas of high technology that could lead to the extraction of technology or intellectual property from foreign rights holders, draft government procurement regulations mandating purchases of Chinese-produced software, a new steel industrial policy that calls for the state's management of nearly every major aspect of China's steel industry, continuing export restrictions on coke, and excessive government subsidization benefiting a range of domestic industries in China. Some of these policies may raise concerns with respect to China's WTO commitments in the areas of market access, national treatment, subsidies disciplines and technology transfer, among others.

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In the area of services, concerns in many sectors remain, largely due to arbitrary and non-transparent policies, delays in the issuance of regulatory measures, and China's use of entry threshold requirements that exceed international norms. Indeed, Chinese regulatory authorities continue to frustrate efforts of U.S. providers of distribution, direct selling, franchising, insurance, construction and engineering, telecommunications and other services to achieve their full market potential in China.

In the area of agriculture, while the United States was able to reach agreement on and initial a Memorandum of Understanding in July 2005 to facilitate cooperation on animal and plant health safety issues and improved U.S. access to China's markets for agricultural commodities, agricultural trade with China remains among the least transparent and predictable of the world's major markets. Capricious practices by Chinese customs and quarantine officials can delay or halt shipments of agricultural products into China, while sanitary and phytosanitary (SPS) standards with questionable scientific bases and a generally opaque regulatory regime frequently bedevil traders in agricultural commodities.

Transparency concerns cut across sectors, as China's various regulatory regimes continue to suffer from systemic opacity, frustrating efforts of foreign – and domestic – businesses to achieve the potential benefits of China's WTO accession. Although China has taken steps to improve transparency across a wide range of national and provincial regulatory authorities, particularly at the Ministry of Commerce (MOFCOM), many other ministries and agencies have made less than impressive efforts to improve their transparency.

Overall, while China has a more open and competitive economy than 25 years ago, and China's WTO accession has led to the removal of many trade barriers, there are still substantial barriers to trade that have yet to be dismantled. The central government continues to implement industrial policies and protect noncompetitive or emerging sectors of the economy from foreign competition. In many sectors, import barriers, opaque and inconsistently applied legal provisions, and limitations on foreign direct investment often combine to make it difficult for foreign firms to operate in China. In addition, some ministries, agencies and government-sponsored trade associations have renewed efforts to erect new technical barriers to trade. Meanwhile, many provincial governments at times have strongly resisted reforms that would eliminate sheltered markets for local enterprises or reduce jobs and revenues in their jurisdictions, although they have also supported market access for other foreign investors that do not pose a threat to local vested interests.

If China is to complete the implementation of its WTO commitments and institutionalize market-oriented reforms, it will need to eliminate mechanisms that allow government officials to intervene in the Chinese economy in a manner that is inconsistent with market principles. Despite its remarkable transformation over the past quarter century, China continues to suffer from its command economy legacy. As a result, Chinese economic policy-making often operates in a way that prevents U.S. businesses from achieving their full potential in the China market. As U.S. expectations shift from the establishment of basic regulations and implementation of specific WTO commitments to measurable improvements in market access for U.S. products and services, there will be decreasing tolerance for Chinese efforts to protect domestic industries.

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In early 2006, the Administration completed a USTR-led interagency “top-to-bottom” review of the United States’ China trade policy. Recognizing the importance of the United States’ trade relationship with China and the challenges that confront the United States in that relationship, the Administration issued a report concluding that the United States is entering an important new phase in its relationship with China. While U.S. trade policy for the past 20 years had been focused principally on encouraging market-based reforms and bringing China into the international trading system, the report explained that the end of China’s transition period as a new WTO member was drawing near, and it recommended that U.S. trade resources and priorities should be readjusted to meet new challenges. Specifically, in addition to strengthening the United States’ current focus on China’s WTO compliance and adherence to international norms, the report urged that more focus be put on ensuring that: (1) the bilateral trade relationship offers more balanced opportunities and is equitable and durable; (2) U.S. trade policymaking is more proactive and informed by more comprehensive information regarding China’s economic trends and developments and stronger coordination within the Executive branch and between the Executive and Congressional branches; (3) China participates more fully in the global trading system as a responsible trading partner; and (4) the U.S. remains an active and influential economic and trading power in the Asia Pacific region. Based on the results of the interagency review, the Administration committed to take a series of actions to help ensure that the United States is best positioned to meet its key China trade objectives. Among other things, the Administration committed: (1) to expand USTR’s trade enforcement capacity; (2) to expand USTR’s capability to obtain and process comprehensive, forward-looking information about the U.S.-China trade relationship; (3) to expand U.S. trade resources in Beijing; (4) to strengthen interagency coordination and the Executive-Congressional partnership on China trade; and (5) to increase coordination with other trading partners on China trade issues. The Administration also committed to strengthen, expand and increase the effectiveness of the U.S.-China dialogue on needed structural economic reforms and numerous specific issues, such as standards and SPS issues, China’s subsidies practices, financial services, telecommunications services, labor, environmental protection, and transparency and the rule of law, among other issues.

IMPORT REGULATION

Prior to its WTO accession in December 2001, China restricted imports through high tariffs and taxes, quotas and other non-tariff measures, and restrictions on trading rights. Beginning in 2002, its first year in the WTO, China significantly reduced tariff rates on many products and the number of goods subject to import quotas, expanded trading rights for Chinese enterprises, and increased the transparency of its licensing procedures. Since then, China has continued to make progress by implementing tariff reductions on schedule, phasing out import quotas and expanding trading rights for foreign enterprises and individuals, although some serious problems remain, such as China’s tariff treatment of imported automotive parts.

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Trading Rights

Prior to its WTO accession, China restricted the types and numbers of entities with the right to trade. Only those domestic and foreign firms with trading rights could import goods into, or export goods out of, China. Restrictions on the type and number of firms with trading rights contribute to systemic inefficiencies in China's trading rights system and create substantial incentives to engage in smuggling and other corrupt practices.

Liberalization of China's trading rights system had been proceeding gradually since 1995. The pace accelerated in 1999 when MOFCOM's predecessor, the Ministry of Foreign Trade and Economic Cooperation (MOFTEC), announced new guidelines allowing a wide variety of Chinese firms with annual export volumes valued in excess of \$10 million to register for trading rights. In August 2001, China extended this regulation to allow foreign-invested firms to export their finished products. Import rights of foreign-invested firms were still restricted to the importation of inputs, equipment and other materials directly related to their manufacturing or processing operations. Firms and individuals without trading rights, including foreign-invested firms with a manufacturing presence in China seeking to import products made outside of China, were required to use a local agent.

In its WTO accession agreement, China committed to substantial liberalization in the area of trading rights. Specifically, China committed to eliminate its system of examination and approval of trading rights and to make full trading rights automatically available to all Chinese enterprises, Chinese-foreign joint ventures, wholly foreign-owned enterprises and foreign individuals, including sole proprietorships, within three years of its accession, or by December 11, 2004, which was the same deadline for China to eliminate most restrictions in the area of distribution services. China further committed to expand the availability of trading rights pursuant to an agreed schedule during the first three years of its WTO membership.

Although China did not fully adhere to the agreed phase-in schedule in some instances, it has put in place a registration system implementing the required liberalization of trading rights, both for Chinese enterprises and for Chinese-foreign joint ventures, wholly foreign-owned enterprises and foreign individuals, including sole proprietorships. This liberalization is reflected in China's revised Foreign Trade Law, issued in April 2004 by the National People's Congress. It provides for trading rights to be automatically available through a registration process for all domestic and foreign entities and individuals, effective July 1, 2004, almost six months ahead of the scheduled full liberalization required by China's accession agreement. In June 2004, MOFCOM issued implementing rules setting out the procedures for registering as a foreign trade operator. U.S. companies have reported few problems with the new trading rights registration process, although China's slow progress in implementing related distribution services commitments has made these new rights less meaningful for some U.S. companies.

In December 2004, as required by its WTO accession agreement, China also ended its practice of granting import rights or export rights for certain products – steel, natural rubber, wools, acrylic and plywood – only to designated enterprises. Any domestic or foreign enterprise or individual can now trade in these products.

Consistent with the terms of China's WTO accession agreement, the importation of some goods, such as petroleum and sugar, is still reserved for state trading enterprises. In addition, for goods still subject to tariff-rate quotas such as grains, cotton, vegetable oils and fertilizers, China reserves a portion of the in-quota imports for state trading enterprises, while it committed to make the remaining portion (ranging from 10 percent to 90 percent depending on the commodity) available for importation through non-state traders. In some cases, the percentage available to non-state traders increases annually for a set number of years.

Meanwhile, China has not yet implemented its trading rights commitments insofar as they relate to the importation of books, newspapers and magazines. Under the terms of China's accession agreement, China's trading rights commitments apply fully to books, newspapers and magazines, as they are not among the products for which China reserved the right to engage in state trading. As a result, trading rights for books, newspapers and magazines should have been automatically available to all Chinese enterprises, Chinese-foreign joint ventures, wholly foreign-owned enterprises and foreign individuals as of December 11, 2004. Nevertheless, China continues to wholly reserve the right to import books, newspapers and magazines to state trading enterprises.

China has also not yet implemented its trading rights commitments insofar as they relate to the importation of pharmaceuticals. Even though China's accession agreement creates no exception for pharmaceuticals, and trading rights should have been automatically available to foreign pharmaceutical companies as of December 11, 2004, China still requires foreign pharmaceutical companies to hire Chinese importers to bring their finished products into the country (and it also requires them to sell their finished products through Chinese wholesalers).

Import Substitution Policies

Throughout the 1990s, China gradually reduced formal import substitution policies. In its WTO accession agreement, China committed that it would not condition import or investment approvals on whether there are competing domestic suppliers or imposes other performance requirements. In anticipation of this commitment, China enacted legal changes in 2000 and 2001 to eliminate local content requirements for foreign investments. Under the prevailing rules, however, investors are still "encouraged" to follow some of the formerly mandated practices. Instances in which the Chinese Government has reportedly pursued import substitution or similar policies are described below.

Corporate Tax Deductions to Foreign-Invested Firms

The State Administration for Taxation (SAT) in May 2005 issued Circular No. 488/2005 that allows foreign-invested firms to deduct the costs of domestic-manufactured equipment from their corporate income taxes. According to the notice, equipment manufactured in China is eligible for the tax deduction but equipment assembled in China from imported parts is not eligible.

Automotive Parts

Before China's WTO accession, China's automobile industrial policy offered significant advantages for foreign-invested factories using high-levels of local content. In 2001, in anticipation of China's new obligations as a WTO Member, the State Economic and Trade Commission (SETC) issued Bulletin No.13, which provided that the preferential policy for

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automobile localization rates would be cancelled upon China's WTO accession. However, U.S. automobile manufacturers reported that some local government officials continued to require local content and cited the old automobile industrial policy's standards. China also committed to issue a revised automotive industrial policy within two years of its WTO accession, or by December 11, 2003, but missed this deadline. In May 2004, China issued a new automobile industrial policy. It included provisions discouraging the importation of auto parts and encouraging the use of domestic technology. It also included a number of vague provisions, such as in the area of complete knocked-down automotive kits, whose implementation will warrant close scrutiny.

In 2005, China issued measures implementing the new automobile industrial policy. One problematic measure is the *Measures on the Importation of Parts for Entire Automobiles*, which was issued by the National Development and Reform Commission (NDRC) in February 2005 and became effective in April 2005. These new rules require manufacturers in China to register the parts they use in the assembly of new automobiles, and if the number or value of imported parts exceeds specified thresholds, China's General Administration of Customs will apply the tariff rate assessed a complete automobile on each of the various imported parts rather than the tariff rate applicable to an individual part. China's bound and applied tariff rates for complete automobiles are significantly higher than the tariff rates for imported auto parts. The new rules appear to improperly condition tariff treatment on local content and to result in the imposition of a tariff on automotive parts in excess of the bound rate.

Steel

China issued a new Steel and Iron Industry Development Policy in July 2005. Although many aspects of this new policy have not yet been implemented, it still includes a host of objectives and guidelines that raise serious concerns. For example, this policy appears to discriminate against foreign equipment and technology imports. Like other measures, this policy encourages the use of local content by calling for a variety of government financial support for steel and iron projects utilizing newly developed domestic equipment. Even more troubling, however, it calls for the use of domestically produced steel-manufacturing equipment and domestic technologies whenever domestic suppliers exist, apparently in contravention of the commitment in China's accession agreement not to condition the right of investment or importation on whether competing domestic suppliers exist.

Semiconductors

China's 10th Five-Year Plan calls for an increase in Chinese semiconductor output from \$2 billion in 2000 to \$24 billion in 2010. In pursuit of this policy, China has attempted to encourage the development of China's domestic integrated circuit (IC) industry through, among other things, discriminatory VAT policies. In particular, through a series of measures, China has provided for the rebate of a substantial portion of the 17 percent VAT paid by domestic manufacturers on their locally produced ICs. China, meanwhile, charged the full 17 percent VAT on imported ICs, unless they were designed in China. After bilateral meetings on this issue failed to yield a change in China's policy, in March 2004, the United States filed the first and to date only WTO case against China. In the ensuing consultations, China signaled its willingness

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to discuss a possible resolution. In July 2004, the United States and China reached a settlement in which China agreed to immediately cease certifying new Chinese IC manufacturers or products as eligible for the VAT rebate and to issue the necessary regulations to eliminate the VAT rebate entirely by November 1, 2004, with an effective date no later than April 1, 2005. China also agreed to repeal the relevant implementing rules that had made VAT rebates available for ICs designed in China but manufactured abroad by September 1, 2004, with an effective date no later than October 1, 2004. China followed through on each of these agreed steps in a timely manner, and the two sides notified the WTO in October 2005 that their dispute had been satisfactorily resolved. Nevertheless, the United States continues to monitor closely new financial support that China is making available to its domestic producers for consistency with the WTO Subsidies Agreement's disciplines.

Fertilizer

In 2001, China began exempting all phosphate fertilizers except diammonium phosphate (DAP) from the VAT. DAP, a product that the United States exports to China, competes with other phosphate fertilizers produced in China, particularly monoammonium phosphate. Both the United States Government and U.S. producers have complained that China has employed its VAT policies to benefit domestic fertilizer production.

Telecommunications Equipment

There have been continuing reports of Ministry of Information Industry (MII) and China Telecom adopting policies to discourage the use of imported components or equipment. For example, MII has reportedly still not rescinded an internal circular issued in 1998 instructing telecommunications companies to buy components and equipment from domestic sources.

Tariffs and Other Import Charges

Under the terms of its WTO accession, China committed to substantial annual reductions in its tariff rates, with most of them taking place within five years of China's WTO accession. The largest reductions took place in 2002, immediately after China acceded to the WTO, when the overall average tariff rate fell from over 15 percent to 12 percent.

China's post-WTO accession tariff rates are "bound," meaning that China cannot raise them above the bound rates without "compensating" WTO trading partners, i.e., re-balancing tariff concessions or, in accordance with WTO rules, being subject to withdrawal of substantially equivalent concessions by other WTO members. "Bound" rates give importers a more predictable environment. China may also apply tariff rates significantly lower than the WTO-required rate, as in the case of goods that the government has identified as necessary to the development of a key industry. For example, China's Customs Administration has occasionally announced preferential tariff rates for items that benefit key economic sectors, in particular for the automotive, steel and chemical industries.

China's WTO accession commitments are having a dramatic effect on tariffs for many products of interest to the United States. As in prior years, China implemented its scheduled tariff

reductions for 2005 on schedule. These tariff reductions further increased market access for U.S. exporters in a range of industries, as China continued the process of reducing tariffs on goods of greatest importance to U.S. industry from a base average of 25 percent (in 1997) to 7 percent over a period of five years, running from January 1, 2002, while it made similar reductions throughout the agricultural sector (see the Agriculture section below). The reductions made on January 1, 2005, involved a range of sectors, including motor vehicles and motor vehicle parts, office machinery, large appliances, furniture and chemicals, and contributed to another significant increase in U.S. exports, which rose approximately 17 percent from January through September 2005, when compared to the same time period in 2004.

In one of its more significant tariff initiatives, China continued its participation in the Information Technology Agreement (ITA), which requires the elimination of tariffs on semiconductors and semiconductor manufacturing equipment, computers and computer parts, software, telecommunications equipment, computer-based analytical instruments and other information technology products. China began reducing and eliminating these tariffs in 2002 and continued to do so in the ensuing years, achieving the elimination of all ITA tariffs on January 1, 2005, as tariffs on ITA products dropped to zero from a pre-WTO accession average of 13.3 percent. U.S. exports of ITA goods continued to perform well in 2005, as they were projected to exceed \$5 billion by the end of the year, although they did decrease by 12 percent from January through September 2005, when compared to the same time period in 2004.

China also continued its timely implementation of another significant tariff initiative, the WTO's Chemical Tariff Harmonization Agreement. U.S. chemical exports covered by this agreement increased by 36 percent from January through September 2005 and were projected to reach \$5.8 billion by the end of the year, well above 2004's healthy total of \$4.7 billion.

Meanwhile, exports of some bulk agricultural commodities have increased dramatically in recent years, particularly cotton and wheat, while exports of soybeans continued to perform strongly, totaling \$1.2 billion for the first nine months of 2005. Exports of forest products such as lumber performed strongly, increasing by 26 percent for the first nine months of 2005, with a projected year-end total of \$477 million. Fish and seafood exports, after having increased from \$119 million in 2001 to \$135 million in 2002, and then to \$176 million in 2003 and \$258 million in 2004, rose by another 41 percent in the first nine months of 2005 and were projected to reach \$363 million by the end of the year. Meanwhile, exports of consumer-oriented agricultural products increased by only 4 percent from January through September 2005, when compared to the same period in 2004, although they were still projected to exceed \$500 million by the end of the year.

However, China still maintains high duties on some products that compete with sensitive domestic industries. For example, the tariff on large motorcycles will only fall from 60 percent to 45 percent. Likewise, most video, digital video and audio recorders and players still face duties of around 30 percent. Raisins face duties of 35 percent.

Tariff Classification

Chinese customs officers have wide discretion in classifying a particular import. While foreign businesses might at times have benefited from their ability to negotiate tariff classification into

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tariff categories with lower import duty rates, lack of uniformity makes it difficult to anticipate border charges.

Recent foreign and joint venture auto manufacturing entrants to the Chinese market complain about disparate treatment under tariff classification rules. They are less able than domestic manufacturers and the early joint venture entrants to assemble cars with locally manufactured components, and their knock-down kits imported for assembly in China are more likely to be classified as complete vehicles than are the kits imported by domestic manufacturers and the early joint venture entrants.

Customs Valuation

In January 2002, shortly after acceding to the WTO, China's Customs Administration issued the *Measures for Examining and Determining Customs Valuation of Imported Goods*. This measure addressed the inconsistencies that had existed between China's customs valuation methodologies and the Agreement on Customs Valuation.

The Customs Administration subsequently issued the *Rules on the Determination of Customs Value of Royalties and License Fees Related to Imported Goods*, effective July 2003. This measure was intended to clarify provisions of the January 2002 measure that address the valuation of royalties and license fees. In addition, by December 11, 2003, China had issued a measure on interest charges and a measure requiring duties on software to be assessed on the basis of the value of the underlying carrier medium, meaning, for example, the floppy disk or CD-ROM itself, rather than based on the imputed value of the content, which includes, for example, the data recorded on a floppy disk or CD-ROM.

Nevertheless, China has not uniformly implemented these various measures. U.S. exporters continue to report that they are encountering valuation problems at many ports. For example, even though the January 2002 and July 2003 measures provide that imported goods normally should be valued on the basis of their transaction price, meaning the price the importer actually paid, nearly four years later, many Chinese customs officials are still improperly using "reference pricing," which usually results in a higher dutiable value. In 2005, China appeared to continue its efforts to eliminate the use of "reference pricing," although it still occurs at many ports.

In addition, some of China's customs officials are reportedly not applying the provisions in the January 2002 and July 2003 measures as they relate to software royalties and license fees. Following their pre-WTO accession practice, these officials are still automatically adding royalties and license fees to the dutiable value (for example, when an imported personal computer includes pre-installed software), even though China's July 2003 measure expressly directs them to add those fees only if they are import-related and a condition of sale for the goods being valued. While some improvement appears to have taken place with regard to the valuation of royalties and license fees since the issuance of the July 2003 measure, that measure has not led to uniform, WTO-consistent implementation by China's customs officials in this area.

Beginning in 2004, U.S. exporters also complained about the Customs Administration's handling of imports of digital media that contain instructions for the subsequent production of multiple copies of products such as DVDs. The Customs Administration has been inappropriately assessing duties based on the estimated value of the yet-to-be-produced copies.

Rules of Origin

In September 2004, nearly three years after China acceded to the WTO, the State Council finally issued the regulations intended to bring China's rules of origin into conformity with WTO rules for import and export purposes. These regulations took effect on January 1, 2005, although necessary implementing rules are still being drafted. Nevertheless, importers have not reported problems stemming from inappropriate application of rules of origin.

Border Trade

China's border trade policy continues to generate MFN and other concerns. China provides preferential import duty and VAT treatment to certain products, often from Russia, apparently even when those products are not confined to frontier traffic as envisioned by Article XXIV of GATT 1994. China addressed some of these concerns in 2003 when it eliminated preferential treatment for boric acid and 19 other products. Nonetheless, it appears that large operators are still able to take advantage of border trade policies to import bulk shipments across China's land borders into its interior at preferential rates. In addition, U.S. industry reports that China continues to use border trade policies to provide preferential treatment for Russian timber imports, to the detriment of U.S. timber exporters.

Antidumping, Countervailing Duty and Safeguard Measures

Since acceding to the WTO, China has emerged as a significant user of antidumping measures, with a total of 67 antidumping measures covering 19 countries currently in place and 42 antidumping investigations in progress. China continued to actively apply its antidumping law in 2005, initiating several new investigations, four of which involved U.S. exports. Chemical products remain the most frequent target of Chinese antidumping actions.

Most of the rules and regulations used by MOFCOM to conduct its antidumping investigations were issued as provisional measures by MOFCOM's predecessor agencies – MOFTEC and the State Economic and Trade Commission – shortly after China acceded to the WTO. While these measures generally represent good-faith efforts to implement the relevant WTO commitments and to improve China's pre-WTO accession measures, they also contain vague language, have gaps in areas of practice and allow inordinate discretion. Meanwhile, China's handling of antidumping investigations and reviews continues to raise concerns in key areas such as transparency and procedural fairness. Concerns with transparency, including access to information, are especially acute with regard to the injury portion of investigations.

To date, China has not initiated a countervailing duty investigation. China's only safeguard measure was removed at the end of 2003 after being in place for less than two years.

The Supreme People's Court has issued a judicial interpretation covering the review of antidumping and other trade remedy decisions. To date, however, judicial review of these types of decisions remains untested.

In one antidumping investigation involving imports of kraft linerboard from the United States, following an affirmative final determination and the imposition of antidumping duties in September 2005, the affected U.S. exporters filed for administrative reconsideration with MOFCOM in which it raised concerns with various aspects of the final determination, particularly the injury finding. Immediately after the United States notified China that it also intended to commence dispute settlement at the WTO, MOFCOM issued a decision repealing the antidumping order.

Non-Tariff Barriers

China's WTO accession agreement obligated China to address many of the non-tariff barriers it had historically used to restrict trade. For example, China is obligated to phase out its import quota system, apply international norms to its testing and standards administration, remove local content requirements, and make its licensing and registration regimes transparent. At the national level, China made progress following its WTO accession in reforming its testing system, revising regulations requiring local content, and improving overall regulatory transparency, including in the licensing area. Despite this progress, however, as China's trade liberalization efforts moved forward, some non-tariff barriers remained in place and others were added.

Four years after China's WTO accession, many U.S. industries complain that they face significant non-tariff barriers to trade, which are discussed in more detail in various sections below. These barriers include, for example, regulations that set high thresholds for entry into service sectors such as banking, insurance and telecommunications, selective and unwarranted inspection requirements for agricultural imports and the use of questionable sanitary and phytosanitary measures to control import volumes. Many U.S. industries have also complained about China's manipulation of technical regulations and standards to favor domestic industries.

Import Quotas

In the past, China often did not announce import quota amounts or the process for allocating import quotas. China set import quotas through negotiations between central and local government officials at the end of each year. Import quotas on most products were eliminated or are scheduled for phase-out under the terms of China's WTO accession. China's accession agreement required China to eliminate existing import quotas for the top U.S. priority products upon accession and phase out remaining import quotas, on industrial goods such as air conditioners, sound and video recording machines, color TVs, cameras, watches, crane lorries and chassis, and motorcycles, by January 1, 2005. While China's post-WTO accession import quota system was beset with problems, China did fully adhere to the agreed schedule for the elimination of all of its import quotas, the last of which China eliminated on January 1, 2005.

Tariff-Rate Quotas

In 1996, China claimed to have introduced a tariff-rate quota (TRQ) system for imports of wheat, corn, rice, soy oil, cotton, barley, and vegetable oils. The quota amounts were not publicly announced, application and allocation procedures were not transparent, and importation occurred through state trading enterprises. China later introduced a TRQ system for fertilizer imports. Under these TRQ systems, China places quantitative restrictions on the amount of these commodities that can enter at a low “in-quota” tariff rate; any imports over that quantity are charged a prohibitively high duty.

As part of its WTO accession commitments, China was to establish large and increasing TRQs for imports of wheat, corn, rice, cotton, wool, sugar, vegetable oils, and fertilizer, with most in-quota duties ranging from 1 percent to 9 percent. Each year, a portion of each TRQ is to be reserved for importation through non-state trading entities. China’s accession agreement sets forth specific rules for administration of the TRQs, including increased transparency and reallocation of unused quotas to end-users that have an interest in importing.

For the first two years after China’s WTO accession, China’s implementation of its TRQ systems generated numerous complaints from foreign suppliers, with the most serious problems being lack of transparency, sub-divisions of the TRQ, small allocation sizes and burdensome licensing procedures. Repeated engagement by U.S. officials led regulatory and operational changes by NDRC for shipments beginning January 1, 2004. Key changes included the elimination of separate allocations for general trade and processing trade, the elimination of certain unnecessary licensing requirements, and the creation of a new mechanism for identifying allocation recipients. In 2004, improvements in NDRC’s TRQ administration became evident, although transparency continued to be problematic for some of the commodities subject to TRQs into 2005.

While NDRC was implementing the systemic changes in 2004, exports of some bulk agricultural commodities from the United States showed substantial increases, largely due to market conditions. In particular, despite some continuing problems with NDRC's handling of the cotton TRQs, U.S. cotton exports totaled a record \$1.4 billion in 2004. In addition, U.S. wheat exports totaled \$495 million in 2004, as the TRQ allocations for wheat did not appear to act as a limiting factor. In 2005, U.S. cotton exports totaled \$1.4 billion, while U.S. wheat exports declined significantly to \$78 million. The drop in U.S. wheat exports was due to higher production and lower prices in China, which reduced China’s overall import demand.

Meanwhile, the administration of China’s TRQ system for fertilizer, handled by SETC and subsequently MOFCOM, has suffered from systemic problems since China’s WTO accession. By 2005, this system was still operating with insufficient transparency, and administrative guidance still seemed to be affecting how the allocated quota was used. U.S. fertilizer exports to China have declined throughout the post-WTO accession period, due in part to the continuing problems with MOFCOM's administration of the fertilizer TRQ system and in part to increasing subsidization – and resulting overcapacity – of China's domestic fertilizer industry. U.S. fertilizer exports to China have gone from \$676 million in 2002 to \$459 million in 2003 to \$306 million in 2004. In 2005, U.S. fertilizer exports to China remained stable, as the figures for

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January through September 2005 showed a slight decrease, totaling \$210 million as compared to \$215 million during the same period in 2004.

Import Licenses

In the early 1990s, China began to reduce substantially the number of products subject to import licensing requirements. With its WTO accession in December 2001, China committed to the fair and non-discriminatory application of licensing procedures. Among other things, China also committed upon its WTO accession to limit the information that a trader must provide in order to receive a license, to ensure that licenses are not unnecessarily burdensome, and to increase transparency and predictability in the licensing process.

MOFTEC issued new regulations and implementing rules to facilitate licensing procedures shortly after China's accession to the WTO. However, license applicants initially reported that they have had to provide sensitive business details unnecessary for simple import monitoring. In some sectors, importers also reported that MOFTEC was using a "one-license-per-shipment" system rather than providing licenses to firms for multiple shipments. MOFTEC began to allow more than one shipment per license in late 2002 following U.S. interventions, without modifying the measure authorizing the "one-license-per-shipment" system. In December 2004, MOFCOM issued revised licensing procedures for imported goods. Among the changes, import licenses no longer have quantitative restrictions, provisions related to designated trading were removed, and provisions allowing more than one license per shipment and an "under or over provision" for overloaded or short shipments were added.

In May 2005, after Chinese steel producers negotiated contracts with major foreign iron ore suppliers, the Chinese government began imposing new import licensing procedures for iron ore without prior WTO notification. Even though the WTO's Import Licensing Agreement calls for import licensing procedures that do not have a restrictive effect on trade, China reportedly restricts licenses to 48 traders and 70 steel producers and has not made public a list of the qualified enterprises or the qualifying criteria used. While the Chinese government maintained that it did not impose any qualifying criteria, it did acknowledge that two organizations affiliated with the Chinese government, the China Steel Industry Association and the Commercial Chamber for Metals, Minerals and Chemicals Importers and Exporters, had been discussing a set of rules regarding qualifying criteria such as production capacity and trade performance.

China's inspection and quarantine agency, the State Administration of Quality Supervision and Inspection and Quarantine (AQSIQ), has also imposed inspection-related requirements that have led to restrictions on imports of some U.S. agricultural goods. In particular, two AQSIQ measures issued in 2002 require importers to obtain a Quarantine Inspection Permit (QIP) prior to signing purchase contracts for nearly all traded agricultural commodities. QIPs are one of the most important trade policy issues affecting the United States and China's other agricultural trading partners.

AQSIQ sometimes slows down or even suspends issuance of QIPs at its discretion, without notifying traders in advance or explaining its reasons, resulting in significant commercial uncertainty. Because of the commercial necessity to contract for commodity shipments when

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prices are low, combined with the inherent delays in having QIPs issued, many cargoes of products such as soybeans, meat and poultry arrive in Chinese ports without QIPs, creating delays in discharge and resulting in demurrage bills for Chinese purchasers. In addition, traders report that shipment quantities are often closely scrutinized and are at risk for disapproval if considered too large.

Some improvements were made to the QIP system in 2004 following repeated U.S. engagement, both bilaterally and at the WTO. In June 2004, AQSIQ issued Decree 73, the *Items on Handling the Review and Approval for Entry Animal and Plant Quarantine*, which extended the period of validity for QIPs from three months to six months. AQSIQ also began issuing QIPs more frequently within the established time lines. Nevertheless, a great deal of uncertainty remains even with the extended period of validity, because a QIP still locks purchasers into a very narrow period to purchase, transport and discharge cargoes or containers before the QIP's expiration, and because AQSIQ continues to administer the QIP system in a seemingly arbitrary manner.

Meanwhile, traders are hesitant to press AQSIQ for change because they would risk falling out of favor. Many traders would at least like AQSIQ to eliminate the quantity requirements that it unofficially places on QIPs. These quantity requirements have been used often by AQSIQ during peak harvest periods to limit the flow of commodity imports. Eliminating this requirement would make the QIP system more dependent on market forecast.

In 2005, the QIP system underwent little improvement. AQSIQ officials continued to insist that the QIP system ensures that an adequate number of examiners are on duty at ports when shipments arrive to certify and inspect them for quality and quantity. The United States, with support from other WTO members, has questioned the scientific basis for the QIP system and has maintained that it serves as an unjust and overly restrictive barrier to trade.

INTERNAL POLICIES

Taxation

In April 2001, the National People's Congress Standing Committee passed long-awaited changes to the tax collection law, designed to standardize and increase the transparency of China's tax procedures. The State Council issued detailed regulations for the implementation of this law in September 2002. As part of a broader campaign to "rectify market order" and eliminate inter-provincial barriers to domestic commerce, the Chinese central government also implemented measures to prevent local governments from applying tax treatment that discriminated in favor of locally owned firms.

In order to narrow the widening urban-rural income gap, the Central Committee of the Communist Party of China and the State Council issued Document No. 1 of 2004, which instructed the governments at all levels to reduce the agricultural tax rate of 8.4 percent by 1 percent in 2004, along with the removal of all taxes on special farm produce except for tobacco. Document No. 1 also calls for further reductions in the agricultural tax rate until it is totally eliminated within five years. Where fiscally feasible, governments were also called upon to reduce or eliminate agricultural taxes more quickly. In December 2005, China announced that agricultural taxes would be abolished nationwide effective January 1, 2006.

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Foreign investors, including those who have used investment as an entry point to the Chinese domestic market, have benefited from investment incentives, such as tax holidays and grace periods, which allow them to reduce substantially their tax burden. Domestic enterprises have long resented rebates and other tax benefits enjoyed by foreign-invested firms, and these benefits may be gradually phased out. Plans to unify the enterprise income tax laws, which impose higher rates on domestic as compared to foreign enterprises, have been postponed due to policy differences within the central government, and are not expected to take effect before 2007.

Application of China's single most important revenue source – the VAT, which ranges between 13 percent and 17 percent, depending on the product – continues to be uneven. Importers from a wide range of sectors report that, because taxes on imported goods are reliably collected at the border, they are sometimes subject to application of a VAT that their domestic competitors often fail to pay. As discussed above (in the section on Import Substitution Policies), the United States was successful in obtaining China's agreement to remove discriminatory VAT policies favoring domestically produced semiconductors. China's selective exemption of certain fertilizer products from the VAT has also operated to the disadvantage of imports from the United States.

China retains an active VAT rebate program for exports, although rebate payments are often delayed. In 2003, China announced the reduction of VAT rebates for exports by three percentage points partly in response to foreign complaints about an under-valued RMB. Although State Administration of Taxation officials reportedly plan to eliminate rebates eventually in order to increase tax revenues, China has continued this practice in order to spur domestic economic growth. In December 2004, for example, the Ministry of Finance (MOF) and the State Administration of Taxation issued a circular announcing an increase in the VAT rebate rate from 13 percent to 17 percent for the export of certain IT products, including integrated circuits, independent components, mobile telecommunication equipment and terminals, computers and periphery equipment, and numerical-controlled machine tools. In 2005, China adjusted the ratio of the share of the export VAT refund burden between the central and local governments, from 75-25 to 92.5-7.5. China also halted refunds for some products in high demand domestically in order to discourage their export. For example, China eliminated a 13 percent VAT rebate for exports of steel billets and ingots, although it maintained VAT rebates of 11 percent to 13 percent for more processed steel products.

Meanwhile, China continues to consider fundamental reform of its VAT regime from production-based to consumption-based, which began with a pilot program in the Northeast. This reform reportedly may be extended nationwide as early as this year.

China's 1993 consumption tax system continues to raise concerns among U.S. exporters. Because China uses a substantially different tax base to compute consumption taxes for domestic and imported products, the tax burden imposed on imported consumer goods ranging from alcoholic beverages to cosmetics to automobiles is higher than for competing domestic products.

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Standards, Technical Regulations and Conformity Assessment Procedures

In its WTO accession agreement, China committed that it would ensure that its regulatory authorities apply the same standards, technical regulations and conformity assessment procedures to both imported and domestic goods and use the same fees, processing periods and complaint procedures for both imported and domestic goods. China also committed that, in order to eliminate unnecessary barriers to trade, it would not maintain multiple or duplicative conformity assessment procedures and would not impose requirements exclusively on imported products. China further committed to ensure that its standards developers, regulatory authorities and conformity assessment bodies operated with transparency and allowed reasonable opportunities for public comment on proposed standards, technical regulations and conformity assessment procedures.

In anticipation of these commitments, China devoted significant energy to reforming its standards and testing and certification regimes prior to its WTO entry. In April 2001, China merged its domestic standards and conformity assessment agency and entry-exit inspection and quarantine agency into one new organization, AQSIQ. Chinese officials explained that this merger was designed to eliminate discriminatory treatment of imports, including requirements for multiple testing simply because a product was imported rather than domestically produced. China also formed two quasi-independent agencies administratively under AQSIQ: (1) the Certification and Accreditation Administration of China (CNCA), charged with the task of unifying the country's conformity assessment regime; and (2) the Standardization Administration of China (SAC), responsible for setting mandatory national standards and unifying China's administration of product standards and aligning its standards and technical regulations with international practices and China's commitments under the WTO Agreement on Technical Barriers to Trade (TBT Agreement).

In January 2002, China began the task of bringing its standards regime more in line with international practice with AQSIQ's issuance of rules designed to facilitate China's adoption of international standards. China subsequently embarked on the task of reviewing all of its existing 21,000 technical regulations to determine their continuing relevance and consistency with international standards. In November 2005, China reported that as of October 2005 it had nullified 1,416 national standards as a result of this review.

Nevertheless, in a number of sectors, including autos, auto parts, telecommunications equipment, Internet protocols, wireless local area networks (see the "WAPI" section below), radio frequency identification tag technology, audio and video coding, whiskey and other distilled spirits, and fertilizer, concern has grown as China has pursued the development of unique technical requirements, despite the existence of well-established international standards. These China-specific standards, which sometimes appear to lack a sound basis, could create significant barriers to entry into China's markets because of the high cost of compliance for foreign companies.

The lack of transparency in China's standards development process also troubles many foreign companies. The vast majority of standards-setting bodies are not fully open to foreign participation, in some cases refusing membership to foreign firms and in other cases refusing to

allow companies with majority foreign ownership to vote. In some cases, foreign firms are allowed non-voting observer status, but are required to pay membership fees far in excess of those paid by the voting members. Nevertheless, in 2005, some U.S. companies concluded that China had begun to make steady progress in reforming its standardization system by strengthening its links with standards-setters in other countries and by moving its standards regime into closer conformity with international practice.

China's designated standards notification authority, MOFCOM, has been notifying proposed technical regulations and conformity assessment procedures to WTO members, as required by the TBT Agreement. Almost all of these notified measures have emanated from AQSIQ or SAC, however, and generally have not included measures drafted by other agencies. Lack of meaningful comment periods is also an issue. In many other cases, Chinese regulatory authorities provided insufficient time to consider interested parties' comments before a regulation was adopted.

Despite China's commitment to apply the same standards and fees to domestic and imported products upon its accession to the WTO, many U.S. industries have complained about China's manipulation of technical regulations and standards to favor domestic industries. In fact, SAC issued a strategy report in September 2004 promoting China's development of standards and technical regulations as a means of protecting domestic industry as tariff rates fall. At the sub-national level, importers have expressed concern that local officials do not understand China's WTO commitments and apply arbitrary technical regulations and standards to protect local industries. These problems are compounded by the fact that coordination between AQSIQ and its new affiliated bodies, CNCA and SAC, is lacking, as is coordination between these bodies and China Customs and other ministries and agencies, at both the central and local government levels, with responsibilities relating to technical regulations and standards.

China's new "China Compulsory Certification" (CCC) mark system took full effect on August 1, 2003, following a transition period that lasted for fifteen months. The new CCC mark replaces the old "Great Wall" and "CCIB" marks and is now required for more than 130 product categories, such as electrical machinery, information technology equipment, household appliances and their components.

In 2005, as in prior years, U.S. companies continued to complain that the regulations lack clarity regarding the products that require a CCC mark. They also have reported that China is applying the CCC mark requirements inconsistently and that many domestic products required by AQSIQ's regulations to have the CCC mark are still being sold without the mark. U.S. companies in some sectors further complained that certification remains a difficult, time-consuming and costly process. The process involves on-site inspection of manufacturing facilities outside of China, the cost of which is borne by producers. In addition, small and medium-sized U.S. companies without a presence in China find it particularly burdensome to apply for CCC mark exemptions, such as for replacement and re-export, because China requires the applications to be done in person in the Beijing offices of CNCA. China also continues to require the CCC mark for products that would no longer seem to warrant mandatory certification, such as low-risk products and components.

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Meanwhile, to date, China has granted well over one hundred Chinese enterprises accreditation to test and certify for purposes of the CCC mark. Despite China's commitment that qualifying minority foreign-owned (upon China's accession to the WTO) and majority foreign-owned (two years later) joint venture conformity assessment bodies would be eligible for accreditation and would be accorded national treatment, China so far has not granted accreditation to any foreign-invested conformity assessment bodies. As a result, exporters to China are often required to submit their products to Chinese laboratories for tests that have already been performed abroad, resulting in greater expense and a longer time to market.

In other conformity assessment contexts, some importers report discriminatory treatment and uneven enforcement of technical regulations and standards. For example, foreign companies' products can only be tested at certain laboratories. Limited testing and certification capacity means that evaluations sometimes take much longer than international best practice would suggest appropriate. As testing and certification capacity expands to meet this demand, U.S. companies with multi-country operations worry that inexperienced laboratories might make negative determinations that would have global consequences for the company.

Meanwhile, redundant testing requirements continue to trouble U.S. companies, particularly in cosmetics, new chemicals, pharmaceuticals, medical equipment, cellular telephones and other telecommunications products, consumer electronic products and automobiles. For example, China often requires telecommunications and information technology equipment to be tested and certified to the same electro-magnetic compatibility requirements by both MIC and CNCA. In December 2004, SAC created technical committees to develop standards for testing environmental equipment, genetically modified organisms, and new plant and animal varieties, suggesting that foreign companies may soon see additional requirements in these industries as well.

U.S. companies also cite problems with a lack of transparency in the certification process, lack of coordination among standards bodies, burdensome requirements and long processing times for licenses. Some companies have also expressed concern that their intellectual property will be released to competitors when they submit samples of high-technology products for mandatory quality testing. Technical committees that evaluate products for licensing and certification are generally drawn from a pool of government, academic and industrial experts that companies fear may be too closely associated with their competitors. In some cases, laboratories responsible for testing imported products are affiliated with domestic competitors, making the possibility of intellectual property being released more likely.

WAPI

A particularly significant example of China's development of unique technical requirements, despite the existence of well-established international standards, arose in May 2003, when China issued two mandatory standards for encryption over Wireless Local Area Networks (WLANs), applicable to domestic and imported equipment containing WLAN (also known as Wi-Fi) technologies. These standards, which were scheduled to become fully effective in June 2004, incorporated the WLAN Authentication and Privacy Infrastructure (WAPI) encryption technique for secure communications. This component of the standards differed significantly from internationally recognized standards. China sought to enforce the use of WAPI by providing the necessary algorithms only to a limited number of Chinese companies. U.S. and other foreign manufacturers would be compelled to work with and through these companies, some of which were competitors, and provide them with technical product specifications. Following high-level bilateral engagement, AQSIQ, SAC and CNCA jointly announced in April 2004 that China would suspend indefinitely its proposed implementation of WAPI as a mandatory wireless encryption standard, that it would instead work to revise its WAPI standard, taking into account comments received from Chinese and foreign enterprises, and submit it for consideration as an international standard with appropriate international standards setting bodies addressing wireless encryption for computer networks generally. The WAPI standard is currently under consideration by ISO/IEC for adoption as an international standard, and a decision will likely be made in 2006.

On December 30, 2005, MOF, NDRC and MII jointly issued the *Opinions for Implementing Government Procurements of Wireless Local Areas Network*. This measure seems to require all government agencies, quasi-government bodies and government-affiliated organizations, when procuring WLAN and related products using fiscal funds, to give priority to WAPI-compliant products. This measure took effect on February 1, 2006.

Encryption and Decryption Technologies

China generally prohibits foreign-developed encryption and decryption technologies. In the past, this prohibition has not applied to software and hardware for which encryption is only an incidental feature. However, in December 2003, China dramatically changed this precedent with the issuance of standards on encryption for WLAN, which have since been suspended, as discussed in the WAPI section above.

Enhanced Versatile Disc (EVD) Systems

In February 2005, MII announced the issuance of *Technical Standards for Enhanced Versatile Disc Systems*. The recommended, non-compulsory technical standards announced by MII consist of three parts, governing EVD discs, document systems, and data and soundtrack coding for surround-sound speakers. According to MII, these standards will be applicable to the development of chips, software and core parts of EVD players, and will unify the technical standards of the disc and player industries.

The team leader of China's EVD Standards Working Group reportedly stated that the EVD standards will become a technical barrier protecting the domestic industry, reduce the expensive digital versatile disc (DVD) royalty fees domestic firms are currently charged, break the monopoly of foreign DVD firms and provide China with leverage in the international market.

Chemicals

In September 2003, China's State Environmental Protection Administration (SEPA) issued a regulation requiring manufacturers and importers of new chemicals to apply to SEPA's Chemical Registration Center (CRC) for approval and to provide extensive test data to substantiate the physical properties, consumer safety and environmental impact of the new chemical. U.S. industry's primary concerns are that CRC has not been able to make decisions on the approval of new chemicals in a timely manner and that the governing rules and testing requirements are not transparent and accessible. SEPA's CRC acknowledges receipt of more than 40 completed applications for new chemicals since October 15, 2003. According to the most recent information available from CRC, approximately 10 of these applications have been approved. U.S. industry notes that a number of applications have been pending well beyond the 120-day timeline set forth in the regulation. U.S. industry also complains of shifting requirements and implementation changes, such as recently expanded eco-toxicity testing requirements, which mandate that certain eco-toxicity testing, particularly fish eco-toxicity and bio-degradation studies, be carried out in one of six SEPA-accredited laboratories in China. These accredited laboratories have all been established since mid-2004 in response to the September 2003 regulation, and U.S. industry fears that if inexperience leads one of these new labs to declare a product unsafe, it could affect sales globally. China's lack of a low-volume exemption, meaning an exemption where trade in a given chemical falls below an annual volume threshold, also appears to hinder the importation of U.S. chemicals, particularly for high value specialty chemicals sold in small quantities.

Hazardous Substances

In response to the European Union's *Directive on the Restriction of the Use of Hazardous Substances* (EU RoHS Directive), which is scheduled to go into effect on July 1, 2006, China's MII has issued a draft regulation, the *Management Methods for Pollution Prevention and Control in the Production of Electronic Information Products* (China RoHS), which would, like the EU RoHS Directive, ban the use of lead, mercury, cadmium, hexavalent chromium, PBB and PBDE in electronic products. However, at present, this draft regulation is much narrower in scope than the EU RoHS directive, affecting only electronic information products. It is expected that MII will eventually include other types of products and possibly restrict other substances. MII reportedly views a China RoHS regime as an opportunity for China to engage in a new phase of technology innovation with the rest of the world. MII's current goal is to make the China RoHS regime effective early next year.

U.S. industry has been working with MII to improve the draft China RoHS regulation and harmonize it with the EU RoHS regime, with some progress in the area of maximum tolerated thresholds. However, U.S. industry continues to be concerned that harmonization between the EU RoHS and China RoHS regimes will not be achieved, particularly in the areas of marking and labeling, test methods, material declarations and compliance schemes, where the China RoHS regime is overly burdensome and will likely result in significant added expenses and delays without any apparent added benefit to society.

Scrap Recycling

Scrap exports from the United States to China exceed \$2 billion annually, making scrap one of the United States' largest exports to China by value. In late 2003, China's AQSIQ issued a notice requiring overseas scrap material exporters to register with AQSIQ. The stated purpose of the new requirement was to better monitor the entry of scrap shipments into China reportedly due to high occurrences of receiving dangerous waste and illegal material in past shipments from overseas. It was not until May 2004 that AQSIQ issued the implementing rules. These rules established registration procedures, including an application deadline of July 1, 2004, and set substantive requirements. In response to U.S. and other WTO members' concerns that the application period was too short, AQSIQ extended the application deadline to August 1, 2004, allowed companies who submitted incomplete applications to supplement required documents and extended the new requirement's effective date from November 1, 2004 to January 1, 2005.

In 2004, AQSIQ made public on its website the names of overseas exporters approved to ship scrap to China in two postings, the first in mid-October and the second at the end of December, only days before the new registration would take effect. In total, about 85 percent of worldwide applicants were granted approval, including hundreds of U.S. exporters. AQSIQ indicated that it would notify applicants that were not approved and that these exporters would be able to apply again six months after receiving notice of their rejection.

On July 29, 2005, AQSIQ posted Bulletin No. 103/2005 on its website, announcing the resumption of the review and approval of registration applications for scrap imports. According to the bulletin, as of August 1, 2005, scrap suppliers must wait three years to reapply for registration if they are denied eligibility. An AQSIQ notice dated December 30, 2005, reports that an additional 260 company registrations had been approved, including 55 U.S. companies.

Meanwhile, U.S. scrap exporters continue to experience problems related to inconsistent and unexplained rejections of licenses, confusing requirements imposed with little or no notice, and rejections of shipments at the point of entry. Problems are also being encountered within the United States as a result of pre-inspection requirements imposed by the Chinese authorities and conducted by Chinese-authorized inspectors at the shipment origin point.

Scrap Waste

In December 2004, China's President Hu Jintao signed Presidential Order No. 31, publishing the amended *Law for the Prevention of Solid Scrap Waste Pollution*, which went into effect in April 2005. According to this law, firms manufacturing, selling and importing items listed in the mandatory reclamation catalogue must recycle these items, and it is illegal to import scrap waste

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as component materials that cannot be rendered safe. Depending on the particular item, items that can be safely used as component materials are subject to either restricted import procedures or automatic licensing procedures. The State Administration of Environment Protection (SEPA) is charged with coordinating with MOFCOM, NDRC, China Customs and AQSIQ to design, adjust and publish the catalogues of imported solid scrap waste subject to the restricted or automatic licensing regimes. SEPA and MOFCOM, meanwhile, are responsible for reviewing and issuing licenses for the items subject to restricted import procedures.

Medical Devices

Although China is moving toward greater use of quality systems and utilization of Good Manufacturing Practice audits for medical devices, it still requires outdated type-testing (batch testing) for medical devices. Quality systems audits address product safety and efficacy in a more rigorous manner than type-testing. As a result, requiring firms that have undergone internationally recognized quality systems audits to also be type-tested is redundant and does not provide any additional safety benefits, while it adds unnecessary costs and delays in getting needed medical device products to Chinese patients.

Certain electro-medical devices also face redundant testing by two different agencies, the State Food and Drug Administration (SFDA) and AQSIQ, which administers the “CCC” mark for electrical safety. Both agencies perform virtually identical product tests and factory inspections prior to registration, but they do not recognize the results of one another’s tests and inspections. The U.S. medical devices industry reports that this redundancy adds significant time and costs to bringing a new technology to market in China without providing any additional safety benefits.

A similar concern exists for imported pacemakers, which are scanned by AQSIQ upon clearing customs. This review adds unnecessary delay and costs to the distribution of these pacemakers, without providing any additional safety benefits, as pacemakers are re-scanned and re-calibrated by the hospital before implantation into patients.

Sanitary and Phytosanitary (SPS) Measures

In 2005, China's general lack of transparency remained a problem. China either failed to notify or belatedly notified to the WTO numerous SPS measures, resulting in measures that were adopted without the benefit of comments from other interested WTO members. In addition, in some cases, the adopted measures were overly burdensome, appeared to lack a scientific foundation, or raised significant national treatment concerns. U.S. engagement with China at the WTO and bilaterally, including through the provision of technical assistance, has generated some improvements in China’s compliance with its WTO transparency obligations. At the same time, however, various U.S. agricultural exports continued to be subjected to unnotified entry, inspection and labeling requirements or faced unwarranted import bans. The most problematic of China’s SPS measures are described below.

Bovine Spongiform Encephalopathy (BSE)-Related Bans on Beef and Low-Risk Bovine Products

In December 2003, China and other countries imposed a ban on U.S. cattle, beef and processed beef products in response to a case of BSE found in the United States. Since that time, the

United States has repeatedly provided China with extensive technical information on all aspects of its BSE-related surveillance and mitigation measures, internationally recognized by the OIE as effective and appropriate, for both food safety and animal health. After two years, China still has not provided any scientific justification for continuing to maintain its ban, nor has it identified any of the administrative and regulatory steps necessary to lift the ban. China finally sent a technical team to the United States in October 2005 to gather information on the United States' surveillance and mitigation measures, but no further progress took place during the remainder of the year.

At the same time that it banned U.S. cattle, beef and processed beef products, China also banned low-risk bovine products, i.e., bovine semen and embryos, protein-free tallow and non-ruminant feeds and fats, even though they are deemed tradable based on OIE guidelines regardless of a country's BSE status. After numerous bilateral meetings and technical discussions in 2004, including a visit to U.S. bovine facilities by Chinese food safety officials, China announced a lifting of its BSE-related ban for low-risk bovine products in late September 2004. However, China conditioned the lifting of the ban on the negotiation of protocol agreements setting technical and certification parameters for incoming low-risk bovine products. In November 2004, U.S. and Chinese officials finalized and signed protocols that would enable the resumption of exports of U.S.-origin bovine semen and embryos, contingent on facility certification by China's regulatory authorities, as well as a resumption of exports of U.S.-origin non-ruminant feeds and fats. In July 2005, China finally announced the resumption of trade in bovine semen and embryos, following certifications for 52 U.S. facilities made earlier in the year. However, trade in U.S.-origin non-ruminant feeds and fats did not resume, as China's regulatory authorities were insisting on a series of onerous, detailed and unnecessary information requirements that are not consistent with OIE guidelines and contrast sharply with U.S. requirements. As a result of further negotiations in December 2005, export certificates were finalized, and trade was expected to resume in early 2006. Meanwhile, trade in protein-free tallow had not resumed by the end of 2005, as U.S. and Chinese officials had not reached agreement on provisions of a protocol.

Avian Influenza (AI)

In February 2004, China imposed a nationwide ban on U.S. poultry in response to cases of low-pathogenic AI found in Delaware. Throughout 2004, the U.S. provided technical information to China on the U.S. AI situation, and in August 2004 a high-level Chinese delegation conducted a review of the status of AI eradication efforts in the United States. In December 2004, China lifted its nationwide ban on U.S. poultry, leaving in place a ban only for the states of Connecticut and Rhode Island. In early 2005, following the announcement of low-pathogenic AI found in the state of New York, China did not impose a nationwide ban. Instead, demonstrating progress in following OIE guidelines, China imposed a ban limited to poultry from the state of New York. As part of its ongoing dialogue with China's AQSIQ on AI, the United States has presented epidemiological information in support of its request for China to lift the current import bans on poultry products from Connecticut, Rhode Island and New York.

Wheat

The 1999 U.S.-China Agricultural Cooperation Agreement established an agreed level of TCK fungus tolerance in U.S. wheat, and China no longer routinely blocks U.S. wheat exports from the Pacific Northwest on the basis of the TCK fungus. Nevertheless, China has imposed a maximum residue level (MRL) for selenium that is more stringent than the international standard and threatens U.S. wheat exports to China. In addition, China has imposed an MRL for vomitoxin in wheat in the absence of any international standard. Although these measures are problematic, U.S. exports of wheat to China appeared to be unaffected by them in 2005. The drop in U.S. wheat exports in 2005 was attributable to other factors (as discussed in the “Tariff-Rate Quotas” section above).

Zero Pathogen Standards

China enforces zero tolerance standards for certain pathogens in raw meat and poultry products – standards that have resulted in the de-listing of several U.S. meat and poultry facilities. These standards appear to be enforced inconsistently. For some of the pathogens, a zero tolerance is not achievable because certain pathogen levels are unavoidable and do not result in unacceptable risk to consumers. These standards were developed by the Ministry of Health (MOH) and are enforced by AQSIQ. It does not appear that the Chinese authorities apply these standards equally to domestic products. Non-transparent enforcement of these standards has caused minor export disruptions since 2003.

The United States has worked with the Chinese authorities to re-list the affected facilities. It also continues to press China to revise its pathogen standards based on sound science and to adopt modern testing methodologies. Based on actions taken by the Chinese authorities in December 2005, it is expected that zero pathogen standards will become a more significant issue in 2006.

Distilled Spirits

China maintains a mandatory standard on distilled spirits that sets maximum limits on naturally occurring substances, known as superior alcohols or fusel oils, which result from the production process. However, the Joint UN FAO/WHO Expert Committee on Food Additives, like U.S. regulators of alcohol, has recognized that superior alcohols are safe for human consumption.

Food Additive Standards

Another problematic area involves China’s overly restrictive food additive standards. China continues to block many U.S. processed food products from entering the Chinese market by banning certain food additives that are widely used in other countries and have been approved by the World Health Organization. The most recent example is China’s proposed *Hygienic Standard for Uses of Food Additives*, notified to the WTO in July 2005 so that WTO members could comment on it.

This proposed technical regulation is 237 pages long and covers dozens of residues and additives for nearly 1,000 commodities. In some cases, it employs domestic nomenclature rather than internationally recognized technical terms, making it difficult to assess the impact that it would have on specific products. The United States recently submitted detailed comments on the proposed technical regulation and asked China to delay adoption of it until a thorough review could take place.

Fire Blight

Since 1994, China has refused to act on the United States' market access request for California plums, allegedly due to phytosanitary concerns regarding fire blight. In June 2005, the WTO Appellate Body report in *Japan - Measures Affecting the Importation of Apples* made clear that these concerns are unwarranted for imports of mature symptomless fruit. In December 2005, following further U.S. interventions, China formally approved the market access request for California plums.

Biotechnology Regulations

In January 2002, the Ministry of Agriculture (MOA) issued new rules implementing June 2001 regulations on agricultural biotechnology safety, testing and labeling. The product most affected by these rules was soybeans, while corn and other commodities were also potentially affected. However, the rules did not provide adequate time for completion of required safety assessments before their effective date of March 20, 2002. In response to U.S. interventions, China issued interim rules, which allowed trade to continue while authorities carried out safety assessments of biotechnology products. These interim rules were extended twice and were set to expire in April 2004. In December 2003 talks, MOA officials promised that permanent approval of Round-up Ready soybeans would be completed at least 60 days before expiration of the interim rules in order to prevent any trade disruption. China followed through on this promise and approved Round-up Ready soybeans, along with two cotton events and two corn events, in February 2004. Two months later, China issued final safety certificates for four additional corn events and seven canola events. China issued a formal safety certificate for another corn event later in 2004, leaving only one corn event still awaiting final approval. During the July 2005 JCCT meeting, MOA issued the final safety certificate for the remaining corn event.

Other U.S. concerns with China's biotechnology regulations remain. Areas of concern include limited timelines for submission of products, lack of clarity on assessment requirements for stacked (multiple trait) products and, at times, duplicative and unprecedented testing requirements. The United States is also concerned with the apparent lack of coordination of the development of biotechnology policy in China.

Food Labeling

The U.S. processed food industry has registered concerns with a number of standards and labeling requirements on its exports to China. The meat industry in particular is concerned that labeling regulations issued in late 2002 contain several requirements that go beyond those of any other country. They assert that these requirements are unnecessary and costly.

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Agricultural importers and importers of processed foods are also concerned about measures requiring labels for products containing transgenic material, such as soybeans and corn. The June 2001 biotechnology regulations issued by MOA require labeling of bulk commodities, but implementation has been limited and sporadic. Future implementation of these measures remains uncertain.

The distilled spirits industry is concerned that China will require its products to comply with all existing food labeling requirements. The industry believes that some of these requirements are inappropriate. For example, China requires distilled spirits product labels to include a bottling date. Under international practice relating to wines and spirits, however, the date of manufacture (production or bottling date) is not required. As many spirits products consist of a blend of spirits that are aged for varying periods, a single "date of manufacture" is often not possible to specify, would not represent the actual age of the product, and would confuse consumers regarding the actual age of the product. China also requires the labels of distilled spirits products to include a list of ingredients, even though the original ingredients (e.g., corn, wheat, rye and barley) are completely transformed and are no longer present after distillation. Furthermore, China maintains typeface specifications and translation requirements that are inconsistent with international standards.

EXPORT REGULATION

Export Licenses and Quotas

Over the last several years, China has progressively reduced the number of products requiring some type of export license. In 2005, China continued this trend, as it freed up three more categories of products from this requirement (man-made jade, satin and some kinds of silk). However, 47 categories of products (totaling 316 items at the 8-digit tariff level) are still subject to various types of export licenses. Products requiring export licenses include some grains, cotton, livestock, raw materials and metals, lethal chemicals and food products. In addition, China occasionally imposes new export licensing requirements on strategically sensitive commodities.

For some products, such as blast furnace coke and fluorspar, the export licensing system raises strong concerns under WTO rules that generally prohibit export restrictions. Export licenses for these two products are accompanied by export quotas and at times have required the payment of high export license fees beyond the administrative costs of administering an export license system.

In 2004, China's export restrictions on blast furnace coke, a key steel input, began to have a significant, adverse effect on U.S. integrated steel producers and their customers. The United States began to raise its concerns with China's coke export restrictions during high-level meetings in Washington in April 2004. The United States urged China to eliminate the practice of using export restrictions, not just for coke but also for other products. In late July 2004, China raised the 2004 quota allotment for coke to 12.3 million MT, and it indicated that it would eventually raise the quota to the 2003 level of 14.3 million MT.

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Shortly thereafter, MOFCOM also issued an urgent notice reiterating that the sale of export licenses was illegal. In the ensuing months, with the increased supply of Chinese coke and the crackdown on the sale of export licenses, the export prices for Chinese coke declined significantly. U.S. industry was also able to obtain a substantially larger quantity of Chinese coke in 2004 than it had in 2003.

In May 2005, consistent with earlier indications from China, an NDRC official stated publicly that China would eliminate the coke export quota system as of January 1, 2006. A MOFCOM official also noted that while WTO rules allow member countries to impose quotas on exports under certain circumstances, the rules simultaneously require restrictions on domestic consumption, which had not been done to date. In November 2005, when MOFCOM announced the 2006 export quota levels for agricultural, industrial and textile products, coke was absent from the list. MOFCOM later indicated that coke would still be subject to an export quota, except the export quota would now be administered by the NDRC, not MOFCOM. The reason given for the switch in coke export quota administration is that NDRC is responsible for administering industrial products that have significant influence on the national economy. In early December 2005, the NDRC released a list of 2006 coal export quotas, but did not include coke. In late December 2005, the NDRC finally issued the coke export quota, set at 14 million MT for 2006.

China has imposed quotas and high license fees on exports of fluorspar since before it acceded to the WTO, apparently with the objective of supporting China's domestic users of fluorspar, which face no comparable restrictions. China has refused to modify its practices in this area, despite repeated U.S. requests.

In December 2004, in an apparent effort by China to manage the export growth of textile and apparel products in response to concerns from its trading partners as the January 1, 2005 deadline for removal of global textile quotas drew near, China announced plans to impose export duties on certain categories of textile and apparel products. In February 2005, MOFCOM issued rules imposing automatic licensing requirements for textile exports to the United States, the European Union and Hong Kong. Subsequently, China suspended the licensing requirements only to restore similar measures in June 2005 and July 2005 after the United States imposed safeguards on certain categories of textile imports from China. China claimed the measures were needed to avoid uncertainty among Chinese textile exporting firms, to encourage exports of high value added items and to avoid rent seeking in license distributions. Under the June 2005 measures, MOFCOM, China Customs and AQSIQ jointly issued and made adjustments to a catalogue of subject items, listed by tariff codes, destination countries and regions, implementing periods and total licensed export quantities of subject items. Included in the catalogue were textile products subject to foreign safeguard actions or those subject to temporary quantitative regulation in accordance with bilateral agreements. In November 2005, USTR and MOFCOM signed a memorandum of understanding (MOU), under which China agreed to limit export growth rates in 34 categories of textiles, representing approximately 40 percent of bilateral trade in textiles, through 2008. The United States in turn agreed to dismiss all pending China-specific textile safeguard investigations and agreed to exercise restraint in invoking safeguards for categories of textiles falling outside the MOU. The United States and China also established an Electronic Visa Information System (ELVIS) Arrangement to monitor trade in the affected products.

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China also requires export licenses on products that are the subject of antidumping duties in a foreign market. As was initially the case in 2005 for textile exports subject to safeguard limitations in the United States, the central government has often delegated responsibility for issuing these licenses to quasi-governmental industry associations formed to take the place of the ministries that governed production during the earlier central planning era. Foreign investors report that the industry associations are using the power to issue export licenses to force companies to participate in association-supported activities. For example, the steel producers' industry association will not issue an export license to any company that does not contribute to its antidumping defense funds.

Export Subsidies

China officially abolished subsidies in the form of direct budgetary outlays for exports of industrial goods on January 1, 1991. China agreed to eliminate all subsidies prohibited under Article 3 of the WTO Agreement on Subsidies and Countervailing Measures, including all forms of export subsidies on industrial and agricultural goods, upon its accession to the WTO in December 2001.

A general lack of transparency makes it difficult to identify and quantify possible export subsidies provided by the Chinese government. China's subsidy programs are often the result of internal administrative measures and are not publicized. Sometimes they take the form of income tax reductions or exemptions that are *de facto* contingent on export performance. For example, the Chinese government announced in 2005 that it would provide financial and export credit assistance for automobile manufacturers with domestically owned intellectual property rights and noted that MOFCOM is selecting 100 Chinese auto or auto parts manufacturers to be designated as "state-level auto and part exporters" for financial support. In addition, according to a 2002 OECD report, foreign-invested enterprises exporting 70 percent or more of their output in a given year are eligible for a 50 percent tax reduction in that year even after the expiry of the normal tax holiday. China's subsidy programs can also take a variety of other forms, including mechanisms such as credit allocations, low-interest loans, debt forgiveness and reduction of freight charges. U.S. industry has alleged that subsidization is a key reason that Chinese exports are undercutting prices in the United States and gaining market share. Of particular concern are China's practices in the textiles industry as well as in the steel, petrochemical, high technology, forestry and paper products, machinery and copper and other non-ferrous metals industries.

U.S. subsidy experts continue to seek more information about several Chinese programs and policies that may confer export subsidies. Their efforts have been frustrated in part because China has failed to make any of its required subsidies notifications since becoming a member of the WTO three years ago. At the July 2005 JCCT meeting and in formal meetings at the WTO, China committed to submit its long-overdue subsidies notification by the end of 2005. China did not meet this deadline.

Since shortly after China acceded to the WTO, U.S. corn exporters began to complain that China was subsidizing its corn exports. In 2002 and 2003, it appeared that significant quantities of corn had been exported from China, including corn from Chinese government stocks, at prices that may have been 15 percent to 20 percent below domestic prices in China. As a result, U.S. corn

exporters were losing market share for corn in their traditional Asian markets, such as South Korea and Malaysia, while China was exporting record amounts of corn. In 2004, however, trade analysts began to conclude that, because of several economic factors, including changes in the relationship between domestic prices and world prices, China was trending toward becoming a net importer of corn. One result appeared to have been that China's exports were largely made on a commercial basis in 2004 and 2005, although concern remains regarding the operation of China's VAT rebate system for corn.

INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

China has undertaken substantial efforts to implement its commitment to overhaul its legal regime to ensure the protection of intellectual property rights in accordance with the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS Agreement). Those efforts have fallen short in some respects, particularly with regard to criminal liability for copyright piracy and trademark counterfeiting. In other areas, China has done a relatively good job of revising its legal regime. However, China has been much less successful in enforcing its laws and regulations and ensuring the effective IPR enforcement required by the TRIPS Agreement. With U.S. industry reporting no significant reduction in IPR infringement levels in 2005, IPR enforcement remains problematic. Counterfeiting and piracy in China remain at epidemic levels and cause serious economic harm to U.S. businesses in virtually every sector of the economy.

Throughout 2005, the United States continued to place the highest priority on improving IPR enforcement in China, taking several aggressive steps in an effort to obtain meaningful progress in this area. First, the United States conducted an out-of-cycle review under the Special 301 provisions of U.S. trade law. At the conclusion of this review in April 2005, the Administration elevated China to the Special 301 "Priority Watch List" and set out a comprehensive strategy for addressing China's ineffective IPR enforcement regime, including the possible use of WTO mechanisms, as appropriate. The United States immediately began to pursue this strategy during the run up to the July 2005 JCCT meeting, and China subsequently agreed to take a series of specific actions designed to increase criminal prosecutions of IPR violators, improve enforcement at the Chinese border, counter piracy of movies, audio visual products and software, address Internet-related piracy, and appoint an IPR ombudsman to serve as a point of contact for U.S. companies, particularly small and medium sized U.S. companies experiencing China-related IPR problems. After concluding that lack of transparency is a serious barrier to a more complete understanding of key deficiencies in China's IPR enforcement system, the United States also submitted a transparency request to China under Article 63.3 of the TRIPS Agreement in October 2005. The request, made in conjunction with similar requests by Japan and Switzerland, seeks detailed information from China on its IPR enforcement efforts over the last four years.

The United States is committed to working constructively with China to significantly reduce IPR infringement levels in China and continues to devote extra staff and resources, both in Washington and in Beijing, to address the many aspects of this problem.

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At the same time, the United States remains prepared to take whatever action is necessary and appropriate to ensure that China develops and implements an effective system of IPR enforcement, as required by the TRIPS Agreement.

Legal Framework

In anticipation of its accession to the WTO, China began modifying the full range of IPR laws, regulations and implementing rules, including those relating to patents, trademarks and copyrights, in an effort to comply with the TRIPS Agreement. By the end of 2001, China had completed amendments to its patent law, trademark law and copyright law, along with regulations for the patent law and regulations addressing computer software protection and the protection of layout designs of integrated circuits. After it acceded to the WTO, China issued regulations for the trademark law and the copyright law. China also issued various sets of implementing rules and judicial interpretations in the patent, trademark and copyright areas. In addition, China issued regulations and implementing rules covering specific subject areas, such as integrated circuits, computer software and pharmaceuticals. Many of the legal changes made by China represent major improvements that have moved China generally in line with international norms in most key areas. More work needs to be done, however, particularly with regard to administrative and criminal enforcement. In addition, new legislation may be required in certain “cutting edge” areas like Internet copyright protection.

In the trademark area, some progress was made in 2004 on the recognition of foreign well-known marks. More than a year after the issuance of implementing rules on well-known marks, a handful of foreign marks has been recognized as well-known. In addition, in June 2005, the Trademark Administration circulated draft amendments to its *Regulations on the Timely Transfer of Suspected Criminal Cases in the Enforcement of Administrative Law*, which are designed to provide guidance to provincial administrations for industry and commerce in facilitating effective trademark enforcement and protection.

With regard to copyright protection over information networks, in November 2004, the National Copyright Administration of China and MII jointly organized a hearing on draft implementing rules known as the *Draft Measures for Administrative Protection of Copyright on the Internet*. The Chinese authorities issued these rules in final form in April 2005. The rules require Internet service providers to take remedial actions to delete contents that infringe on copyrights upon receipt of a complaint from the right holder, or face administrative penalties ranging from confiscation of illegal gains to fines of up to RMB 100,000 (\$12,000). In September 2005, China circulated a more important Internet-related measure for public comment, the draft *Regulations on the Protection of Copyright Over Information Networks*, with the goal of issuing the final version in 2006. This development is a concrete step in line with China’s April 2004 JCCT commitments to improve protection of electronic data while China continues its preparations for accession to the WIPO Internet-related treaties – the *WIPO Copyright Treaty* and the *WIPO Performances and Phonograms Treaty*.

Although China is not obligated under WTO rules to accede to the WIPO Internet-related treaties, the United States considers these treaties to reflect international norms for providing copyright protection over the Internet. These treaties entered into force in 2002 and have been

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ratified by many developed and developing countries. While China's existing regulations and implementing rules do address certain copyright issues related to the Internet, and China is in the process of drafting further revisions, the United States has urged China for some time to accede to the WIPO Internet-related treaties and fully harmonize its regulations and implementing rules with them. These steps are important as a means for preventing China's Internet environment from becoming a "safe harbor" for piracy, especially in light of the rapidly increasing number of Internet users in China, most of whom have broadband access. At the April 2004 JCCT meeting, China agreed to ratify and implement the WIPO Internet-related treaties as soon as possible.

At the July 2005 JCCT meeting, the United States obtained China's commitment to submit the legislative package necessary for China's accession to the WIPO Internet-related treaties to the National People's Congress by June 2006.

In furtherance of China's April 2004 JCCT commitment to increase border measures protecting against the import and export of infringing products and to make it easier for rights-holders to secure effective enforcement at the border, the Customs Administration issued the *Regulations on Customs Protection of Intellectual Property Rights*, which went into effect in March 2004. The Customs Administration subsequently issued implementing rules for these regulations, effective July 2004. These regulations and implementing rules addressed the duties of the Customs Administration and improved guidance on the implementation of the customs IPR recordal mechanism. In other areas, however, the regulations and implementing rules lacked clarity or could have benefitted from further changes, such as with regard to the storage and disposition of infringing goods and the transferal of cases for possible criminal prosecution. Meanwhile, in September 2004, the Customs Administration issued new regulations on administrative penalties in the customs context, the *Implementing Regulations for the Imposition of Administrative Penalties by the General Administration of Customs*, effective November 2004. In an apparent improvement over the prior regulations, these new regulations do not impose a "knowledge" requirement before penalties can be imposed. However, the new regulations provide for fines not to exceed 30 percent of the value of the goods confiscated, or RMB 50,000 (\$6,000), whichever is lower. In contrast, the prior regulations allowed for fines up to the full value of the goods confiscated. The fines allowed under the new regulations are also lower than those imposed by other Chinese agencies focusing on domestic IPR infringement. At present, the effectiveness of these various regulations and implementing rules remains in doubt, as exports of counterfeit and pirated goods from China are increasing, facilitated by trading rights liberalization and the rapid growth of Internet usage and e-commerce.

The United States has urged China to pursue additional legislative changes to improve the legal framework supporting enforcement, particularly in the area of criminal enforcement. For example, the criminal enforcement legal framework could be improved through the removal of various evidentiary and liability thresholds, the "for profit" requirement in the copyright area, the "identical trademark" requirement and the distinction between individual and enterprise liability. Among these issues, China's high thresholds for criminal liability (i.e., the minimum values or volumes of infringement deemed criminal by authorities) pose a particular problem.

Despite efforts at reform, these thresholds remain so high that they have the effect of insulating commercial infringers' retail sales and other significant commercial activities involving counterfeit and pirated goods from criminal penalties. China's legal framework has thus created a "safe harbor" that protects a large group of commercial infringers and operates to deprive the criminal enforcement authorities of needed information regarding the sources of counterfeit and pirated goods.

The United States also remains concerned about weaknesses in China's legal framework that encourage or support counterfeiting and piracy. Some of these weaknesses have facilitated the establishment of Chinese companies under the false appearances of foreign companies, the squatting of foreign company names, designs and trademarks, and the theft of trade secrets.

In addition, restrictions on market access for legitimate movies, music, software and books and built-in delays in the marketing approval system for pharmaceuticals have created incentives for counterfeiting and piracy that are difficult to address through the existing legal framework.

Enforcement

IPR infringement in China in 2005 continued to affect products, brands and technologies from a wide range of industries, including films, music, publishing, software, pharmaceuticals, chemicals, information technology, consumer goods, industrial goods, food products, medical devices, electrical equipment, automotive parts and clothing, among many others. This situation not only has had an enormous economic impact, but also presents a direct challenge to China's ability to regulate many products that have health and safety implications for China's population and, given the increasing amount of counterfeit and pirated products being exported from China, for others around the world.

The United States places the highest priority on addressing IPR enforcement problems in China, and since 2004 it has devoted additional staff and resources, both in Washington and in Beijing, to address these problems. While a domestic Chinese business constituency is increasingly active in promoting IPR enforcement, it is clear that there will continue to be a need for sustained efforts from the United States and other WTO members, along with the devotion of considerable resources and political will by the Chinese government to IPR enforcement, if significant improvements are to be achieved on this front. At present, however, China's IPR enforcement efforts remain hampered by the challenges of coordination among Chinese government ministries and agencies, local protectionism and corruption, high thresholds for initiating investigations and prosecuting cases, and inadequate and non-transparent administrative penalties.

At the April 2004 JCCT meeting, China announced a comprehensive action plan on IPR enforcement that included five major commitments, for which the results have been mixed. First, and most importantly, China agreed that it would significantly reduce IPR infringement levels. Nevertheless, IPR infringement in China remains rampant, and IPR infringement levels reported by U.S. industry have not improved. Second, China committed that it would take steps by the end of 2004 to increase penalties for IPR violations by subjecting a greater range of violations to criminal investigation, applying criminal sanctions to the import, export, storage

and distribution of pirated and counterfeit products and applying criminal sanctions to on-line piracy. China did take some steps to increase penalties for IPR violations, as China's Supreme People's Court and Supreme People's Procuratorate issued a judicial interpretation in December 2004 redefining the criteria for commencing criminal prosecutions and reaching criminal convictions. Nevertheless, while this judicial interpretation has generated improvements, it did not address deficiencies in China's criminal law still in need of correction. Third, China committed to crack down on IPR violators by conducting nation-wide enforcement actions and increasing customs enforcement actions. Vice Premier Wu launched this crack down at the time of the Xiamen China International Fair for Investment and Trade in August 2004. However, a lack of transparency hinders an assessment of the disposition of any ensuing enforcement and customs actions. Fourth, China committed to improve protection of on-line works by ratifying and implementing the World Intellectual Property Organization (WIPO) Internet-related treaties as soon as possible, and by extending an existing ban on the use of pirated software in government offices. Although China has not yet ratified the WIPO Internet-related treaties, the Chinese government did extend its ban on the use of pirated software in government offices. Fifth, China committed to launch a national IPR education campaign. China followed through on this commitment by launching a national public awareness campaign to educate the Chinese public on IPR protection, which included radio and television programs, newspaper inserts, awards and national and local level training programs. The campaign also included the introduction of a television program, "Intellectual Fortune," which is broadcasted in 20 provinces nationwide, the publication of an English language inserts in the China Daily English-language newspaper on intellectual property, and radio broadcast programs, among other targeted efforts. The long-term impact of these efforts continues to be evaluated.

In early 2005, the United States conducted an out-of-cycle review under the Special 301 provisions of U.S. trade law. At the conclusion of this review in April 2005, the Administration elevated China to the Special 301 "Priority Watch List" and set forth a comprehensive strategy for addressing China's ineffective IPR enforcement regime, which included the possible use of WTO mechanisms, as appropriate.

The United States immediately began to pursue this strategy during the run-up to the July 2005 JCCT meeting, as the United States sought to strengthen the commitments that China had made at the April 2004 JCCT meeting and to obtain China's commitment for greater involvement of its police authorities in IPR enforcement matters. China subsequently agreed to: (1) increase criminal prosecutions for IPR violations relative to the total number of IPR administrative enforcement cases; (2) reduce exports of infringing goods by issuing regulations to ensure the timely transfer of cases for criminal investigation; (3) improve national police coordination by establishing a coordinating group in the Ministry of Public Security responsible for overall research, planning and coordination of all IPR criminal enforcement to ensure a focused and coordinated nationwide enforcement effort; (4) enhance cooperation on law enforcement matters with the United States by immediately establishing a bilateral IPR law enforcement working group focusing on the reduction of cross-border infringement activities; (5) expand an ongoing initiative to aggressively counter piracy of movies and audio-visual products; (6) complete its program ensuring that only licensed software is used by all central, provincial and local government offices by the end of 2005 and extend this program to enterprises in 2006; (7) fight software end-user piracy by declaring that it is considered to constitute "harm to the public

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interest” and therefore is subject to administrative penalties nationwide and criminal penalties in appropriate circumstances; (8) establish an IPR ombudsman in the Chinese embassy in Washington to assist U.S. companies, particularly small- and medium-sized companies, experiencing IPR problems, (9) develop measures to rid trade fairs of fake goods; (10) join the WIPO Internet-related treaties in 2006; and (11) clarify the December 2004 Judicial Interpretation to make clear that its criminal thresholds apply to sound recordings and that exporters are subject to independent criminal liability.

By the end of 2005, China had already taken several steps to implement these commitments. Nevertheless, the overall results of China’s efforts remain unclear, largely because of transparency problems associated with IPR enforcement activities in China. For example, China will not make public the enforcement decisions made by administrative authorities. China has issued statistics that appear to show some increase in enforcement activities, but there is no evidence of any significant corresponding reduction in IPR infringement levels. In October 2005, the United States submitted a request to China under the transparency provisions of Article 63 of the TRIPS Agreement, in conjunction with similar requests by Japan and Switzerland, seeking to clarify China’s efforts to improve IPR enforcement.

A detailed review of the three different mechanisms for IPR enforcement provided for by China’s IPR laws and regulations – enforcement by administrative authorities, criminal prosecutions and civil actions for monetary damages or injunctive relief – is set forth below.

Administrative Enforcement

Although the central government continues to promote periodic anti-counterfeiting and anti-piracy campaigns, and these campaigns in the short term result in high numbers of seizures of infringing materials, they are largely ineffective. For one thing, the cases subsequently brought by the administrative authorities usually result in artificially low fines because the administrative authorities often do not treat the infringing goods as having the value of the genuine articles, but rather establish value based on the price charged for the counterfeit or pirated goods. In addition, evidence showing that a person was caught warehousing infringing goods is not sufficient to prove an intent to sell them, and as a result the administrative authorities will not even include those goods in the value of the infringing goods when determining the fine amounts.

The lack of deterrence from the fines is compounded by the fact that the administrative authorities rarely forward an administrative case on to the Ministry of Public Security for criminal investigation, even for commercial-scale counterfeiting or piracy. Statistics provided by China confirm this fact. In 2004, only 96 out of 51,851 administrative trademark cases (approximately 0.2 percent) and 101 out of 9,691 administrative copyright cases (approximately 1.0 percent) were transferred for criminal prosecution. These statistics showed no improvement over 2001, when the corresponding statistics similarly indicated very low transfer rates of 0.2 percent for administrative trademark cases and 1.5 percent for administrative copyright cases. As a result, infringers continue to consider the seizures and fines simply to be a cost of doing business, and are usually able to resume their operations without much difficulty.

At the 2005 JCCT meeting, as discussed above, China committed to increase the number of criminal IPR prosecutions relative to the number of administrative IPR cases. Since then, China has prepared and made available for public comment draft rules to facilitate the transfer of administrative cases for criminal enforcement. The United States has submitted written comments on these draft rules, which were expected to be finalized by the end of 2005. China is working separately on draft rules for the transfer of customs cases for criminal enforcement.

Meanwhile, China's administrative enforcement efforts have also failed to put an end to open and notorious IPR infringement at trade fairs, retail markets and wholesale markets throughout China. The United States has urged China to step up efforts at retail markets such as the "Silk Street" market in Beijing and wholesale markets such as Xiangyang in Shanghai, Yiwu in Yiwu City, and Lowu in Shenzhen. At major trade fairs, exhibitors displaying infringing goods in the past have escaped with only non-deterrent administrative penalties. China pledged to address the trade fair problem as part of its July 2005 JCCT commitments, and it is expected to issue final measures designed to improve administrative IPR enforcement at trade fairs, including provisions enhancing on-site complaint centers at major fairs, in early 2006.

The Customs Administration developed an action plan in mid-2004 calling for increased enforcement over exports of infringing goods, in conformity with China's April 2004 JCCT commitments. Currently, China's share of U.S. seizures of exports of counterfeit and pirated goods remain very high, although mid-year 2005 U.S. Customs and Border Patrol seizure data did show a modest decrease in seizures of infringing imports from China as compared with the same period in 2004, both in terms of aggregate value and percentage of total seizures.

Criminal Enforcement

In the view of the United States and U.S. industry, the most critical steps for China to take in improving its IPR enforcement are in the criminal area. Effective criminal enforcement is a core WTO obligation, and it offers the deterrence needed for China to begin to handle the rampant IPR infringement hurting both foreign and domestic enterprises. For this reason, the United States sought and obtained at the April 2004 and July 2005 JCCT meetings commitments by China to apply criminal sanctions to a wider range of IPR-infringing activities, to increase the penalties for IPR violations, to increase the number of criminal prosecutions for IPR violations, to reduce exports of infringing goods through the timely transfer of cases for criminal investigation, to improve national police coordination, and to ensure that its criminal thresholds apply to sound recordings and that exporters are subject to independent criminal liability.

There are some reports that the number of criminal prosecutions in China has increased in certain types of cases, but lack of transparency makes it difficult to confirm the existence, extent or significance of any improvement. Criminal prosecutions remain very rare in relation to administrative cases, and they have not created an adequate deterrent for IPR infringers. U.S. companies also continue to complain that, in most regions of China, the police are either not interested in pursuing counterfeiting and piracy cases or simply lack the resources and training required to investigate these types of cases effectively. Moreover, even when IPR violations are referred for criminal enforcement, the actual prosecution of IPR crimes frequently requires coordination among a relatively large number of agencies at the national and local levels.

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Coordination remains problematic, however, with different agencies using different standards to determine whether criminal conduct exists and some agencies apparently unwilling or unable to work together.

Civil Enforcement

In part because of the ineffectiveness of the administrative and criminal enforcement mechanisms in China, particularly in the copyright area, there has been an increase in the number of civil actions being brought for monetary damages or injunctive relief. Most of the civil actions have been brought by Chinese rights-holders. This increased use of civil actions has coincided with an increasing sophistication on behalf of China's IPR courts, as China continues to make efforts to upgrade its judicial system. These efforts are still in progress, however. U.S. companies still complain about local protectionism and have also found that most judges lack necessary technical training and that court rules regarding evidence, expert witnesses, and protection of confidential information are vague or ineffective. In addition, in the patent area, where enforcement through civil litigation is of particular importance, a single case still takes several years to complete, rendering the damages provisions adopted to comply with China's TRIPS Agreement obligations less meaningful.

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Until China's entry into the WTO, China's service sectors were among the most heavily regulated and protected sectors of the national economy. Foreign service providers were largely restricted to operations under the terms of selective "experimental" licenses. However, both as a matter of policy and as a result of its WTO commitments, China decided to significantly liberalize foreign investment in its service sectors. At present, the market for services, underdeveloped due to historical attitudes and policies, has significant growth potential in both the short and long term.

China's WTO commitments are designed to provide meaningful access for U.S. service providers. In its accession agreement, China committed to the substantial opening of a broad range of service sectors through the elimination of many existing limitations on market access, at all levels of government, particularly in sectors of importance to the United States, such as banking, insurance, distribution, telecommunications and professional services. These commitments are far-reaching, particularly when compared to the services commitments of many other WTO members.

China also made certain "horizontal" commitments, which apply to all sectors listed in its services schedule. The two most important of these cross-cutting commitments involve acquired rights and the licensing process. Under the acquired rights commitment, China agreed that the conditions of ownership, operation and scope of activities for a foreign company, as set out in the respective contractual or shareholder agreement or in a license establishing or authorizing the operation or supply of services by an existing foreign service supplier, will not be made more restrictive than they were on the date of China's accession to the WTO.

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In other words, if a foreign company had pre-WTO accession rights that went beyond the commitments made by China in its services schedule that company could continue to operate with those rights. In the licensing area, prior to China's WTO accession, foreign companies in many sectors did not have an unqualified right to apply for a license to operate in China. They could only apply for a license if they first received an invitation from the relevant Chinese regulatory authorities, and even then the decision-making process lacked transparency and was subject to inordinate delay and discretion. In its accession agreement, China committed to licensing procedures that were streamlined, transparent and more predictable.

At present, many challenges remain in securing the benefits of China's services commitments. While China continued to keep pace nominally with the openings required by its WTO accession agreement, it frequently maintained or erected terms of entry that were so high or cumbersome as to prevent or discourage many foreign suppliers from gaining market access. For example, despite some progress, excessive capital requirements continue to restrict market entry for foreign suppliers in many sectors, such as insurance, banking, securities, non-bank motor vehicle financing, asset management, direct selling, franchising, freight forwarding and telecommunications, among others. In addition, in sectors such as insurance and legal services, branching restrictions have been put into effect that call into question commitments made by China in its services schedule. In other sectors, particularly express delivery and construction services, problematic proposed or final measures continue to threaten to take away previously acquired market access rights.

Progress was made on some fronts in 2005. For example, the licensing process in many sectors continued to proceed in a workman-like fashion, although national treatment concerns remain, particularly in the banking and insurance sectors. The *Administrative Licensing Law*, which took effect in July 2004, has also increased transparency in the licensing process, while reducing procedural obstacles and strengthening the legal environment for domestic and foreign enterprises.

Insurance Services

In its WTO accession agreement, China agreed to phase-in expanded ownership rights for foreign companies, for the most part during the first three years of China's WTO membership. Upon China's accession to the WTO, foreign life insurers were to be permitted to hold 50 percent equity share in a joint venture; within two years of accession, foreign property, casualty and other non-life insurers were to be permitted to establish as a branch, joint venture or a wholly foreign-owned subsidiary; and, within three years of accession, or by December 11, 2004, foreign insurers handling large scale commercial risks, marine, aviation and transport insurance, and reinsurance were to be permitted 51 percent foreign equity share in a joint venture (with the right to establish as a wholly foreign-owned subsidiary within two more years). China further agreed that all foreign insurers would be permitted to expand the scope of their activities to include group, health and pension lines of insurance by December 11, 2004. In addition, China agreed to eliminate geographic restrictions on all types of insurance operations by December 11, 2004.

Shortly after China acceded to the WTO, the China Insurance Regulatory Commission (CIRC) issued several new insurance regulations, including ones directed at the regulation of foreign insurance companies. These regulations implemented many of China's commitments, but they also created problems in three critical areas – capitalization requirements, transparency and branching. In particular, China's capitalization requirements were significantly more exacting than those of other populous countries, and they limited the ability of foreign insurers to make necessary joint venture arrangements. The regulations also continued to permit considerable bureaucratic discretion and to offer limited predictability to foreign insurers seeking to operate in China's market.

With regard to branching, China scheduled a commitment to allow non-life firms to establish as a branch in China upon accession and to permit internal branching in accordance with the lifting of China's geographic restrictions. China further agreed that foreign insurers already established in China that were seeking authorization to establish branches or sub-branches would not have to satisfy the requirements applicable to foreign insurers seeking a license to enter China's market.

China's regulations regarding foreign insurers' branching rights, however, remain vague, and CIRC has so far insisted that non-life insurers that are already in the market as a branch and that wish to branch or sub-branch cannot do so unless they first establish as a subsidiary, a costly condition. Further complicating this issue, CIRC has apparently waived this requirement for at least one foreign non-life insurer, but has not explained how or whether other foreign insurers could apply for this waiver.

In May 2004, CIRC took steps to address concerns related to China's high capitalization requirements by issuing the *Detailed Rules on the Regulations for the Administration of Foreign-Invested Insurance Companies*. These rules lowered capital requirements for national licenses from RMB 500 million (\$60 million) to RMB 200 million (\$24 million) and for branch offices from RMB 50 million (\$6 million) to RMB 20 million (\$2.4 million). These changes have been welcomed by some U.S. insurers, but others still consider them to be too high. The rules also streamlined licensing application procedures and shortened approval times, although some procedures remain unclear. Meanwhile, the rules did not adequately address branching rights, as many aspects of this issue remain vague.

By December 2004, in accordance with its WTO commitments, China lifted all of its geographic restrictions on foreign insurers. China also took steps in 2005 to permit foreign insurers to offer health and group insurance as well as pension/corporate annuities and increased the 50 percent ceiling on foreign ownership of joint venture insurance brokerages to 51 percent.

With all geographic restrictions removed and most business scope restrictions lifted in 2005, the operations of foreign insurers in China continued to grow. Foreign insurer premium income more than doubled, increasing from \$1.2 billion in 2004 (representing 2.3 percent of total premium income) to \$4.3 billion in 2005 (representing 6.9 percent of total premium income). While foreign insurers still had a relatively low share of the national market, in some areas market share was increasing more quickly. According to the most recently available figures from CIRC, in 2004, the 37 foreign insurers present in China (a figure that rose to 40 in 2005) held a 15.3 percent market share in Shanghai and an 8.2 percent market share in Guangzhou.

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However, despite these developments, U.S. and other foreign insurers are concerned that apparent discrimination in branching approvals may limit their ability to expand. In practice, it appears that established Chinese insurers are being granted new branch approvals on a concurrent basis, meaning more than one branch at a time. In contrast, foreign insurers so far have only received approvals on a consecutive basis, meaning one branch at a time. Meanwhile, a number of U.S. investors have taken significant minority equity stakes in major Chinese insurance companies as a means of accessing China's insurance market.

Banking Services

As part of its WTO accession agreement, China agreed to allow foreign banks to conduct local currency business with Chinese companies two years after its WTO accession and with Chinese individuals five years after accession, or by December 11, 2006. China also committed to opening four new cities every year where foreign banks could engage in local currency operations. All non-prudential market access and national treatment restrictions on foreign banks are to be lifted by December 11, 2006.

Under regulations issued in December 2001, foreign banks must meet stringent criteria such as having gross assets of \$20 billion when opening new branches in China. Although China reduced capital requirements for foreign bank branches in December 2003, they remained excessively high, increasing local capital costs for foreign banks. Foreign bank branches must also place 30 percent of their operating capital in interest bearing assets designated by the People's Bank of China (PBOC). Foreign bank branch current assets (cash, local bank demand deposits, and PBOC deposits) must continue to be greater than 25 percent of customer deposits. In addition, the ratio of customer deposits in foreign currency to domestic foreign currency assets may not exceed 70 percent, an increase from the 40 percent-level mandated previously. China calculates prudential ratios and limits based on the local capital of foreign bank branches rather than on the global capital base of the bank, although more lenient rules apply in authorized cities in the northeastern and western regions of China.

China also continues to have strict limitations on foreign banks' participation in local currency operations, which are regulated by the PBOC. These restrictions are being gradually relaxed, but local currency transactions with individuals remain prohibited until December 11, 2006. Restrictions on the rights of foreign banks to raise RMB in the interbank market also inhibit the ability of foreign banks to build RMB loan portfolios necessary for profitable operations in China. Meanwhile, although foreign currency business with any customer, foreign or domestic, is now freely permitted, only a limited number of foreign banks are allowed to do forward foreign exchange contracts.

In December 2003, the Chinese Government increased the stake a single foreign investor can take in a Chinese bank from 15 to 20 percent, with a total 24.9 percent allowed for all foreign investors. The United States and other WTO members have objected to these limitations, as China did not schedule any limitation on the percentage of foreign ownership in these banks when it acceded to the WTO.

Nevertheless, since the increased ownership limitations went into effect, a number of foreign investors have taken significant equity stakes in Chinese banks, including three of the four large state-owned banks. In the case of the Shenzhen Development Bank, a foreign investor has been allowed to take a controlling interest. Two of the foreign-invested banks have successfully listed on the Hong Kong stock exchange and more are expected in the near future.

By October 2005, despite high capital requirements and other impediments, 173 foreign banks, including a number of U.S. banks, reportedly had branches or representative offices in China, although only major banks have been large enough to satisfy the application requirements. In addition, the business that foreign banks were most eager to pursue in China – domestic currency – had expanded tremendously, although China's regulatory authorities continued to shield domestic banks from foreign competition in some areas, such as by limiting product innovation by foreign banks. According to the PBOC and CBRC, the domestic currency business of U.S. and other foreign banks grew rapidly in the first two years after China's WTO accession, even though the banks' clients were then limited to foreign-invested enterprises and foreign individuals. Following the PBOC's December 2003 announcement that foreign banks would be permitted to conduct domestic currency business with Chinese enterprises subject to previously permitted geographic restrictions, the growth in U.S. and other foreign banks' domestic currency business accelerated. The total assets of foreign banks in China reportedly had reached \$84.5 billion by October 2005, representing approximately 2 percent of the total banking assets in China. In some coastal cities, the share was higher. For example, in Shanghai, foreign banks' assets reportedly represented 12.4 percent of total banking assets.

Securities Services

Pursuant to the terms of China's WTO accession agreement, foreign securities firms were to receive the right to form joint ventures for fund management upon China's accession to the WTO in December 2001, while joint ventures for securities underwriting were to be permitted within three years after accession.

The China Securities Regulatory Commission issued regulations on the establishment of joint venture fund management companies and securities underwriting by Chinese-foreign joint ventures shortly after China's WTO accession. China's decision to limit foreign partners to a minority stake of these joint ventures (49 percent for fund management and 33 percent for securities trading), however, continues to limit their appeal to leading foreign firms and only a handful of joint ventures have been formed. In addition, China continues to limit the security underwriting joint ventures to underwriting A-shares and to underwriting and trading government and corporate debt, B-shares and H-shares.

Since December 2002, China has allowed Qualified Foreign Institutional Investors (QFIIs) to trade in A-shares via special accounts opened at designated custodian banks. However, stringent criteria currently make it difficult for foreign institutions to qualify as QFIIs, while other requirements limit the extent to which QFIIs can trade in A-shares.

Motor Vehicle Financing Services

China's WTO accession agreement required China to allow foreign non-bank financial institutions to provide motor vehicle financing immediately upon its accession in December 2001 and without any limits on market access. As a result of persistent U.S. engagement with China, both bilaterally and at WTO meetings, China issued regulations in October and November 2003 allowing foreign non-bank financial institutions to provide motor vehicle financing. The capital requirements set by these regulations are relatively high, with minimum registered capital at RMB 300 million (\$36 million), and minimum paid-in capital at RMB 500 million (\$60 million). In January 2004, CBRC granted licenses for one U.S. auto company and two other foreign auto companies to set up non-bank motor vehicle financing institutions. CBRC granted licenses for other foreign auto companies later in the year as well. In August 2004, the PBOC and CBRC jointly issued the *Administrative Rules on Auto Financing*, which became effective in October 2004. These rules set forth administrative requirements and risk management rules for extending auto loans in China and allowed the licensed companies to actually begin operations.

Financial Information Services

In its WTO accession agreement, as discussed above, China committed that, for the services included in its Services Schedule, the relevant regulatory authorities would be separate from, and not accountable to, any service suppliers they regulated, with two specified exceptions. One of the services included in China's services schedule – and not listed as an exception – is the “provision and transfer of financial information, and financial data processing and related software by suppliers of other financial services.”

Nevertheless, China has still not established an independent regulator in the financial information services sector. Xinhua, the Chinese state news agency, is both a major market competitor of, and the regulator of, foreign financial information service providers in China. As problems with Xinhua's regulation of this sector mounted in 2005, U.S. and other foreign financial information service providers began to call for the establishment of an independent regulator.

Wholesaling Services and Commission Agents' Services

In its WTO accession agreement, China committed to provide national treatment and eliminate market access restrictions for foreign enterprises seeking to provide wholesaling and commission agents' services and related services, such as repair and maintenance services, through a local presence within three years of China's accession (or by December 11, 2004), subject to limited product exceptions. In the meantime, China agreed to progressively liberalize its treatment of these services pursuant to a set schedule. The phase-in of these services was supposed to start with minority foreign-owned joint ventures by December 11, 2002, followed by majority foreign-owned joint ventures by December 11, 2003.

Shortly after acceding to the WTO, China fell behind in its implementation of the required progressive liberalization, as foreign enterprises continued to face a variety of restrictions. It was not until mid-2004, following high-level U.S. engagement that China began to take steps to

liberalize. At that time, MOFCOM issued regulations providing national treatment and eliminating market access restrictions on joint ventures providing wholesaling services and commission agents' services. These regulations also established a timetable for extending this liberalization to wholly foreign-owned enterprises on December 11, 2004.

While these regulations were welcome, MOFCOM was very slow to implement them, and it still has not implemented them fully. Initially, MOFCOM did not issue any guidance regarding how its approval system would operate, and the application process remained opaque. In most instances, the application process turned into a protracted negotiation, as the central and local approving authorities were still in the process of determining the appropriate procedures and documentation requirements. When approvals were issued, moreover, the central and local approving authorities imposed a variety of restrictions, such as limits on the scope of products that could be distributed and limits on the specific services that could be supplied. Registered capital requirements have also varied.

In addition, through the first six months of 2005, the Chinese authorities rarely issued approvals for existing enterprises seeking to expand their business scope to include wholesale distribution, in part because the Chinese authorities were sorting out historical tax treatment and Free Trade Zone (FTZ) issues. The Chinese authorities did issue some approvals for the establishment of new wholesale distribution enterprises, but this route did not make business sense for many enterprises already established in China.

By June 2005, the Chinese authorities had begun to make progress in resolving many of the problems that had plagued the application and approval process, including how it would handle the tax and FTZ issues that had stalled many enterprises' applications. In July 2005, MOFCOM and the General Administration of Customs (Customs Administration) issued the Circular on Issues Concerning the Trade Administration of Bonded Zones and Bonded Logistics Parks, which clarified the handling of applications from enterprises located in FTZs. At the July 2005 JCCT meeting, China also committed to improve the transparency of the application and approval process. Consistent with this commitment, in September 2005, MOFCOM issued the Application and Approval Guidelines for Foreign Investments, which clarify many aspects of the application and approval process. Since then, some improvements have taken place in the application and approval process, although U.S. industry continues to have concerns with regard to continuing product and services restrictions. U.S. industry is also concerned about the uncertainty created by the provision in the April 2004 regulations that allows the local approving authorities to withhold wholesale (and retail) distribution license approvals when, as is the case in most cities, urban commercial network plans have not yet been formulated. This provision could operate as a de facto restriction on the operations of foreign wholesalers (and retailers).

One area that requires clarification from the Chinese authorities involves the distribution of books, newspapers and magazines. While the April 2004 regulations purport to allow foreign enterprises to obtain the right to distribute books, newspapers and magazines in China, other measures appear to restrict this right.

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For example, the *Administrative Measures on the Subscription of Imported Publications*, issued by the General Administration of Press and Publications in September 2004, appear to restrict the distribution of imported publications by subscription to state trading enterprises. While China has since confirmed that foreign enterprises are now permitted to distribute books, newspapers and magazines in China, it has not provided a justification for the measure that restricts the distribution of imported publications by subscription to state trading enterprises.

In 2005, China began to implement several measures designed to implement its commitment to allow the distribution of automobiles by foreign enterprises, including the *Implementing Rules for the Administration of Brand-Specific Automobile Dealerships*, the *Policies for Automobile Trade* and the *Measures for the Administration of the Distribution of Used Vehicles*. However, under these rules, foreign cars face more, not fewer, restrictions, especially in the area of dealerships. For example, foreign automobile manufacturers are required to delegate the operations of its distribution network to either a domestic firm or a newly created firm. Moreover, prior to December 11, 2006, foreign investors cannot hold more than 49 percent of any new dealership if it already owns thirty or more dealerships. Dealerships, post-sales service and supply of parts are all restricted to delegated operators.

Meanwhile, China has delayed the implementation of its commitments with regard to the distribution of pharmaceuticals, despite the fact that the exception for pharmaceuticals contained in China's accession agreement expired as of December 11, 2004. Although the April 2004 regulations indicated that separate regulations would be issued for the pharmaceuticals sector, China has not issued any further regulations and has continued to require foreign pharmaceutical companies to sell their finished products through Chinese wholesalers (after hiring Chinese importers to bring their finished products into the country). China reportedly decided in the last half of 2005 to begin accepting applications from foreign pharmaceutical companies for wholesale (and retail) licenses under the April 2004 regulations and the State Food and Drug Administration's *Rules on the Management of Drug Business Licenses*.

Retailing Services

In 1999, the Chinese government broadened the scope for foreign investment in the retail sector. New regulations encouraged the entry of large international retailers (such as hypermarkets and warehouse-style stores) into China. China's subsequent WTO commitments were designed to further expand the ability of foreign retailers to enter the market through a much wider range of modalities. Smaller retail operations, some large retail operations, gas stations and even car dealerships may be wholly foreign-owned within three to five years of China's December 2001 WTO accession, although certain types of large retail operations may still face ownership limitations.

As in the area of wholesaling and commission agents' services, China fell behind in its implementation of the required progressive liberalization of retailing services shortly after acceding to the WTO, as foreign enterprises continued to face a variety of restrictions.

China only began to take steps to liberalize in mid-2004, when MOFCOM issued regulations providing national treatment and eliminating market access restrictions on joint ventures providing retailing services. These regulations also established a timetable for extending this liberalization to wholly foreign-owned enterprises on December 11, 2004.

Many of the same problems that plagued the application and approval process for wholesaling and commission agents' services in 2005 also arose in the area of retailing services. While improvements took place throughout the year, U.S. industry continues to have concerns, particularly with regard to the provision in the April 2004 regulations allowing the local approving authorities to withhold retail distribution license approvals when, as is the case in most cities, urban commercial network plans have not yet been formulated.

Meanwhile, it appears that China may not be fully implementing its commitment to allow foreign enterprises to sell gasoline at the retail level. Although China's retail services commitments initially did not apply to processed oil, as it was one of the excepted goods under China's services schedule, that exception expired on December 11, 2004, and by that time China committed to permit wholly foreign-owned enterprises to operate gas stations. However, according to some recent reports, China is now claiming that gas stations fall under the chain store provision in its services schedule, which applies to "those chain stores which sell products of different types and brands from multiple suppliers with more than 30 outlets" and permits only joint ventures with minority foreign ownership.

Franchising Services

As part of its services commitments, China committed to permit the cross-border supply of franchising services immediately upon its accession to the WTO. It also committed to permit foreign enterprises to provide franchising services in China, without any market access or national treatment limitations, by December 11, 2004. In December 2004, MOFCOM issued new rules governing the supply of franchising services in China, the *Measures for the Administration of Commercial Franchises*, effective February 2005. These rules raised a number of concerns. Of particular concern is a requirement that a franchiser own and operate at least two units in China for one year before being eligible to offer franchises in China. The business models of many U.S. franchising companies, including some large hotel chains, are adversely affected by this requirement because they do not own and operate units, instead relying exclusively on franchisees to distribute goods and services. The rules also impose high capital requirements and require broad and vague information disclosure by franchisers, with uncertain liability if these disclosure requirements are not met.

Sales Away From a Fixed Location

In 1998, China banned all direct selling activities (or sales away from a fixed location) activities after some foreign and domestic firms used direct selling techniques to operate fraudulent pyramid schemes and other less-than-legitimate operations disguised as direct selling to bilk participants. No U.S. firms were implicated in these schemes. Meanwhile, some large U.S. and other foreign direct selling firms were allowed to continue operating in China after altering their business models. In its WTO accession agreement, China committed to the resumption of direct selling activities by December 2004.

In September 2005, nine months overdue, the Chinese authorities issued the measures designed to implement China's direct selling commitments – the *Measures for the Administration of Direct Selling* and the *Regulations on the Administration of Anti-Pyramid Sales Scams*. These measures contained several problematic provisions. For example, one provision outlaws practices allowed in every country in which the U.S. industry operates – reportedly 170 countries in all – by refusing to allow direct selling enterprises to pay compensation based on team sales, where upstream personnel are compensated based on downstream sales. The United States has pointed out that China could revise this provision to permit team-based compensation while still addressing its legitimate concerns about pyramid schemes. Other problematic provisions include a three-year experience requirement that only applies to foreign enterprises, not domestic ones, restrictions on the cross-border supply of direct selling services and high capital requirements that may limit smaller direct sellers' access to the market. These measures also forbid foreigners from working as salespersons or as trainers for salespersons.

Express Delivery Services

Beginning in December 2001, the State Postal Bureau (together with MOFTEC and MII) issued restrictive measures that could have jeopardized market access that foreign express delivery firms (which were then required to operate as joint ventures with Chinese partners) enjoyed prior to China's accession. These measures threatened to curtail the scope of operations of foreign express delivery firms licensed prior to China's accession to the WTO, despite China's horizontal commitment on acquired rights. Specifically, a measure issued in December 2001 required firms wishing to deliver letters to apply for entrustment with China Post. A second measure, issued in February 2002, extended China Post's monopoly on letters by creating weight and rate restrictions on letter deliveries by private firms. Following high-level U.S. interventions, in September 2002, a third measure eliminated the weight and rate restrictions on letter deliveries and streamlined the entrustment application procedure. Two major U.S. express delivery firms subsequently applied for and obtained entrustment certificates from China Post.

In July 2003, however, China circulated draft amendments to its postal services law that generated two immediate concerns among U.S. companies. First, the draft amendments purported to give China Post a monopoly over the delivery of letters under 500 grams, which would have constituted a new restriction on the scope of activities of existing foreign-invested express delivery companies, contrary to China's horizontal acquired rights commitment. Second, the draft amendments did not address the need for an independent regulator.

In September, October and November 2003, China circulated new sets of draft amendments. While each set of draft amendments included a different definition of the China Post monopoly, the most recent draft amendments continued to provide China Post with a monopoly on letters weighing less than 500 grams. They also included other problematic provisions. For example, they appeared to create a new, more burdensome licensing process, and they seemed to require express couriers to pay a percentage of their revenue from the delivery of letters into a universal service fund.

In April 2004, following high-level U.S. engagement urging China not to cut back on the scope of activities that foreign-invested express delivery companies had been licensed to provide prior to China's WTO accession, Vice Premier Wu Yi committed that old problems, like the weight restriction, would not resurface as new problems. In July 2004, however, the State Council circulated another set of draft amendments to the postal services law. Despite Vice Premier Wu's commitment, these draft amendments continued to include a weight restriction, now reduced from 500 grams to 350 grams and did little to address other U.S. concerns. A new but still problematic set of draft amendments was reportedly circulating within China's ministries and agencies and to select domestic enterprises in early 2006, as U.S. engagement continued.

Construction, Engineering, Architectural and Contracting Services

Since before China's WTO accession, U.S. construction, engineering and architectural firms and U.S. contractors have enjoyed a relatively cooperative and open relationship with the Chinese government. These firms have operated in the Chinese market through joint venture arrangements and have been less affected by regulatory problems than other service sectors. Nevertheless, they have also faced restrictions. It has been difficult for foreign firms to obtain licenses to perform services except on a project-by-project basis. Foreign firms have also faced severe partnering and bidding restrictions.

In September 2002, the Ministry of Construction and MOFTEC jointly issued Decrees 113 and 114, which opened up construction and related construction design services to joint ventures with majority foreign ownership and, two years ahead of schedule, wholly foreign-owned enterprises. At the same time, however, these decrees created concerns for U.S. and other foreign firms by imposing new and more restrictive conditions than existed prior to China's WTO accession, when they were permitted to work in China on a project-by-project basis pursuant to Ministry of Construction rules. In particular, these decrees for the first time required foreign firms to obtain qualification certificates, effective October 1, 2003. In addition, these decrees for the first time required foreign-invested firms supplying construction services to incorporate in China, and they impose high minimum registered capital requirements and foreign personnel residency requirements that are difficult for many foreign firms to satisfy. In consultation with U.S. industry, the United States, in a high-level intervention, pressed its concerns about Decrees 113 and 114 and sought a delay before the decrees' problematic requirements would become effective. In September 2003, the Ministry of Construction agreed to extend the implementation date from October 1, 2003 until April 1, 2004 so the concerns of foreign firms could be analyzed further.

In April 2004, Decree 113 went into effect. However, in September 2004, the Ministry of Construction and MOFCOM issued Circular 159, which permitted foreign providers of construction services and related construction engineering design services to continue operating on a project by-project basis until July 1, 2005, effectively extending the effective date of the incorporation-related requirements. With the expiration of Circular 159 in July 2005, however, U.S. and other foreign companies now face a great deal of uncertainty as they seek to participate in projects in China.

In September 2005, the Ministry of Construction and MOFCOM circulated draft *Regulations on the Administration of Foreign-Invested Construction Service Enterprises* for public comment. These draft regulations call for the Chinese authorities to begin accepting applications from foreign-invested enterprises on December 1, 2006. While the draft regulations bring clarity to the application and approval process, they fail to address foreign companies' concerns regarding high capital requirements and recognition of foreign credentials. They also create obstacles and delay for foreign companies by establishing a complicated grading system for construction service enterprises.

Meanwhile, in late November 2004, the Ministry of Construction issued the *Provisional Measures for Construction Project Management* (known as Decree 200), which became effective on December 1, 2004. Among other things, Decree 200 appears to preclude the same company from providing construction services and related construction engineering design services if it also provides project management services on the same project. This aspect of the decree raises concerns because U.S. companies often provide all of these services in combination when working on a project in a foreign market.

Finally, a number of restrictions continue to apply to foreign providers of engineering and architectural services. Foreign firms cannot hire Chinese nationals to practice engineering and architectural services as licensed professionals. Currently, Chinese engineering and architectural firms must approve and stamp all drawings prior to construction. China also sets extremely low design fees, rather than letting the market set prices, while China does not have adequate lien laws to protect the rights of engineering and architectural firms from non-payment. There have also been instances in which U.S. engineering and architectural firms have had to pay Chinese domestic taxes on designs prepared in the United States for Chinese projects.

Transportation and Logistics Services

The transportation and logistics sector has in the past faced severe regulatory restrictions, high costs, dominance by government-invested agents, and limitations on permitted activities. The multiple government bodies responsible for this sector include the Ministry of Communications, the Ministry of Railways, MOFCOM, NDRC and the Civil Aviation Administration of China. Overlapping jurisdictions, multiple sets of approval requirements and opaque regulations hinder market access. In some areas, domestic firms have also used government connections and investments to monopolize the sector.

Nevertheless, like China's own reform policies, China's WTO commitments support a broad opening of the transportation and logistics sector to foreign services providers, to be phased in over time. Foreign firms should be able to invest freely in warehousing, road freight transport, rail freight transport and freight forwarding companies within three to six years after WTO accession, depending on the sector.

In July 2002, MOFCOM's predecessor, MOFTEC, issued a *Notice on Establishing Foreign-Invested Logistics Companies in Trial Regions*. This notice allows foreign-invested logistics companies (with up to 50 percent foreign ownership and registered capital of \$5 million) to establish in several designated cities. U.S. firms have expressed concern about the high capital requirement and the 50 percent cap on foreign ownership, which may conflict with China's WTO commitments for certain types of logistics services.

In November 2002, China issued regulations allowing majority foreign ownership of road transportation firms, as it was required to do within one year of its WTO accession. China was also obligated to issue regulations allowing majority foreign-owned joint ventures to enter the fields of packaging services, storage and warehousing, and freight forwarding one year after its accession; it issued timely regulations allowing 75 percent foreign-owned joint ventures in these fields.

China took a significant step in July 2004 to increase market access for U.S. passenger and cargo carriers by signing a landmark amendment to the aviation agreement with the United States. The amended agreement will more than double the number of U.S. airlines operating in China and will increase by five times the number of flights providing passenger and cargo services between the two countries over the next six years. The agreement also allows each country's carriers to serve any city in the other country, provides for unlimited code-sharing between them, expands opportunities for charter operators, and eliminates government regulation of pricing as of 2008. U.S. passenger and cargo carriers have since obtained additional routes and increased flight frequencies, as envisioned by the agreement.

Similarly, in late 2003, China took steps to liberalize the maritime services sector despite having made no WTO commitment. The United States and China signed a far-reaching, five-year bilateral maritime agreement, which will give U.S.-registered companies the legal flexibility to perform an extensive range of additional shipping and logistics activities in China. U.S. shipping and container transport services companies, along with their subsidiaries, affiliates and joint ventures will also be able to establish branch offices in China without geographic limitation.

In April 2005, AQSIQ issued the *Criteria for the Classification and Assessment of Logistics Firms*. Under this measure, AQSIQ uses a firm's business and financial situation, equipment, operating infrastructure, management, services provided, and human resource information as of the time of its business license application in order to classify the firm into one of three broad categories, i.e., transport, warehouse or multi-service, for regulatory purposes.

Some firms have criticized this measure as creating “hastily formulated standards” that inappropriately restrict the business scope of logistics firms and have also complained about unnecessary and burdensome requirements. In addition, freight forwarding firms are concerned about not being included in one of the three logistics business categories, particularly because it may prevent their participation in relevant standards-setting activities.

Telecommunications

In its WTO accession agreement, China made important commitments in the area of telecommunications services. It agreed to permit foreign suppliers to provide a broad range of services through joint ventures with Chinese companies, including domestic and international wired services, mobile voice and data services, value-added services, such as electronic mail, voice mail and on-line information and database retrieval, and paging services. The foreign stake permitted in the joint ventures is to increase over time, reaching a maximum of 49 percent for most types of services. In addition, China agreed to eliminate all geographical restrictions within two to six years after its WTO accession, depending on the particular service sector.

Importantly, when it acceded to the WTO, China also accepted key regulatory principles from the WTO Reference Paper. As a result, China became obligated to separate the regulatory and operating functions of MII (which had been both the telecommunications regulatory agency in China and the operator of China Telecom) upon its accession and to implement its regulations in an impartial manner. Since China’s accession, MII has spun-off China Telecom, which now competes in the market with other telecom operators. While the formal separation of regulator and operator has occurred, evidence of continued MII influence over operational decisions of the telecom operators (e.g., relating to personnel, corporate organization and standards) suggests that regulatory independence is far from complete. The current regulator, MII, is not structured as an independent entity as it still bears the responsibility to help develop China’s IT and telecom manufacturing industries.

China is also obligated to adopt pro-competitive regulatory principles, such as transparent licensing, cost-based pricing and the right of interconnection, which are necessary for foreign-invested joint ventures to compete against established operators. China appears laggard in implementing these commitments, however. For example, there is no sign that “major suppliers” in China have made their interconnection arrangements public. With practically no foreign participation in the market, it has been difficult to assess compliance with such commitments. This very lack of foreign participation, however, is indicative of a licensing regime that has not been conducive to foreign investment, in part due to lack of transparency.

China’s *Regulations on Foreign-Invested Telecommunications Enterprises* went into effect January 1, 2002. These regulations define registered-capital requirements, equity caps, requirements for Chinese and foreign partners, and licensing procedures. The regulations stipulate that foreign-invested telecommunications enterprises can undertake either basic or value-added telecommunications services. Foreign ownership may not exceed 49 percent in the case of basic telecommunications services (excluding wireless paging) and 50 percent in the case of value-added services (including wireless paging, which is otherwise categorized as a basic service). The entire process of forming a Sino-foreign joint venture for basic services pursuant

to the new regulations is believed to be lengthy, lasting on average 9 to 12 months. While China committed to giving foreign applicants freedom to choose potential joint venture partners, it appears that MII is interpreting requirements regarding technical qualifications to effectively exclude all but incumbent operators, foreclosing additional competition in the market. For foreign operators interested in offering international services, requirements to use a gateway operated by a state-owned operator appear excessive and unjustified. The capitalization requirement established for new entrants, which exceeds \$200 million, is another major impediment to market access. There appears to be no justification for such a requirement, particularly for companies interested in leasing, rather than building facilities, while specific licensing terms for resale-based operators do not appear to exist. Meanwhile, MII continues to process applications very slowly for the few foreign-invested telecommunications enterprises that have attempted to satisfy MII's licensing requirements. The results have been predictable: no new joint ventures appear to have been formed in the basic telecom sector since China introduced the January 2002 regulations.

At times, MII has also changed applicable rules without notice and without transparency. For example, in February 2003, MII announced a reclassification of certain basic and value-added telecommunications services effective April 1, 2003. No public comment period was provided. This move limited the ability of U.S. firms to access China's telecommunications market because basic services are on a slower liberalization schedule and are subject to lower foreign equity limits and higher capitalization requirements.

Little progress has been made in opening the market for value-added services, such as Internet service and content providers. MII announced moves toward convergence in voice, video and data services in 2000, but China considers information content sensitive, so foreign companies face significant barriers in the Internet services sector. Although more foreign companies are registering ".com.cn" websites in China, these sites are still often blocked, which hinders companies' abilities to maintain a stable Internet presence. The requirement that Internet service providers (ISPs) must provide user login information and transaction records to authorities upon request, without clear guidelines as to the circumstances and situations that warrant such actions, raises concerns about consumer privacy and prevention of data misuse. Meanwhile, even though China has now completed its fourth year of WTO membership, the United States is aware of only one application for a license to provide value-added services that has completed the MII licensing process. That license was awarded to a Chinese-Korean joint venture in 2005.

Foreign equity investment limitations for ISPs and Internet content providers (ICPs) mirror the timetable for value-added services in China's WTO accession agreement (30 percent upon accession, 49 percent within one year after accession and 50 percent within two years after accession). However, ICPs must still win the approval of MII and/or local telecom administrations depending on the geographic coverage of their services before they can receive foreign capital, cooperate with foreign businesses, or attempt domestic or overseas stock listings. Their services, including even simple commercial websites, are also subject to excessive capitalization requirements that bear little relation to any legitimate licensing goals.

FOREIGN TRADE BARRIERS

In 2004, a draft of the long-awaited Telecommunications Law began to circulate among Chinese ministries and agencies. If China takes the initiative, this law could be a vehicle for addressing existing market access barriers and other problematic aspects of China's current telecommunications regime. The current status and content of this legislation is unclear, despite repeated U.S. efforts to obtain this information.

Meanwhile, even though China committed in its WTO accession agreement that further liberalization of this sector would be discussed in the current round of WTO negotiations, China has yet to make an improved services offer. With the modest telecommunications commitments made by China in its WTO accession agreement having so far failed to facilitate effective market entry for foreign firms, further liberalization, bound through the current round of WTO negotiations, appears critical to improving market access prospects for this sector.

On-Line Services

Chinese authorities routinely filter Internet traffic entering China, focusing primarily on the content they deem objectionable on political, social or religious grounds. In 2002, China lifted filters on most major western news sites. Nevertheless, since then, foreign news websites have periodically been blocked, as happened, for example, for several weeks during the 16th National Congress of the Communist Party of China in 2003. More generally, according to a Harvard University study published in 2002, China had still blocked 19,032 sites on multiple occasions. In addition to blocking sites related to Taiwan, the Falun Gong spiritual movement, Tibetan and Uighur support groups and human rights organizations focusing specifically on China, the study states that China repeatedly blocked university alumni homepages such as MIT's homepage, various church and other religious-themed sites and search engines such as Alta Vista. Changes to Internet filtering can occur without warning or public explanation. For example, the popular Internet search engine Google was blocked completely in China for a few weeks starting in late August 2002. When Google became available again in September 2002, its "cached pages" feature remained blocked; that feature had previously allowed users in China to access "snapshots" of some web pages that were otherwise blocked in China. All of these practices remained prevalent in 2005. Few, if any, websites related strictly to economic and business matters, however, are blocked.

Internet content restrictions for ICPs, electronic commerce sites and application service providers located in China are governed by a number of measures, not all of which are public. Some of these measures restrict who may report news and place limits on what exactly may constitute news. The most important of these measures was issued in September 2000 and updated in September 2005. In addition to interfering with news reporting in the traditional sense, this measure may provide a basis for Chinese authorities to interfere with the normal business reporting operations of non-news organizations, such as multinational corporations, if they use the Internet to keep clients, members, their headquarters and other interested parties informed about events in China.

In March 2002, the Internet Society of China, a nominally private group affiliated with MII, established a “Public Pledge on Self-Discipline for the China Internet Industry.” Signatories commit to “refrain from producing, posting or disseminating pernicious information that may jeopardize state security and disrupt social stability, contravene laws and regulations and spread superstition and obscenity.” Reportedly, 130 major Internet portals have since signed the pledge.

Audio-Visual Services (Including Film Imports)

China’s *Regulations on the Administration of Audio-Visual Products and Regulations on the Management of Film* went into effect on February 1, 2002. They are designed to bring more order and transparency to the film and audio-visual industries, with an eye to moving toward greater commercial efficiency in accordance with domestic reform efforts and China’s WTO commitments. Despite these positive moves, China’s desire to protect the revenues earned by the state-owned movie and print media importers and distributors, and China’s concerns about politically sensitive materials, result in continued restrictions on foreign providers of audio-visual services. For example, distribution of sound recordings, videos, movies, books and magazines remains highly restricted. In addition news services remain wary that the Chinese government will impose new restrictions on their activities. Inconsistent and subjective application of censorship regulations further impedes market growth for foreign and domestic providers alike.

China issued a number of regulations in 2004 that should lead to expanded market access in the audio-visual services sector, although many restrictions remain. In July 2004, the State Administration for Radio, Film and TV (SARFT) issued the *Rules for the Administration of China-Foreign Cooperation in Filmmaking*. According to these rules, licenses are required for both the joint Chinese-foreign filmmaking cooperative and the cooperating domestic partner. In October 2004, SARFT and MOFCOM issued the *Provisional Rules on the Access Requirements for Film*. These rules cover film production, distribution, screening and imports by domestic firms, and film production and screenings involving foreign firms. All firms engaged in these businesses are subject to SARFT licensing. Foreign firms are allowed to form joint ventures and cooperative firms engaged in film production, technology and equipment. Joint ventures or cooperative firms must have at least RMB 5 million (\$600,000) of registered capital, and foreign capital cannot make up more than 49 percent of the total share. In October 2004, SARFT and MOFCOM issued the *Provisional Rules on the Administration of China-Foreign Joint Venture and Cooperative TV Program Production Firms*. These rules establish a minimum registered capital requirement of RMB 2 million (\$240,000) for joint ventures and cooperative firms and mandate a share of no less than 51 percent for domestic partners. In February 2005, SARFT issued a circular placing further restrictions on foreign partners and requiring two-thirds of the programs of a joint venture or cooperative firm to have Chinese themes. Finally, in August 2005, the State Council issued a directive stating that non-public capital cannot be used to establish or operate a news agency, newspaper, publishing house, radio station, or TV station. The directive also stated that radio and television signal broadcasting and relay station, satellite and backbone networks are closed to non-public capital.

China began importing foreign films on a revenue-sharing basis in 1994. The Chinese government limits the number of foreign films allowed to enter China. China allowed in only ten foreign films annually through much of the 1990s, but more recently allowed in 20 foreign films annually on a revenue-sharing basis under its WTO commitments. However, China treats its WTO commitment as a ceiling, rather than a floor, which artificially increases demand for pirated products. Although China is also obligated to open theaters and film distribution to foreign investment, currently there are only two authorized distributors of foreign films, the state-owned China Film Distribution Company and Huaxia. Furthermore, lengthy censorship reviews by Chinese authorities delay the arrival of legitimately imported foreign films on Chinese movie screens. When the films do make it to the screen, they have sometimes been subject to blackout viewing periods during national holidays. China's large black market for foreign films continues to grow because these market access restrictions not only create a demand for pirated DVDs in the absence of legitimately licensed films, but also diminish the incentive for foreign investment in movie theaters (which is currently limited to a minority stake). Rights holders who comply with Chinese law must forego marketing legitimate products, leaving the demand for movies to be satisfied almost entirely by pirates. Some progress was achieved in 2004, when MOFCOM approved a U.S.-invested film distribution joint venture and took steps to shorten the time required to bring films to market.

Meanwhile, China is reportedly in the process of formulating a policy to support its weak cartoon industry. According to several reports, in June 2005, SARFT began circulating a draft measure providing that only domestically produced cartoons could be broadcast during prime-time viewing hours and that advertisements shown during this period should be used to finance the production of domestic cartoons. The draft measure also reportedly forbids the introduction of foreign cartoons under the disguise of domestic cartoons as well as cartoons that are jointly made with foreigners.

Tourism and Travel Services

Immediately following China's WTO accession in December 2001, China issued new travel agency administration regulations, the *Regulations on the Administration of Travel Agencies*, which were designed to make it easier for large foreign travel and tourism service providers to participate as minority partners in the operation of full-service joint venture travel agencies handling foreign inbound tourism. China subsequently issued the *Provisional Measures for the Establishment of Foreign-controlled and Wholly Foreign-funded Travel Agencies*, effective July 2003, which for the first time expressly allowed both foreign-controlled joint ventures and wholly foreign-owned enterprises. Under this measure, these travel agencies were allowed to engage in foreign inbound tourism through the establishment of offices in five major foreign tourist destinations in China – Beijing, Shanghai, Guangzhou, Shenzhen and Xian. Foreign-controlled travel agencies must have an annual worldwide turnover in excess of \$40 million, and wholly foreign-funded travel agencies must have an annual worldwide turnover in excess of \$500 million. For both types of travel agencies, there is also a local registered capital requirement of RMB 4 million (\$480,000).

In November 2003, Germany's Touristic Union International (TUI) signed a letter of intent with the China Tourism Agency to form the first joint venture travel agency controlled by a foreign interest since China's WTO accession. Japan Airlines subsequently established the first wholly foreign-funded travel agency.

In February 2005, China issued a measure lowering the minimum registered capital requirement for foreign-controlled and wholly foreign-owned travel agencies from RMB 4 million (\$480,000) to RMB 2.5 million (\$300,000), which had been required as of December 11, 2004, by its WTO accession agreement. It also lifted all remaining geographical restrictions on the establishment of foreign-controlled and wholly foreign-owned travel agencies, nearly three years in advance of the schedule set forth in its WTO accession agreement.

Foreign firms continue to be restricted from competing in the Chinese outbound tourist market. In addition, China requires all travel agents, airlines and other booking entities to use or connect into China's nationally owned and operated computer reservation system when booking airline tickets. Foreign computer reservation companies can only provide reservations by connecting with the Chinese system. The total number of non-immigrant visas issued to Chinese wishing to travel to the United States rose from approximately 263,000 in FY 2004 (October 1, 2003-September 30, 2004) to more than 326,000 in FY 2005 (October 1, 2004-September 30, 2005), a 24 percent increase. Most of this increase is accounted for by a resumption of normal travel patterns following the containment of the SARS outbreak in China in 2003.

Beginning on January 15, 2005, eligible Chinese nationals wishing to visit the United States temporarily for business (B-1) or tourism (B-2) could be issued visas that were valid for 12 months and multiple entries. The previous maximum validity for U.S. visas issued for these purposes was six months and multiple entries.

Meanwhile, holders of official Chinese passports, nearly 23,000 of who were issued U.S. visas in 2004, are required to use China's state-owned airlines or their code-share partners. Most of these individuals are employees of state-owned enterprises, who would not be considered government employees in most countries. This represents a significant loss of business for U.S. airlines.

Education and Training Services

China faces a shortage of qualified teachers and clearly needs educators in inland regions. However, the Ministry of Education (MOE) continues to restrict participation by foreign educators and trainers. China permits only non-profit educational activities that do not compete with the MOE-supervised nine years of compulsory education, thereby inhibiting much-needed foreign investment in the education sector. In April 2000, MOE also banned foreign companies and organizations from offering educational services via satellite networks.

In June 2004, the Ministry of Education issued the *Implementing Rules for China-Foreign Cooperative Education Projects*. Although formulated to implement the *Regulations on China-Foreign Cooperation in Running Schools*, issued in September 2003, the rules allow foreign educators to participate only in certain activities, including education offering academic certificates, supplementary education and pre-school education. These activities cannot take the form of activities at actual educational institutions.

Foreign universities may set up non-profit operations. However, they must have a Chinese university host and partner to ensure that programs bar subversive content and localize imported information.

Meanwhile, China's training market is unregulated, which discourages potential investors from entering the market.

Legal Services

Prior to its WTO accession, China maintained various restrictions in the area of legal services. It prohibited representative offices of foreign law firms from practicing Chinese law or engaging in profit-making activities with regard to non-Chinese law. It also imposed restrictions on foreign law firms' formal affiliation with Chinese law firms, limited foreign law firms to one representative office and maintained geographic restrictions. Chinese law firms, on the other hand, have been able to open offices freely throughout China since 1996.

As part of its WTO accession, China agreed to lift quantitative and geographical restrictions on the establishment of representative offices by foreign law firms within one year after accession. In addition, foreign representative offices are to be able to engage in profit-making business, to advise clients on foreign legal matters and to provide information on the impact of the Chinese legal environment, among other things. They also are to be able to maintain long-term "entrustment" relationships with Chinese law firms and to instruct lawyers in the Chinese law firm as agreed between the two law firms.

The State Council issued the *Regulations on the Administration of Foreign Law Firm Representative Offices* in December 2001, and the Ministry of Justice issued implementing rules in July 2002. While these measures removed some market access barriers, they also generated concern among foreign law firms doing business in China. In many areas, these measures were ambiguous. For example, it appeared that these measures created an economic needs test for foreign law firms that want to establish offices in China, which would raise concerns regarding China's compliance with its GATS commitments. The measures also seemed to take an overly restrictive view of the types of legal services that foreign law firms may provide. In addition, the procedures for establishing a new office or an additional office were unnecessarily time-consuming. For example, a foreign law firm may not establish an additional representative office until its most recently established representative office has been in practice for three consecutive years. Foreign attorneys also may not take China's bar examination, and they may not hire registered members of the Chinese bar as attorneys.

Although a number of U.S. and other foreign law firms have been able to open a second office in China, little progress has been made on the other problematic aspects of these measures, particularly the economic needs test, the unreasonable restrictions on the types of legal services that can be provided and the unnecessary delays that must be endured when seeking to establish new offices. These obstacles continue to prevent foreign law firms from participating fully in China's legal market.

Accounting and Management Consultancy Services

Prior to China's accession to the WTO, foreign accounting firms could not choose their own Chinese joint venture partners freely or enter into contractual agreements that could fully integrate these joint ventures. Upon its accession to the WTO, China agreed to allow foreign accounting firms to partner with any Chinese entity of their choice. China also agreed to abandon the prohibition on foreign accounting firms' representative offices engaging in profit-making activities. In addition, China agreed that foreign accounting firms could engage in taxation and management consulting services, without having to satisfy the more restrictive requirements on form of establishment applicable to new entities seeking to provide those services separately.

The Chinese Institute of Certified Public Accountants, a government body under MOF, has made progress in modernizing accounting in China. In 2002, MOF released four newly revised auditing statements covering inter-bank confirmation, capital verification, accounting estimates and the audit of commercial bank financial statements. Furthermore, MOF has been active in standardizing accounting procedures across a wide range of topics including investments, inventories, cash flow statements, and fixed assets. The Chinese Securities Regulatory Commission, meanwhile, requires a listed company to appoint a certified international CPA firm to conduct audits on prospectuses and annual reports in accordance with international standards.

Despite these positive changes, pervasive problems remain. Differing accounting regulations limit the comparability of data, and the accounting practices followed by many domestic firms do not meet international conventions.

Advertising Services

In the past, foreign firms had been restricted to representative offices or minority ownership of joint-venture operations. As part of its WTO accession commitments, however, China agreed to allow majority foreign ownership of joint venture advertising companies by December 11, 2003, and wholly foreign-owned subsidiaries by December 11, 2005.

In March 2004, the State Administration of Industry and Commerce (SAIC) and MOFCOM issued rules governing joint venture, cooperative and wholly foreign-owned advertisement firms. To establish branches, a firm must have paid in full its registered capital and have at least RMB 20 million (\$2.4 million) in annual advertising revenue. Foreign firms are currently limited to a 70 percent share of joint venture and cooperative firms. Implementing rules, effective January 1, 2005, subsequently allowed wholly foreign-owned advertising firms to conduct business in China.

FOREIGN TRADE BARRIERS

Advertising in China is still governed by China's 1995 Advertising Law, which is enforced by SAIC. Among other things, the law bans messages "hindering the public or violating social customs." The law is also subject to interpretation by SAIC, which must approve all advertising campaigns. One additional difficulty for foreign advertising firms, as well as foreign manufacturers, is that China has strict regulations prohibiting comparative advertising as well as any advertising with claims about the relative superiority of one brand over another. Marketing strategies that are successful in some other countries are therefore illegal in China.

Movement of Professionals

Generally, there are no special entry restrictions placed on U.S. professionals who wish to work in China, such as doctors or engineers. However, like other foreign professionals, they must receive approval from the Foreign Experts Bureau. Prior to arrival, a prospective American job applicant may be asked to provide notarized copies of his or her professional credentials and a summary of past work experience. The credentials will be used by the employer to file for a "foreign experts residency permit" for the American employee. Once the "foreign expert" permit is authorized, the prospective employee can request a work visa (a "Z" visa) from a Chinese embassy or consulate. If the prospective employee arrives in China on a visitors' visa (an "L" visa) prior to commencing employment, the prospective employee is usually asked to depart China prior to starting work, and to apply for the appropriate work visa from a foreign entry point (usually Hong Kong). Local employers are responsible for all employment or income tax and other withholdings for these "foreign experts" while they are employed in China. Recent press reports indicate that the government is considering measures to liberalize access by issuing "permanent resident" visas to long-time foreign residents of China. Meanwhile, for long-term foreign residents in China, the government is liberalizing access by replacing the "Residence Card" with the "Permanent Resident Visa."

INVESTMENT BARRIERS

Foreign investors continue to show great interest in China despite significant obstacles. According to the United Nations Conference on Trade and Development, China received \$60.3 billion in FDI in 2005, about 0.5 percent under the 2004 figure but still making China the third largest destination for FDI after the United States and the United Kingdom. Investors in China continue to confront a lack of transparency, inconsistently enforced laws and regulations, weak IPR protection, corruption and an unreliable legal system incapable of protecting the sanctity of contracts. In 2005, U.S. companies highlighted the inadequate supply of qualified management-level human resources and local protectionism as two new areas of concern, and noted that China's performance in both areas had deteriorated since 2004.

China's leadership has reaffirmed its commitment to "further open" China to investment and to continue movement toward a rules-based economic system. Meanwhile, foreign (and domestic) companies have continued to report high profitability in 2005, indicating that challenges to doing business in China have been largely surmountable. Nonetheless, faster progress toward removing investment barriers could spur even more investment, particularly in new, higher value-added manufacturing and services.

FOREIGN TRADE BARRIERS

Investment Requirements

In addition to taking on the obligations of the WTO Agreement on Trade-Related Investment Measures, China committed in its WTO accession agreement to eliminate export performance, local content and foreign exchange balancing requirements from its laws and regulations and not to enforce any contracts imposing those requirements. China also agreed that it would no longer condition investment (or import) approvals on those requirements or on requirements such as technology transfer and offsets.

In anticipation of these commitments, China revised its laws and regulations on foreign-invested enterprises in an attempt to eliminate WTO-inconsistent requirements relating to export performance, local content and foreign exchange balancing as well as technology transfer. China also revised “Buy China” policies that regulated procurement of raw materials and fuels, and removed requirements that joint ventures and wholly foreign-owned enterprises submit production/operation plans to Chinese authorities. However, some measures continue to “encourage” technology transfer, without formally requiring it. U.S. companies are concerned that this encouragement will in practice amount to a requirement in many cases, particularly in light of the high degree of discretion provided to Chinese government officials when reviewing investment applications. In addition, according to U.S. companies, some Chinese government officials still consider factors such as export performance and local content when deciding whether to approve an investment or to recommend approval of a loan from a Chinese bank, which is often essential to the success of an investment project.

Foreign investors remain wary of potential investment-related practices that would be inconsistent with WTO rules. In their experience, central government commitments to WTO-compliant measures often do not translate into provincial practices.

Investment Guidelines

Foreign investment inflows continue to be controlled and channeled toward areas that support national development objectives. China has adjusted its investment guidelines a number of times over the last several years. The revisions have confused potential investors and added to the perception that the investment guidelines do not provide a stable basis for business planning. Uncertainty as to which industries are being promoted as investment targets and how long such designations will be valid undermines confidence in the stability of the investment climate. The most recent catalogue of investment targets took effect January 1, 2005, replacing the April 2002 catalogue. Like its predecessor, it lists sectors in which foreign investment would be encouraged, restricted or prohibited. Investment in unlisted sectors is considered to be permitted.

Sectors in which China encourage investment include those in which China believes that it could benefit from foreign assistance or technology, such as construction and the operation of infrastructure facilities. In addition, the April 2002 catalogue had implemented elements of openings in sectors to which China committed in its WTO accession agreement, including banking, insurance, petroleum extraction, value-added telecommunications, and distribution. The January 2005 catalogue opens television program production and movie production to foreign investors by allowing minority participation in joint ventures. It also adds production of

certain components for large-screen color projection tubes, automobile electronics, industrial boilers and the manufacture of compact disc media to the list of encouraged investments, which benefit from duty-free import of capital equipment and VAT rebates on inputs.

Over the past several years, China has also introduced incentives for foreign investment in certain encouraged sectors. For example, China introduced incentives for investments in high-technology industries, such as a measure issued in November 1999 that provided foreign-invested enterprises a tax deduction for contributions to non-affiliated research and development or educational institutions. In December 2001, China announced comprehensive new incentives for investment in the less-developed central and western parts of the country. Other tax incentives include a reduction of income taxes for foreign-invested enterprises in targeted regions and special economic zones as well as for foreign-invested enterprises engaged in certain industries, such as machinery or construction.

The government also announced a series of measures in August 1999 that began to decentralize authority for approving investments and to create new incentives for investments in key sectors and geographic regions. These guidelines also expanded the authority of provincial-level governments to approve foreign-invested projects. The current rules, set forth in measures issued by the State Council in July and October 2004, significantly expanded provincial governments' approval authority. Under these measures, only project proposals in "encouraged" and "permitted" sectors valued above \$500 million, and those in "restricted" sectors valued above \$50 million, require NDRC review and State Council approval.

Meanwhile, the Chinese government restricts foreign investment projects in sectors not in line with "the needs of China's national economic development." In these sectors, foreign firms must form a joint venture with a Chinese company and restrict their equity ownership to a minority share in order to invest in the Chinese market.

Beginning in 2004 and continuing through 2005, the government employed a series of restrictive measures to cool what it considered an overheating economy. Some of these measures attempted to restrict further domestic and foreign investment in certain sectors, like real estate and steel. In the case of steel, the new measure – China's July 2005 steel policy – treats foreign investors more strictly. In particular, the new steel policy restricts foreign investment in a number of ways. For example, it requires that foreign investors possess proprietary technology or intellectual property in the processing of steel. Given that foreign investors are not allowed to have a controlling share in steel and iron enterprises in China, this requirement would seem to constitute a *de facto* technology transfer requirement, in conflict with the commitment in China's accession agreement not to condition investment on the transfer of technology. This policy is also troubling because it attempts to dictate industry outcomes and involves the government making decisions that should be made by the market. The policy also prescribes the number and size of steel producers in China, where they will be located, the types of products that will and will not be produced, and the technology that will be used.

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This high degree of government direction and decision-making regarding the allocation of resources into and out of China's steel industry is not only inconsistent with the spirit of China's obligations as a member of the WTO, but raises concerns specifically because of the commitment that China made in its WTO accession agreement that the government would not influence, directly or indirectly, commercial decisions on the part of state-owned or state-invested enterprises.

China also prohibits foreign investment in certain sectors. Citing national security interests, China bans foreign investment in news agencies, radio and TV broadcasting stations and networks, radio and TV programming, film production and screening, and the publication, importation and wholesale distribution of press and audio-visual products. The production of arms by foreign investors is also prohibited, as is the mining and processing of certain minerals. U.S. investors have expressed particular concern about China's prohibition of investment in the production and development of plant seeds that are a product of biotechnology.

Other Investment Issues

Venture Capital

Regulations that took effect in March 2003 replaced earlier regulations permitting the establishment of foreign-invested venture capital firms, including wholly foreign-owned enterprises, aimed at funding high-technology and new technology startups in industries open to foreign investment. The March 2003 regulations lower capital requirements, allow these firms to manage funds directly invested from overseas, and offer the option of establishing venture capital firms under an organizational form similar to the limited liability partnerships used in other countries.

Meanwhile, regulations that took effect in April 2001 permit foreign private equity firms subject to limits on corporate structure, share issuance and transfers, and investment exit options. These same regulations, however, bar all domestic and foreign securities firms from the private equity business.

Investment exit problems, especially the difficulty of listing on China's stock exchanges, coupled with the bureaucratic approvals required to list overseas, have limited interest in establishing China-based venture capital and private equity investment. As a result, most foreign venture capital and private equity investments in China are actually housed in offshore investment entities, which, as with other offshore FDI, can be transferred without Chinese government approval.

The Chinese government issued new regulations for domestic venture capital firms in the fall of 2005, and implementing rules are expected to be issued in 2006. It is unclear if these measures will allow foreign firms choosing to operate onshore to take advantage of the incentives offered to domestic firms.

Holding Companies

There has been some relaxation of restrictions on the scope and operations of holding companies, although minimum capital requirements normally make them suitable only for corporations with several sizeable investments to manage. Holding companies may manage human resources across their affiliates and also provide certain market research and other services. However, some restrictions on services provided by holding companies and on holding companies' financial operations and ability to balance foreign exchange internally will remain even after full implementation of China's WTO commitments. Profit and loss consolidation within holding companies also remains prohibited.

Access to Capital Markets

Foreign-invested enterprises in China remain largely unable to access domestic and international stock markets, to sell corporate bonds, to accept venture capital investment, to sell equity, or to engage in normal merger, acquisition and divestment activity. Foreign exchange transactions on the capital account can be concluded only with case-by-case official review, and approvals are subject to very tight regulatory control. These barriers to capital market access were not addressed by China's WTO accession agreement.

China has begun to experiment with liberalization, such as the opening of domestic stock markets to listings by foreign-invested firms. Through the Qualified Foreign Institutional Investor (QFII) program, foreign securities firms can gain limited access to the RMB-denominated A share market by applying for QFII status with the Chinese government. As of December 2005, 32 foreign firms had been granted QFII status, and 31 of them had been issued QFII investment quotas totaling \$5.645 billion.

GOVERNMENT PROCUREMENT

In accordance with the terms of its WTO accession agreement, China agreed to conduct its government procurement in a transparent manner and to provide all foreign suppliers with equal opportunity to participate in procurements opened to foreign suppliers. China also committed to become an observer to the WTO Agreement on Government Procurement (GPA), which it did in May 2002, and to table an offer and initiate negotiations for membership in the GPA "as soon as possible." In the interim, China agreed that all of its central and local government entities would conduct their procurements in a transparent manner, as reflected in its WTO accession agreement. China also agreed that, if procurement were opened to foreign suppliers, it would provide MFN treatment by allowing all foreign suppliers an equal opportunity to participate in the bidding process.

While China has still not initiated GPA negotiations, it did promulgate its first Government Procurement Law in July 2002. In part, this was a response to the need to separate purchases by "state-owned enterprises," which China had agreed in its WTO accession agreement would be made on a commercial basis, from "government procurement." China also agreed that the government would not influence the commercial decisions of state-owned enterprises, although in practice this has not consistently been the case.

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The Government Procurement Law, which became effective on January 1, 2003, attempts to follow the spirit of the GPA and incorporates provisions from the United Nations Model Law on Procurement of Goods. However, the law also directs central and sub-central government entities to give priority to “local” goods and services, with limited exceptions. China envisions that this law will improve transparency, reduce corruption and lower government costs. The law is also seen as a necessary step toward reforming China’s government procurement system in preparation for China eventually becoming a Party to the GPA. In August 2004, MOF issued implementing rules stipulating that procurement of foreign goods, works and services, which are allowed in exceptional circumstances, are subject to review and approval by MOF.

MOF also issued measures in August 2004 covering bidding procedures, publication of information and the handling of complaints related to government procurements. The rules on bidding procedures require all government procurements over a certain amount to be conducted through public bidding. According to the 2004 catalogue for central-government financed government procurement, the threshold for public bidding is RMB 1.2 million (\$144,000). To be eligible to participate, suppliers must be domestic and provide “domestic goods and services.” MOF is reportedly formulating the criteria for “domestic goods and services.” The rules on publication of information require procuring entities and their agencies to make public all necessary information through media outlets designated by MOF. These rules define this information as statutes, data and other materials concerning government procurements, and also require the disclosure of detailed information concerning bid invitations and bidding. The rules on the handling of complaints require MOF and local finance administrations to respond to complaints from suppliers regarding the conduct of procurements. Suppliers may apply for administrative review of a ruling or file an administrative suit in court.

Meanwhile, beginning in 2003, U.S. companies expressed concerns about implementing rules on government software procurement being drafted by MOF. At a time when China’s already large software market was projected to grow by more than 50 percent annually, the initial draft of these rules reportedly contained guidelines mandating that central and local governments – the largest purchasers of software in China – purchase only software developed in China to the extent possible. In October 2004, MOF issued a notice seeking input from foreign enterprises regarding the software procurement rules being drafted. Although no actual draft of those rules was included, it appeared that MOF was taking a very restrictive approach in defining “domestic products.” The United States and U.S. industry were concerned not only about U.S. software exporters’ continuing access to China’s large and growing market for packaged and custom software – \$7.5 billion in 2004 – but also about the precedent that could be established for other sectors if China proceeded with MOF’s proposed restrictions on the purchase of foreign software by central and local governments. At the July 2005 JCCT meeting, China took note of the United States’ strong concerns and indicated that it would indefinitely suspend the drafting of implementing rules on government software procurement.

Finally, at the July 2005 JCCT meeting, China agreed to commence “technical discussions” with the United States and other WTO members in preparation for the initiation of negotiations to join the GPA. The first round of technical discussions between China and the United States was scheduled to take place in February 2006.

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ELECTRONIC COMMERCE

China has experienced dramatic growth in Internet usage since 1999. According to the 16th Internet survey recently published by the China Internet Network Information Center (CNNIC) in July 2005, the number of people in China with access to the Internet was approximately 103 million, an increase of 10 percent year on year, second only to the United States in terms of total users. Falling personal computer prices and the arrival of devices tailored for the Chinese market will further expand Internet access.

China has also experienced a dramatic increase in the number of electronic businesses established. An estimated 78 percent of all Chinese websites are now operated by “enterprises” and 5 percent by “businesses.” By the end of June 2005, there were roughly 677,500 registered websites in China. Of this total, there were 622,534 domain names registered under “.cn”. However, despite these developments, only 11 percent of Chinese “enterprise” websites and 45 percent of Chinese “business” websites offer “e-commerce services.” Nevertheless, China is experiencing rapid development of on-line business such as search engines, network education, on-line advertisements, audio-video service, paid e-mail, short message, on-line job hunting, Internet consulting and on-line gaming.

The Chinese government recognizes the potential of electronic commerce to promote exports and increase competitiveness and has made some progress toward establishing a viable commercial environment. However, some Chinese ministries with responsibility for electronic commerce have excessively regulated the Internet, thereby stifling the free flow of information and the consumer privacy needed for electronic commerce to flourish. Content is still controlled and encryption regulated, as discussed more fully above (in the “Online Services” section).

A number of technical problems also inhibit the growth of electronic commerce in China. Rates charged by government-approved Internet service providers make Internet access expensive for most Chinese citizens. Slow connection speeds are another problem, although this is changing as broadband connections become more readily available. In 2005, nearly 53 percent of China’s Internet users had broadband connections, representing an increase of 15 percent over 2004, and China Telecom is now reportedly the world’s largest DSL operator. There are now more than 30 million broadband subscribers in China. China surpassed Japan in 2004 as the country with the second most broadband lines after the United States. At the same time, Internet penetration remains relatively low in China, so there is still significant room for growth.

Other impediments to Chinese businesses and consumers conducting online transactions include the paucity of credit payment systems, consumer reluctance to trust online merchants, the lack of secure online payment systems and inefficient delivery systems. China has also yet to develop a legal framework conducive to the rapid growth of electronic commerce. Laws recognizing the validity of “e-contracting” tools and stressing the importance of online privacy and security have been proposed, but not yet issued. Despite these obstacles, however, a large and growing percentage of Chinese Internet users reportedly have made online purchases.

In a positive development, China passed E-signature legislation in August 2004, which became effective on April 1, 2005. China is also in the process of drafting data privacy legislation.

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ANTICOMPETITIVE PRACTICES

China continues to struggle with economic inefficiencies and investment disincentives created by local protectionism, pricing practices and preservation of industry-wide monopolies. Anticompetitive practices in China take several forms. In some cases, industrial conglomerates operating as monopolies, near monopolies or authorized oligopolies (as in the telecommunications industry) may have been allowed to fix prices, allocate contracts and in other ways restrict competition among domestic and foreign suppliers. In addition, regional protectionism by provincial or local authorities often blocks efficient distribution of goods and services inside China. These practices may restrict market access for certain imported products, raise production costs and restrict market opportunities for foreign-invested enterprises in China. There are several existing laws and regulations in China addressing competition matters. However, these measures are largely ineffective due to poor national coordination and inconsistent local and provincial enforcement. China is drafting a new anti-monopoly law that could be adopted by late 2006.

Since November 2002, regulations have allowed foreigners to purchase traded and non-traded (or designated state) shares of Chinese enterprises. In addition, regulations that took effect in April 2003 specify procedures for foreign acquisition of and merger with domestic enterprises. These regulations require pre-merger notification and allow for examination of antitrust considerations in some cases. By requiring approval of all owners of the Chinese enterprise, the regulations implicitly prohibit hostile takeovers. The thresholds for notification are also not straightforward, leaving open the possibility of abuse by officials or domestic competitors. Domestic competitors have the power under the regulations to call for public hearings on prospective mergers.

China also issued regulations in November 2002 addressing the use of foreign investment to reorganize state-owned enterprises. These reorganizations, however, require extensive approvals and the agreement of the state-owned enterprise's labor union. These requirements have limited the appeal of this type of investment.

OTHER BARRIERS

Transparency

In its WTO accession agreement, China committed to publish all laws, regulations and other measures that relate to trade matters, including those that affect imports, and generally to provide a reasonable period for commenting on them before implementation. China also agreed to establish or designate an official journal for the publication of these trade-related measures. In addition, China agreed to provide a copy of new trade-related laws, regulations and other measures to the WTO Secretariat in Geneva, translated into one or more of the WTO's official languages (English, French and Spanish) no later than 90 days after implementation. China further agreed to create various enquiry points for its WTO trading partners and foreign businesses to obtain information about these measures.

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Various government-owned specialty newspapers routinely carry the texts of government regulations, implementing rules, circulars and announcements. Many government ministries also publish digests or gazettes containing the texts of these measures, both in written form and on their websites. In addition, there has been a proliferation of online news and information services that routinely offer up-to-date news about and texts of new laws and regulations. Some services even provide legal-quality English translations by subscription. However, many measures that do not rise to the level of ministry-issued regulations or implementing rules continue to remain unavailable to the public. China's ministries routinely implement policies based on internal "guidance" or "opinions" that are not available to foreign firms. Experimental or informal policies and draft regulations, in addition, are regarded as internal matters and public access is tightly controlled.

While positive in some respects, the sheer number of outlets through which trade-related measures are published complicates the ability of interested parties to track their development and issuance. In late 2002, China designated the China Foreign Economic and Trade Gazette as the official journal for this purpose. Published by MOFCOM and replacing the MOFCOM Gazette, it came out on a trial basis in October 2002 and as an official publication in January 2003. However, this journal does not carry draft measures for public comment, nor does it consistently carry trade-related measures developed by ministries and agencies other than MOFCOM. The establishment or designation of a single comprehensive journal would enhance the ability of WTO members to track the drafting, issuance and implementation of trade-related measures. Furthermore, the use of a single journal to request comments on proposed trade-related measures, as envisioned in China's WTO accession agreement, would facilitate the timely notification of comment periods and submission of comments.

In December 2001, the State Council issued regulations explicitly allowing comment periods and hearings. However, many of China's ministries and agencies continued to follow the practice prior to China's accession to the WTO. The ministry or agency drafting a new or revised law or regulation will normally consult with and submit drafts to other ministries and agencies, Chinese experts and affected Chinese companies. At times, it will also consult with select foreign companies, although it will not necessarily share drafts with them. As a result, only a small proportion of new or revised laws and regulations have been issued after a period for public comment, and even in these cases the amount of time provided for public comment has generally been short.

In 2004, some improvements took place, particularly on the part of MOFCOM, which began following the rules set forth in its *Provisional Regulations on Administrative Transparency*, issued in November 2003. Those rules could potentially serve as a model for other ministries and agencies seeking to improve their transparency. Nevertheless, basic compliance with China's notice-and-comment commitment continued to be uneven, both in 2004 and 2005. For example, China did not provide for public comment on major trade-related laws and regulations, such as the April 2005 *Measures on the Importation of Parts for Entire Automobiles*. In the area of intellectual property rights, however, a number of ministries and agencies circulated proposed measures for public comment in 2005.

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Meanwhile, China's ministries and agencies continue to have a much better record when it comes to making new or revised laws and regulations available to the public. In accordance with State Council regulations issued in December 2001, which require the publication of new or amended regulations thirty days before their implementation, almost all new or revised laws and regulations have been available (in Chinese) soon after issuance and prior to their effective date, an improvement over pre-WTO accession practice. Indeed, these laws and regulations are often published not only in official journals, but also on the Internet. At the same time, however, China continues to lag behind in its obligation to provide translations of these laws and regulations.

U.S. industry continues to report instances where Chinese companies are provided unofficial guidance by Chinese regulators, guidance which is usually unavailable to foreign entities. In some cases, Chinese officials provided unpublished documents to interested parties, but this dissemination was ad hoc and based more on personal connections than formal procedures.

MOFCOM's predecessor, MOFTEC, in late 2001, established an enquiry point to provide information on new trade and investment laws, regulations and other measures. Other ministries and agencies have also established formal or informal, subject-specific enquiry points. Since the creation of these various enquiry points, U.S. companies have generally found them to be responsive and helpful, and have generally received timely replies.

Legal Framework

Laws and Regulations

Laws and regulations in China tend to be more general and ambiguous than in other countries. While this approach allows the Chinese authorities to apply laws and regulations flexibly, it also results in inconsistency and confusion in application. Companies often have difficulty determining whether their activities contravene a particular law or regulation.

In China, regulations are also promulgated by a host of different ministries and governments at the central, provincial and local levels, and it is not unusual for the resulting regulations to be at odds with each other. Even though finalized regulations are now routinely published in China, they often leave room for discretionary application and inconsistencies, either through honest misunderstanding or by design. Indeed, government bureaucracies have sometimes been accused of selectively applying regulations. China has many strict rules that are often ignored in practice until a person or entity falls out of official favor. Governmental authorities can wield their discretionary power to crack down on foreign or disfavored investors or make special demands on them simply by threatening to crack down.

This lack of a clear and consistent framework of laws and regulations can be a barrier to the participation of foreign firms in the Chinese domestic market. A comprehensive legal framework, coupled with adequate prior notice of proposed changes to laws and regulations, and an opportunity to comment on those changes, would greatly enhance business conditions, promote commerce and reduce opportunities for corruption. The U.S. Government has provided technical assistance, at the central and local levels of government in China, in an effort to

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promote improvements in China's legislative and regulatory drafting process. In its WTO accession agreement, China committed to establish tribunals for the review of all administrative actions relating to the implementation of trade-related laws, regulations, judicial decisions and administrative rulings. These tribunals must be impartial and independent of the government authorities entrusted with the administrative enforcement in question, and their review procedures must include the right of appeal. To date, little information is publicly available regarding the frequency or outcomes of review before these tribunals.

China also committed, at all levels of government, to apply, implement and administer all of its laws, regulations and other measures relating to trade in goods and services in a uniform and impartial manner throughout China, including in special economic areas. In connection with this commitment, in 2002, China also established an internal review mechanism, now overseen by MOFCOM's Department of WTO Affairs, to handle cases of non-uniform application of laws. The actual workings of this mechanism remain unclear, however.

Commercial Dispute Resolution

Both foreign and domestic companies often avoid seeking resolution of commercial disputes through the Chinese courts, as skepticism about the independence and professionalism of China's court system and the enforceability of court judgments and awards remains high. There is a widespread perception that judges, particularly outside of China's big cities, are subject to influence by local political or business pressures. Most judges are not trained in the law and/or lack higher education, although this problem decreases at the higher levels of the judiciary.

At the same time, the Chinese government is moving to establish consistent and reliable mechanisms for dispute resolution through the adoption of improved codes of ethics for judges and lawyers and increased emphasis on the consistent and predictable application of laws. The Judges' Law, issued by the Standing Committee of the National People's Congress in 1995, requires judges to have degrees in law or in other subjects where they have acquired specialized legal knowledge, and permits judges appointed before the law's implementation who do not meet these standards to undergo necessary training. In 1999, the Supreme People's Court began requiring judges to be appointed based on merit and educational background and experience, rather than through politics or favoritism. In 2002, the Supreme People's Court issued rules designating certain higher-level courts to hear cases involving administrative agency decisions relating to international trade in goods or services or intellectual property rights. According to the Supreme People's Court, China's more experienced judges sit on the designated courts, and the geographic area under the jurisdiction of each of these designated courts has been broadened in an attempt to minimize local protectionism. The rules provide that foreign or Chinese enterprises and individuals may bring lawsuits in the designated courts raising challenges, under the Administrative Litigation Law, to decisions made by China's administrative agencies relating to international trade matters. The rules also state that when there is more than one reasonable interpretation of a law or regulation, the courts should choose an interpretation that is consistent with the provisions of international agreements to which China has committed, such as the WTO rules.

Despite initial enthusiasm, foreign observers have grown increasingly skeptical of the China International Economic and Trade Arbitration Commission (CIETAC) as a forum for the arbitration of trade disputes. Some foreign firms have obtained satisfactory rulings from CIETAC but other firms and legal professionals have raised concerns about restrictions on the selection of arbitrators and inadequacies in procedural rules necessary to ensure thorough, orderly and fair management of cases.

Finally, in cases where the judiciary or arbitration panels have issued judgments in favor of foreign-invested enterprises, enforcement of the judgments has often been difficult. Officials responsible for enforcement are often beholden to local interests and unwilling to enforce court judgments against locally powerful companies or individuals.

Labor Issues

In recent years, China has expanded the scope of its national labor laws and regulations so they now cover most, though not all, key labor areas. Even with these changes, China does not adhere to certain internationally recognized labor standards, such as the rights of freedom of association and collective bargaining. In addition, critics allege that China's household registration system is equivalent to a form of forced or compulsory labor, and there are many reports indicating that China does not enforce its laws and regulations concerning minimum wages, hours of work and occupational safety and health. There are also persistent concerns about the use of prison labor and child labor.

The Chinese government is slowly developing nationwide pension, unemployment insurance, medical insurance and workplace injury insurance systems that require substantial employer contributions. These systems are still rudimentary and characterized by serious funding shortfalls, in part due to widespread non-compliance among domestic firms. There is also inconsistent application and enforcement of labor regulations between Chinese-owned enterprises and foreign-invested enterprises.

The cost of labor, especially unskilled labor, is low in much of China. The existence of a large pool of surplus rural workers, many of whom seek work in urban areas, helps to keep unskilled wages low. Some companies offering substandard wages and working conditions have experienced shortages of unskilled labor. Where competition for workers is intense and the supply limited, as in the case of technical, managerial and professional staff in China's coastal areas, wages can be higher. However, restrictions on labor mobility distort labor costs. China is gradually easing restrictions under the country's household registration system, which has traditionally limited the movement of workers within the country, in part due to the recognition that labor mobility is essential to the continued growth of the economy.

In 2005, the China National Textile and Apparel Council established the Committee for the Promotion of Corporate Social Accountability System for Chinese Textile Enterprises (CSC9000T). Reportedly, increasing numbers of Chinese firms have realized the importance of social accountability, but remain confused about the various foreign corporate social accountability standards and certifications bodies that exist. The council

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formed CSC9000T to formulate Chinese corporate social responsibility standards to promote among Chinese firms. The standards are based on relevant Chinese legislation and regulations and reference international practices. To date, 160 council members have adopted these standards. This year, the committee will focus its efforts on promoting the adoption of these standards, conducting surveys on standards implementation, increasing communication with international buyers and providing training opportunities.

Corruption

Many people expected that China's entry into the WTO, which mandated a significant reduction in tariffs, would in turn reduce incentives for smuggling-related corruption. While WTO membership has increased China's exposure to international best practices and resulted in some overall improvements in transparency, corruption remains endemic. Chinese officials themselves admit that corruption is one of the most serious problems the country faces, and China's new leadership has called for an acceleration of the country's anti-corruption drive with a focus on closer monitoring of provincial-level officials. According to the most recently available information from Chinese state media sources, in 2004, Chinese prosecutors caught more than 42,000 officials for corruption and other offenses, reflecting a rise of one percent from 2003. Official graft was a leading offense, with prosecutors recovering a total of RMB 3.8 billion (\$456 million) of misappropriated and embezzled funds.

In July 2004, China implemented a new *Administrative Licensing Law*. This law is designed to increase transparency in the licensing process, an area that has long served as a source of official corruption. This law seeks to ensure the reasonable use of administrative licensing powers, to protect the interests of corporations and individuals, and to promote efficient administrative management by requiring government agencies to set up special offices for issuing licenses and to respond to applications within 20 days. It is too early to judge the effectiveness of this law. While some reports suggest that it has resulted in the removal of many unnecessary administrative licensing requirements, some agencies have been reluctant to implement the law and have continued to administer their licensing powers in ways that appear to conflict with the requirements of the law.

China issued its first law on unfair competition in 1993, and the central government continues to call for improved self-discipline and anti-corruption initiatives at all levels of government. While the central government in recent years has pledged to begin awarding contracts solely on the basis of commercial criteria, it is unclear how quickly and to what extent the government will be able to follow through on this commitment. U.S. suppliers complain that the widespread existence of unfair bidding practices in China puts them at a competitive disadvantage. This dilemma is less severe in sectors where the United States holds clear technological or cost advantages. Corruption nevertheless undermines the long-term competitiveness of both foreign and domestic entities in the Chinese market.

Land Issues

China's constitution specifies that all land is owned in common by all the people. In practice, agricultural collectives, under the firm control of local Communist Party chairmen, distribute agricultural land to the rural poor, while city governments distribute land for residential and industrial use. The State and collectives can either "grant" or "allocate" land use rights to enterprises in return for payment of fees. Enterprises granted land-use rights are guaranteed compensation if the State asserts eminent domain over the land, while those with allocated rights are not. Granted land-use rights cost more, not surprisingly, than allocated rights. However, the law does not define standards for compensation when eminent domain supercedes granted land-use rights. This situation creates considerable uncertainty when foreign investors are ordered to vacate. The absence of public hearings on planned public projects, moreover, can give affected parties, including foreign investors, little advance warning.

The time limit for land-use rights acquired by foreign investors for both industrial and commercial enterprises is 50 years. A major problem for foreign investors is the array of regulations that govern their ability to acquire land-use rights. Local implementation of these regulations may vary from central government standards, and prohibited practices may occur in one area while they are enforced in another. Most wholly-owned foreign enterprises seek granted land-use rights to state-owned urban land as the most reliable protection for their operations. Chinese-foreign joint ventures usually attempt to acquire granted land-use rights through lease or contribution arrangements with the local partners.

China's current rural land law, which took effect in 2003, gives peasants fixed contracts for periods of 30 to 50 years, and permits peasants to exchange or rent out their land-use rights while their use contract remains in force. There is no immediate prospect for changing from land-use rights to direct ownership of rural land. However, since 2004, the leadership has pressed for sturdier land rights for farmers along with stricter controls over the legal process for converting farmland from agricultural to industrial or residential use. Local governments are no longer supposed to expropriate land for commercial use, as farmers are now supposed to be able to negotiate a compensation price for land directly with commercial users. However, implementation of these provisions lags.

COLOMBIA

TRADE SUMMARY

The U.S. goods trade deficit with Colombia was \$3.4 billion in 2005, an increase of \$680 million from \$2.8 billion in 2004. U.S. goods exports in 2005 were \$5.4 billion, up 20.2 percent from the previous year. Corresponding U.S. imports from Colombia were \$8.8 billion, up 21.9 percent. Colombia is currently the 28th largest export market for U.S. goods.

The stock of U.S. foreign direct investment (FDI) in Colombia in 2004 was \$3.0 billion, the same as in 2003. U.S. FDI in Colombia is concentrated largely in the manufacturing, mining, and wholesale sectors.

FREE TRADE NEGOTIATIONS

In May 2004, the United States initiated free trade negotiations with Colombia, Ecuador, and Peru. To date, the United States has concluded free trade agreements with Peru and Colombia. Negotiations with Ecuador will resume in late March 2006. Bolivia has participated as an observer and could become part of the agreement at a later stage. The United States has significant economic ties to the region. Total two-way goods trade with the Andean countries of Peru, Colombia, and Ecuador was approximately \$24 billion in 2004. The stock of U.S. foreign direct investment in these countries in 2004 was \$7.7 billion.

IMPORT POLICIES

Tariffs

Colombia has opened its economy considerably since the early 1990s. Customs duties were cut and many non-tariff barriers eliminated. Most duties have been consolidated into three tariff levels: 0 percent to 5 percent on capital goods, industrial goods, and raw materials not produced in Colombia; 10 percent on manufactured goods with some exceptions; and 15 percent to 20 percent on consumer and “sensitive” goods.

Some important exceptions include automobiles, which are subject to a 35 percent tariff, and agricultural products, which fall under a variable “price-band” import duty system. The price band system includes 14 product groups and covers 154 tariff lines, which at times results in duties approaching or exceeding 100 percent for important U.S. exports to Colombia, including corn, wheat, rice, soybeans, pork, poultry, cheeses and powdered milk, and negatively affects U.S. access for products such as dry pet food, some of which is made from corn. When international prices surpass the price-band ceiling, tariffs are reduced; when prices drop below the price-band floor, tariffs are raised.

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The price-band system has affected local competitiveness and has dampened consumption by raising prices and is a barrier to U.S. exports. Processed food imports from Chile and members of the Andean Community (Peru, Ecuador, Bolivia, and Venezuela) enter duty free.

In the free trade agreement concluded between the United States and Colombia, the United States obtained market access for U.S. consumer and industrial products and new opportunities for U.S. farmers and ranchers. Over eighty percent of U.S. exports of consumer and industrial products to Colombia will become duty-free immediately, with remaining tariffs phased out over 10 years. U.S. farm exports to Colombia that will receive immediate duty-free treatment include high quality beef, cotton, wheat, soybeans, soybean meal; key fruits and vegetables including apples, pears, peaches, and cherries; and many processed food products including frozen french fries and cookies. U.S. farm products that will benefit from improved market access include pork, beef, corn, poultry, rice, fruits and vegetables, processed products, and dairy products.

Non-Tariff Measures

Non-tariff barriers in Colombia include discretionary import licensing, which is used to ban imports of milk powder and poultry parts. Colombia removed the “absorption” requirements for all remaining agricultural products at the end of 2003, when the WTO waiver allowing them to link imports to local purchases expired. The Colombian government replaced this system with tariff-rate quotas for rice, yellow corn, white corn and cotton, and a requirement to purchase local production in order to import under the tariff-rate quota. The United States Government addressed a significant number of Colombia’s barriers to trade in U.S. agricultural products during the free trade negotiations.

Colombia treats remanufactured goods as used goods, thereby limiting the market access for major U.S. makers of high-quality remanufactured goods. Colombia assesses a value-added tax (VAT) of 35 percent on whiskey aged for less than twelve years, which is more characteristic of U.S. whiskey, compared to a rate of 20 percent for whiskey aged for twelve or more years, most of which comes from Europe. Colombia also assesses a consumption tax on beverage alcohol by a system of specific rates per degree (percentage point) of alcohol strength. This tax regime discriminates against imported distilled spirits through arbitrary breakpoints that have the effect of applying a lower tax rate per degree of alcohol to domestically produced spirits. For example, locally produced spirits are dominated by *aguardiente* bottled at 35 percent alcohol-by-volume (a.b.v.) or less. By law, most categories of distilled spirits that tend to be imported and all whiskies in Colombia must have a minimum alcohol content of 40 percent a.b.v., while local producers of *aguardiente* have a significantly lower tax burden because (a) their products contain less alcohol by volume, and (b) each unit of that alcohol is taxed at a lower rate.

Several Colombian states are engaged in practices that have restricted the ability of U.S. distilled spirits companies to conduct business in Colombia. For example, some states mandate the minimum quantity of a specific distilled spirit brand that a company must sell during the year. If a company does not meet the minimum sales requirement, the company is fined or its sales contract is revoked in that particular state. Some states also mandate the minimum price at which imported spirits may be sold. In certain cases, the minimum price is set above the price at which imported products can be sold competitively in the market. Other measures that are applied only to importers of distilled spirits include: assessment of a 7.5 percent tax on all contracts based on the minimum volume to be sold in the state; a requirement to share a percentage of profits with the state; and payment of a federal excise tax upon entry into Colombia instead of after the first sale as domestic producers are allowed to do.

According to the Ministry of Industry, Trade and Tourism, under Decision 337 of 1993, imports of used clothing are not permitted in Colombia. Certain importers of used goods may apply for licenses to bring products into Colombia under limited circumstances. These licenses are granted at the discretion of the Ministry of Industry, Trade and Tourism. Industry reports that in practice approval is not granted, resulting in the effective prohibition of these imports. U.S. officials continue to monitor the situation in the context of the World Trade Organization's (WTO) Import Licensing Committee.

In December 2005, Colombia enacted a decree that establishes various new restrictions on importers of textiles and apparel, and footwear. These new restrictions include: 1) requiring the importer to present a list of suppliers, buyers, and clients to Colombian Customs; 2) advising Colombian Customs of any change to this list within 15 days of signing a contract; 3) restricting an importer to import goods in no more than 10 tariff subheadings; and 4) restricting imports to 200 percent in value of the importer's net worth, among numerous other restrictions on importation.

The United States addressed these and other non-tariff barriers during the free trade negotiations with Colombia. As a result of the negotiations, for example, Colombia agreed to allow trade in remanufactured goods and join the WTO Information Technology Agreement.

STANDARDS, TESTING, LABELING AND CERTIFICATION

Regarding pet food, Colombia requires companies not only to list the ingredients but the percentage of those ingredients on their products, which U.S. companies declare as proprietary information. In some cases, sanitary and phytosanitary (SPS) measures have been implemented to restrict U.S. exports. For example, Colombia has maintained restraints on U.S. exports of cattle and beef that do not appear to be consistent with the Office of International Epizootics (OIE) recommendations. Since December 2003, U.S. beef has been banned in Colombia on the basis of Bovine Spongiform Encephalopathy (BSE).

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However, this ban continues to be enforced without adequate scientific justification. U.S. companies retailing nutritional supplements in Colombia continue to experience problems due to the lack of legislation that establishes clear parameters for sanitary registration. Colombia does not have a specific classification for nutritional supplements.

Through the free trade negotiations, the United States and Colombia have worked to resolve sanitary and phytosanitary barriers to agricultural trade, including on food safety inspection procedures for beef, pork, and poultry.

For textile products, Colombia requires that in addition to the name of the producer, the name of the importer also be included on the label. Industry reports that such information is difficult if not impossible to know during the manufacturing process when permanent labels are attached. Re-labeling of products upon entry to meet these requirements results in additional costs and delays.

GOVERNMENT PROCUREMENT

Government procurement is the main public spending instrument used by the Government of Colombia (GOC) and represents approximately 16 percent of the GDP according to the GOC. The Government Procurement and Contracting Law, Law 80/93 established procedures for the selection of suppliers, mainly through public tenders. In order to qualify as a potential supplier to the Government of Colombia, foreign firms must register with the local chamber of commerce and appoint a local representative. Registration must be renewed annually and includes certification of experience, finances, technical expertise, and organization. The certifications are used to qualify and classify suppliers based on “bona fide” criteria. The registration requirements make the process particularly costly for foreign firms, which need to demonstrate a commercial presence in Colombia to participate in government procurement.

A drawback of Law 80 is the absence of fully explained exemption regimes resulting in investor uncertainty. The private sector has complained of lack of transparency, inefficiency and lack of credibility in government procurement processes. This has led the Colombian Congress to study possible reforms to Law 80, which would introduce measures to ensure transparency and efficiency, and would eliminate some of the exception regimes. The possible changes to Law 80 currently being studied by Congress include:

- Making records of government procurement contracts publicly available;
- Providing for public announcements of contract authorizations;
- Implementation of an electronic system for integral government procurement;
- Removal of subjective factors from the selection process;
- Providing for publication of all reference terms;
- Government procurement agreements financed with funds from cooperation or multilateral institutions shall be subject to the rulings of such entities; and
- Direct hiring (to which government procurement rules do not apply) shall be performed only for agreements involving national defense, the provision of

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health services by government entities and those low-value agreements involving low budget quantities.

Congress has postponed reforming Law 80 on at least four occasions in the last two years for two reasons: a lack of political will; and the demands of reforms in other areas, for example pensions, reelection, peace and justice law. Congress began studying possible reforms to Law 80 again in early September 2005.

The private sector has complained of lack of transparency with respect to the awarding of major government contracts. In response to these complaints, the Colombian government has taken positive steps to fight corruption by working with non-governmental organizations to launch probity programs aimed at promoting entrepreneurial and public ethics. In May 2005, the office of the Vice President issued the *Manual for Good Practices in Government Procurement*, aimed at strengthening government procurement practices and eliminating corruption in the awarding of contracts.

In July 2003, the Colombian government promulgated Law 816 to protect national industries in government procurement. Law 816 mandates that all public entities adopt criteria that support national industries and accords preferential treatment to bids that incorporate Colombian goods or services. Under Law 816, national companies are given a 10 to 20 percent “bonus” in their evaluation score, and companies using Colombian goods or services are given a 5 percent to 15 percent “bonus.” Bids without any local content component are scored between 5 percent and 20 percent lower than bids with such a component. Additionally, Law 816 requires that foreign suppliers without local headquarters in Colombia obtain certification from a Colombian mission in the suppliers’ home country, and that government procurement laws in the suppliers’ home country meet reciprocity requirements. To date, this new system, and specifically the lack of an established certification process, has proven to be a barrier against the participation of U.S. suppliers in government procurement contracts.

Colombia is not a signatory of the WTO Agreement on Government Procurement, but is an observer to that agreement. According to industry analysts, the elimination of barriers in the government procurement sector could yield an increase of U.S. exports in the range of \$100 million to \$500 million.

Under the free trade agreement concluded between the United States and Colombia, Colombia agreed to grant U.S. suppliers non-discriminatory rights to bid on contracts from a broad range of Colombian government ministries, agencies, public enterprises, and regional governments. The United States and Colombia agreed to terms that require the use of fair and transparent procurement procedures, such as advance notice of purchases and timely and effective bid review procedures.

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EXPORT SUBSIDIES

Colombia has been working to eliminate export subsidies since its GATT accession. This process has continued under the WTO Agreement on Subsidies and Countervailing Measures.

Free zones are geographic areas where industrialization processes are promoted through special customs, tax, and foreign exchange regimes. Users of free zones are exempt from income tax, import tariffs and value-added tax on imports, and have access to special credit lines offered by Colombia's foreign trade bank (Bancoldex). In compliance with its obligations under the WTO, the Colombian government announced it would phase out all export subsidies in free trade zones by December 31, 2006. However, free trade zones and special import-export zones will maintain their special customs and foreign exchange regimes. In September 2005, the Colombian government presented a bill to Congress that, if approved, would impose a 25 percent income tax on free zones (lower than the normal 35 percent tax) after December 31, 2006, and would maintain the exemption on the 7 percent remittance tax for free zones in the country.

An export subsidy, known as the "Plan Vallejo," allows for duty exemptions on the import of capital goods and raw materials used to manufacture goods that are subsequently exported. In order to qualify for this tax exemption, in the case of capital goods, the producer must show that at least 70 percent of the volume of product produced by the newly imported capital good will be exported. In the case of raw or partially finished materials, the producer must export a value equal to 1.5 times that of the value of the imported materials as valued upon their entry by Colombian government customs. In July 2004, the Colombian government proposed to eliminate the "Plan Vallejo" by December 31, 2006 in the hopes that a free trade agreement between Colombia and the United States would be in place and provide for duty free importation of many capital goods. Currently, 76 percent of Colombia's exports benefit from the "Plan Vallejo" program.

Colombia also operates producer financed export subsidies under "price stabilization" funds for sugar, palm oil, beef, and dairy. The exports under the sugar and palm oil funds are in excess of Colombia's WTO export subsidy commitments of 223,608 tons for sugar and zero for palm oil. In December 2004, the government granted export subsidies for exporters of bananas and flowers to hedge their exchange rate risk, with an estimated fiscal cost of less than 0.1 percent of GDP (approximately \$65.6 million).

The eligibility period for this subsidy expired on February 28, 2005. After this date, the government affirmed that it would not grant any further export subsidies, but may seek other options to assist the agricultural sector within its budget constraints. However, in September 2005, the Minister of Agriculture announced that the government was seeking resources for further export subsidies in 2006. As part of this initiative, the Ministry of Agriculture created the Rural Capitalization Incentives, consisting of direct subsidies to agricultural producers who make new investments directed at modernizing their production for international markets.

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The amount of the subsidy is 20 percent of the value of the new investment for large producers and 40 percent for small producers, up to a maximum of 150 monthly minimum salaries or approximately \$20,000.

INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

Colombia has been on the Special 301 “Watch List” every year since 1991. Key concerns include lax customs enforcement and the inability to conclude legal cases against individuals arrested for trafficking or producing counterfeit goods. Colombia, as a member of the WTO, has ratified legislation to implement its obligations under the Uruguay Round Agreement on Trade-Related Aspects of Intellectual Property Rights. Colombia is a member of the World Intellectual Property Organization (WIPO), the Paris Convention for the Protection of Industrial Property, the Berne Convention for the Protection of Literary and Artistic Works, the WIPO Copyright Treaty, the WIPO Performances and Phonograms Treaty, the Treaty on the International Registration of Audiovisual Works, the 1978 Act of the International Union for the Protection of New Varieties of Plants, and the Patent Cooperation Treaty.

In Colombia, the grant, registration, and administration of intellectual property rights (industrial property and copyright) are carried out by four different government entities. The Superintendence of Industry and Commerce (SIC) acts as the Colombian patent and trademark office. This agency was given control of the government’s IPR policy effective January 2000. The agency suffers from inadequate financing and personnel, a high turnover rate, and a large backlog of trademark and patent applications, which has led to a large number of appeals.

The patent office at the Superintendence believes that the number of new patent and trademark applications (currently 1,600 patent and 15,000 trademark requests per year) will double in the next two or three years, without considering the obvious increase in applications that the signing of a free trade agreement with the United States will produce. This will necessarily increase the already large backlog of applications. Although the SIC is making efforts to provide electronic registration services for patents, industrial designs and trademarks, it still has important deficiencies especially in personnel, with only 16 patent examiners for the whole country.

The Colombian Agricultural Institute (ICA) is in charge of the issuance of plant variety protection and agro-chemical patents. The Ministry of Social Protection is in charge of the issuance of pharmaceutical patents, while the Ministry of Justice is in charge of the issuance of literary copyrights.

Each of these entities suffers from significant financial and technical resource constraints. Moreover, the lack of uniformity and consistency in IPR registration and oversight procedures limits the transparency and predictability of the IPR enforcement regime.

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The free trade agreement concluded between the United States and Colombia provides for improved standards for the protection and enforcement of a broad range of intellectual property rights, which are consistent with both U.S. standards of protection and enforcement and with emerging international standards. Such improvements include state-of-the-art protections for digital products such as U.S. software, music, text, and videos; stronger protection for U.S. patents, trademarks and test data, including an electronic system for the registration and maintenance of trademarks; and further deterrence of piracy and counterfeiting by criminalizing end-use piracy.

Copyrights

Andean Community Decision 351 on the protection of copyrights has been in effect in Colombia since January 1, 1994. Colombia also has a modern copyright law: Law 44 of 1993. The law extends protection for computer software to 50 years, but does not classify it as a literary work. Law 44 and Colombia's civil code includes some provisions for IPR enforcement and have been used to combat infringement and protect copy rights.

Patents and Trademarks

The patent regime in Colombia currently provides for 20-year protection for patents and a 10-year term for industrial designs. Provisions covering protection of trade secrets and new plant varieties have improved Colombia's compliance with its TRIPS obligations. However, U.S. companies are concerned that the Colombian government does not provide patent protection for new uses of previously known or patented products.

In 2002, the Colombian government issued Decree 2085, which improved the protection of confidential data. Until 2002, the Government of Colombia health authorities approved the commercialization of new drugs that were the bioequivalent of already-approved drugs, thereby denying the originator companies the exclusive use of their data. Decree 2085 prohibited this practice for a limited time, thus providing improved protection for industrial information. Under the decree, data presented for health certification of pharmaceuticals is protected for a period of three years for registrations issued in 2002, four years in 2003, and five years in 2004 and beyond. Colombia remains the only Andean country with such protection. In March 2003, the Agricultural Ministry promulgated Decree 502 that provides similar protection for agricultural chemicals. However, the subsequent passage of Law 822 on July 10, 2003, established additional norms in relation to the registration, control and sale of generic agrochemicals, which along with the related Resolution 770 of March 27, 2003, appears to significantly weaken the data protections established by Decree 502.

Counterfeit pharmaceutical products continue to be a major problem in Colombia. Recent surveys, such as the CRECER project, reveal that in rural areas there are more counterfeit pharmaceutical products than original products. The CRECER project found that 10 percent of these counterfeit products are identical to the original product, while 60 percent do not contain any active ingredient and 30 percent contain the wrong active ingredient or the wrong dosage.

In 2004, the National Institute for the Vigilance of Medications (INVIMA) seized 700 tons of counterfeited food, liquors, and pharmaceuticals with a value of approximately \$2.6 million.

Colombia is a member of the Inter-American Convention for Trademark and Commercial Protection. Enforcement of trademark rights legislation in Colombia is showing some progress, but contraband and counterfeiting are widespread.

Enforcement

Colombia's Criminal Code of 2001 included copyright infringement as a crime and significantly increased jail terms from three to five years. The code also contains provisions concerning technological protection measures and rights management information, both key obligations of the WCT and WPPT treaties. Colombia has also created a Special Investigative Unit within the Prosecutor General's Office dedicated to intellectual property rights issues. This unit began operations in November 1999 and is currently working on approximately 60 cases on different issues including trademark usurpation, counterfeit pharmaceuticals, pirated books, CD's, and movies, violations to industrial secrecy, and cases against broadcasters of pirated television programming.

The International Intellectual Property Alliance estimates that in 2005 piracy levels in Colombia for recorded music reached 71 percent, with damage to U.S. industry estimated at about \$48 million. Motion picture piracy represented 75 percent of the market, with an estimated loss of \$40 million. Piracy in both business software and book publishing continued to grow in 2004. According to the Business Software Alliance (BSA), piracy in business software amounted to \$44.8 million in 2005, with a 55 percent piracy level. Although the Colombian police have conducted raids, the judicial process is slow and cumbersome, and fails to incarcerate copyright infringers.

The Motion Picture Association of America (MPAA), in conjunction with local attorneys, took 17 criminal actions against alleged television pirates in 2000, 16 such cases in 2001, and 8 in 2002. However, MPAA's anti-piracy strategy relied on enforcement by the Colombian National Television Commission (CNTV), which largely failed in its efforts. Given the CNTV's poor results in suppressing piracy, MPAA has ceased initiating action against television broadcast or home video piracy.

Colombia's Television Broadcast Law increased legal protection for all copyrighted programming by regulating satellite dishes, and enforcement has begun through a licensing process. However, an MPAA estimate suggests that 75 percent of the motion picture market in Colombia is pirated, while annual losses due to audiovisual piracy remained at \$40 million in 2004. In 2004, CNTV launched an aggressive anti-piracy campaign and signed its first cooperation agreement with FOX Sports to combat piracy in the television market. In view of such efforts, the International Intellectual Property Alliance (IIPA) has acknowledged progress in combating television piracy in the last year in Colombia, although administrative enforcement against signal theft piracy still needs improvement.

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SERVICES BARRIERS

Liberalization has progressed furthest in telecommunications, auditing, and energy. It has occurred to a lesser extent in accounting, tourism, legal services, insurance, distribution services, advertising, and data processing. The provision of legal services is limited to law firms licensed under Colombian law. Foreign law firms can operate in Colombia only by forming a joint venture with a Colombian law firm and operating under the licenses of the Colombian lawyers in the firm.

Economic needs tests are required for foreign providers of professional services to operate temporarily in Colombia. Moreover, residency requirements restrict trans-border trade of certain professional services, such as accounting, bookkeeping, auditing, architecture, engineering, urban planning, and medical and dental services. For firms with more than ten employees, no more than 10 percent of the general workforce and 20 percent of specialists may be foreign nationals. A commercial presence is required to provide information processing services. Foreign educational institutions must have resident status in Colombia in order to receive operational authority from the Ministry of Education.

Trans-border transportation services are restricted in Colombia. Land cargo transportation must be provided by natural or legal persons with commercial presence in the country and licensed by the Ministry of Transportation. Colombia's law permits international companies to provide cabotage services (i.e., transport between two points within Colombian territory) "only when there is no national capacity to provide the service." Cargo reserve requirements in transport have been eliminated. However, the Ministry of Foreign Trade reserves the right to impose restrictions on foreign vessels of those nations that impose reserve requirements on Colombian vessels.

Colombia permits 100 percent foreign ownership of insurance firm subsidiaries. It does not, however, allow foreign insurance companies to establish local branch offices. Insurance companies must maintain a commercial presence in order to sell policies other than those for international travel or reinsurance. Colombia denies market access to foreign maritime insurers.

International banking institutions are required to maintain a commercial presence in Colombia through subsidiary offices and therefore, must comply with the same capital and other requirements as local financial institutions. Colombian legislation has limits on the operation of banks and other financial institutions by separating fiduciary, investment banking, commercial loans, leasing and insurance services, from banking services. Current legislation (Law 389 of 1997) permits banking institutions to develop such activities in the same office/building, but the management of such services must be separate. Colombian legislation permits 100 percent foreign ownership in financial services, although the use of foreign personnel in the financial services sector remains limited to administrators, legal representatives and technicians. In April 2000, the Central Bank completely removed previous reserve requirements on foreign borrowing operations.

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Further constraints on foreign financial institutions are found in Decree 2951, dated September 13, 2004. This decree requires foreign institutions to establish a commercial presence if their promotions target Colombian residents. A banking relationship with a Colombian resident and a financial entity abroad is permitted if the relationship was initiated by the Colombian resident without any publicity or promotion in Colombian territory. Industry experts estimate that the elimination of trade barriers in the financial services sector could create opportunities for U.S. firms to achieve \$100 million to \$500 million in sales.

Significant barriers to entry in telecommunications services include high license fees (\$150 million for a long distance license), commercial presence requirements, and economic needs tests. The Telecommunications Regulatory Commission (CRT) may require an economic needs test for the approval of licenses in voice, facsimile, e-mail and other value-added services. However, the parameters that determine an “economic needs test” are not clearly established. In addition, lack of transparency in the interconnection and trunk access policies, and guidelines applied by the regulatory authority further limit competition for the provision of local, long distance, and mobile services.

In the WTO negotiations on basic telecommunications services, Colombia made fairly liberal commitments on most basic telecommunications services and adopted the WTO reference paper. However, Colombia specifically prohibited “callback” services and excluded fixed and mobile satellite systems. Colombia also limited licenses or concessions for the supply of telecommunications services to enterprises legally established in Colombia. Most other restrictions on foreign participation in telecommunications services have been lifted and Colombia currently permits 100 percent foreign ownership of telecommunications providers.

In 2003, Colombia opened its mobile telecommunications market to Personal Communications Services (PCS) competition. The government issued a PCS license to new competitor Colombia Movil, effectively ending Colombia’s mobile telecommunications duopoly and opening the door for competition (Telefonica and Comcel share approximately 80 percent of the mobile market). Colombia Movil received a 10-year concession to develop the market and compete against the current cellular providers. Two municipality-owned telephone companies, ETB (Empresa de Telecomunicaciones de Bogota) and EPM (Empresas Publicas de Medellin), own Colombia Móvil.

The free trade agreement concluded between the U.S. and Colombia provides for an open and competitive telecommunications market in Colombia. Users of Colombian telecom networks are guaranteed reasonable and nondiscriminatory access to the network. This prevents local firms from having preferential or “first right” of access to telecom networks. U.S. phone companies obtained the right to interconnect with Colombian dominant suppliers’ fixed networks at nondiscriminatory and cost-based rates.

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As part of the de-monopolization of Colombia's government-owned television network, Colombia passed the Television Broadcast Law, Law 182/95, effective January 1995, which increased protection for all copyrighted programming by regulating satellite dishes and permitting private television broadcasters to compete with the government-owned broadcaster. The law increased restrictions on foreign content in broadcasting and imposed a burdensome system of sub-quotas for different hours of the day. The law requires broadcasters to transmit 70 percent nationally produced programming during prime time (7:00 p.m. to 10:30 p.m.), and 50 percent nationally produced programming from 10:00 a.m. to 7:00 p.m. and between 10:30 p.m. and midnight. Regional and local stations must also transmit 50 percent of nationally produced programming.

According to Law 680, national production is defined as production that is made in all stages by Colombian artists and technicians, with the participation of national actors in starring and supporting roles, while foreign actors' participation is allowed as long as it does not exceed 10 percent of the starring roles. Retransmissions of local productions are considered to fulfill only part of the national content requirement.

Television, radio broadcasting, and movie production and reproduction are subject to certain limitations. According to Law 680 and Law 80 of 1993, ownership by foreign operators is limited to 40 percent for broadcast television and 25 percent for radio broadcast. Law 29 of 1944 requires Colombian nationals to be directors and managers of newspapers concerned with domestic politics. All motion picture exhibitions are charged a tax to finance the national Cinematographic Development Fund. Seventy percent of the resources from the Cinematographic Development Fund must be used to promote national film productions.

In the free trade agreement concluded between the United States and Colombia, Colombia accorded substantial market access across their entire services regime, including financial services. Colombia agreed to eliminate measures that require U.S. firms to hire national rather than U.S. professionals and to phase-out market restrictions in cable television. Colombia also agreed that both mutual funds and pension funds in its territory will be allowed to use portfolio managers in the United States.

INVESTMENT BARRIERS

Colombian law currently requires that foreign investments be accorded national treatment. One hundred percent foreign ownership is permitted in most sectors of the Colombian economy. Exceptions include activities related to national security and the disposal of hazardous waste. Investment screening has been eliminated, and the registration requirements that still exist are generally mere formalities. In the telecommunications, financial services, oil and mining sectors, for example, prospective foreign investors must comply with certain registration procedures, but there are no restrictions on the amount of foreign capital that may be invested in these sectors. All foreign investment must be registered with the Central Bank's foreign exchange office within three months in order to ensure the right to repatriate profits and remittances.

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All foreign investors, like domestic investors, must obtain a license from the Superintendent of Companies and register with the local chamber of commerce.

To promote the discovery and exploitation of new oil reserves, the government changed royalties from a flat 20 percent to a sliding scale, from 8 percent to 25 percent, depending on the size of the field. Colombia also implemented in June 2003 a new hydrocarbon policy, Law 1760, designed to attract foreign oil companies to Colombia. The new policy eliminated Ecopetrol's mandatory share in joint ventures, allowed private companies 100 percent control of exploration and production projects, and restructured Ecopetrol by creating the National Hydrocarbon Agency (ANH). Although Ecopetrol is still state-owned, it is now an operating company similar to any other commercial hydrocarbon companies. The ANH regulates the hydrocarbon sector and issues exploration and production contracts. The government is also extending existing contracts on a case-by-case basis. In early November 2005, the ANH established a requirement that companies or joint ventures interested in signing exploration/exploitation agreements with Colombia should be considered "capable." This means that operators of such contracts must prove a minimum of five years of experience at the time of the proposal, or the joint venture partners must prove a minimum of ten years of experience at the time of the exploration/exploitation proposal.

Colombian television broadcast laws (Law 182/95 and Law 375/96) impose several restrictions on foreign investment. For example, foreign investors must be actively engaged in television operations in their home country, and their investments must involve a transfer of technology or know how. The National Planning Department issued a new Foreign Investment Regime – Decree 2080 of October 18, 2000 – that increased the cap on foreign investment in television network and programming companies from 15 percent to 40 percent.

In August 2005, the government issued Law 963, which authorizes the conclusion of legal stability agreements between foreign or local investors and the Colombian government. Under a stability agreement, the Colombian government promises not to change the tax and regulatory treatment applicable to an investor for periods of between 3 and 20 years. All foreign and local investors with new investments of at least one million dollars after the issuance of the law are eligible for stability agreements with the Colombian government. Such agreements may be signed in most sectors of the Colombian economy including manufacturing, agriculture, tourism, mining, petroleum, telecommunications, construction, transportation, energy, and others. Stability agreements are subject to a 1 percent fee on the annual value of new investments.

In late October of 2005, the Social and Economic Policy Council approved a reform to the Colombian Foreign Investment Statute (Decree 2080 of 2000) allowing foreign investors to use local financing resources (local credit) for the purchasing of securities in the Colombian stock market. This practice, which was previously prohibited, will be permitted after the Government of Colombia issues a regulatory decree on the matter.

FOREIGN TRADE BARRIERS

The United States obtained strong protections for U.S. investors during the free trade negotiations with Colombia. The agreement establishes a stable legal framework for U.S. investors operating in Colombia. All forms of investment are protected under the agreement. U.S. investors will enjoy in almost all circumstances the right to establish, acquire, and operate investments in Colombia in an equal footing with local investors. Investor protections will be backed by a transparent, binding international arbitration mechanism.

ELECTRONIC COMMERCE

Banking and financial services organizations have been at the forefront of e-commerce development in Colombia. For example, Colombia's stock exchange and its member banks and brokerages were quick to shift from floor-driven trading to remote private Internet-based electronic trading networks - and were likewise quick to introduce e-banking and e-brokerage systems for their clients. This trend continues today, with a heightened focus on strengthening security and industry-wide self-regulatory capabilities, ensuring data privacy and adding to e-banking, brokerage data, and transaction systems capabilities.

The United States and Colombia agreed to provisions on e-commerce in the free trade negotiations that commit all parties to non-discriminatory treatment of digital products. The parties agreed not to impose customs duties on digital products transmitted electronically and to cooperate in numerous policy areas related to e-commerce. Additionally, the agreement requires procedures for resolving disputes about trademarks used in Internet domain names.

COSTA RICA

TRADE SUMMARY

The U.S. goods trade balance with Costa Rica went from a trade deficit of \$27.4 million in 2004 to a trade surplus of \$177 million in 2005. U.S. goods exports in 2005 were \$3.6 billion, up 8.8 percent. Corresponding U.S. imports from Costa Rica were \$3.4 billion, up 2.6 percent. Costa Rica is currently the 36th largest export market for U.S. goods.

The stock of U.S. foreign direct investment (FDI) in Costa Rica in 2004 was \$1.1 billion, up from \$863 million in 2003. U.S. FDI in Costa Rica is concentrated largely in the manufacturing sector.

IMPORT POLICIES

Free Trade Agreement

The United States concluded free trade agreement negotiations with El Salvador, Guatemala, Honduras, and Nicaragua in December 2003 and with Costa Rica in January 2004. In May 2004, the six countries signed the United States–Central America Free Trade Agreement. During 2004, the United States and the Central American countries integrated the Dominican Republic into the free trade agreement. On August 5, 2004, the seven countries signed the Dominican Republic – Central America – United States Free Trade Agreement (CAFTA-DR).

All of the signatory countries except Costa Rica have ratified the agreement. CAFTA-DR will enter into force between the United States and other signatories on a rolling basis as the United States determines that countries have taken sufficient steps to implement their commitments under the Agreement.

In October 2005, President Pacheco sent CAFTA-DR to the Legislative Assembly to start the ratification process. However, the Administration has yet to submit several significant bills that are needed to implement CAFTA-DR, such as proposed laws to gradually open the telecommunications and insurance markets and to provide greater protections for intellectual property rights. Implementation of CAFTA-DR will remove barriers to trade and investment in the region and strengthen regional economic integration. CAFTA-DR will also require the Central American countries and the Dominican Republic to undertake reforms to provide market liberalization, transparency and certainty in such areas as: customs administration; protection of intellectual property rights; services, investment, financial services; government procurement; sanitary and phytosanitary (SPS) barriers; and to liberalize other non-tariff barriers.

Tariffs

As a member of the Central American Common Market (CACM), Costa Rica agreed in 1995 to reduce its common external tariff to a maximum of 15 percent. However, some industrial goods, such as new and used automobiles, are subject to much higher tariffs. Once CAFTA-DR enters

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into effect, about 80 percent of U.S. industrial goods will enter the region duty free immediately, with the remaining tariffs phased out over ten years. Nearly all textile and apparel goods that meet the agreement's rules of origin will be duty-free and quota-free immediately, promoting new opportunities for U.S. and regional fiber, yarn, fabric, and apparel manufacturing.

Most tariffs on agricultural products range from one percent to 15 percent. However, selected agricultural commodities currently are protected by tariffs that significantly exceed the 15 percent CACM common external tariff ceiling. These commodities include dairy products (40 percent to 65 percent) and poultry products (150 percent). Under CAFTA-DR, Costa Rica will eliminate its tariffs on virtually all agricultural products within fifteen years (17 years for chicken leg quarters and 20 years for rice and dairy products). For the most sensitive products, tariff-rate quotas will permit some immediate zero-duty access for specified quantities during the tariff phase-out period, which will expand over time. Costa Rica will liberalize trade in fresh potatoes and onions through expansion of a tariff-rate quota.

Non-Tariff Measures

Costa Rica levies a sales tax of 13 percent on most goods and services, whether locally produced or imported. Costa Rica also applies a consumption tax (the level of which varies depending on the good) to many locally produced goods and to about half of all imported goods. Among the highest taxed items are arms and ammunition (75 percent), costume jewelry (50 percent), fireworks (50 percent), new and used vehicles (variable), and wine and beer (40 percent). A bill that has been under debate for almost three years before the Costa Rican Congress would replace the sales tax with a general value-added tax on all goods and services with rates up to 79 percent on used cars.

The CAFTA-DR requires transparency and efficiency in administering customs procedures, including CAFTA-DR rules of origin. Costa Rica committed to ensure procedural certainty and fairness and all Parties agreed to share information to combat illegal transshipment of goods.

STANDARDS, TESTING, LABELING AND CERTIFICATION

The establishment of an electronic "one-stop" import-export window and other recent improvements have reduced the time required for customs processing in Costa Rica. Nonetheless, procedures remain complex and bureaucratic.

Delayed entry of products into the country has resulted in lost earnings for U.S. exporters. In some cases, shipments have been destroyed. Currently, all foods, pharmaceuticals, agricultural goods, and chemicals and cosmetics for human and animal consumption, locally produced or imported, must be tested and registered by the Ministry of Health before they can be sold. As implemented, however, this system appears to place greater burdens on imported goods than on domestically produced goods. For example, in practice, local producers are often not subjected to analysis due to a lack of adequate laboratory testing equipment and funds.

In addition, Costa Rica requires that all imported products be certified safe and allowed for sale in the country of origin in order to be registered. Food traders express concern regarding the

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length of time it takes to register a product under this process, which can be months. Costa Rica requires extensive documentation to be notarized by the Costa Rican consulate in the country of origin for the importation of distilled spirits. These import-licensing requirements are burdensome and costly to U.S. exporters. However, the five Central American countries, including Costa Rica, are in the process of developing common standards for several products, including distilled spirits, which should facilitate trade.

Sanitary and phytosanitary (SPS) requirements can often be cumbersome and lengthy. In addition, the Ministry of Agriculture and Livestock (MAG) enforces SPS measures that appear to be inconsistent with international standards and not based on science (e.g., zero tolerance for salmonella on raw meat and poultry products).

Effective December 24, 2003, Costa Rica temporarily banned imports of U.S. beef due to the single case of Bovine Spongiform Encephalopathy (BSE) in the United States. In May 2004, the Ministry of Agriculture (MAG) indicated that imports of boneless beef from animals of less than 30 months of age could be imported. Costa Rica's inspection and certification requirements, however, have prevented the resumption of imports. The United States is working to eliminate these plant-by-plant inspection requirements. In May 2003, Costa Rica issued a decree allowing for the certification of an inspection system to replace a regulation that required individual poultry export plants to be inspected and approved by the Costa Rican government.

Amendments to Costa Rica's Law on Animal Health, which would provide statutory authority for Costa Rica to undertake an equivalency determination, are stalled in the Costa Rican Legislative Assembly. When the United States and Central America launched the free trade agreement negotiations, they initiated an active working group dialogue on SPS barriers to agricultural trade that met in parallel with the negotiations to facilitate market access. The objective was to leverage the impetus of active trade negotiations to seek changes to the Central American countries' SPS regimes. Through the work of this group, Costa Rica has committed to resolve specific measures restricting U.S. exports to Costa Rica. In particular, for meat, dairy and poultry, Costa Rica agreed to recognize the equivalence of the U.S. food safety and inspection system, thereby eliminating the need for plant-by-plant inspections.

GOVERNMENT PROCUREMENT

Costa Rica is not a party to the WTO Agreement on Government Procurement. In recent years, a growing number of U.S. exporters and investors have reported unsatisfactory experiences when responding to Costa Rican government tenders. For example, the GOCR (through the Comptroller General) has occasionally annulled and re-bid tenders to supply large state-owned enterprises after the financial analysis was completed and the awards granted. The GOCR has also substantially modified tender specifications midway through the procurement process. The bidders in these cases were forced to bear the costs associated with these changes. CAFTA-DR requires the use of fair and transparent procurement procedures, including advance notice of purchases and timely and effective bid review procedures, for procurement covered by the Agreement.

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Under CAFTA-DR, U.S. suppliers will be permitted to bid on procurements of most Costa Rican government entities, including key ministries and state-owned enterprises on the same basis as Costa Rican suppliers. The anti-corruption provisions in the agreement require each government to ensure that bribery in trade-related matters, including in government procurement, be treated as a criminal offense or subject to comparable penalties under Costa Rican law.

EXPORT SUBSIDIES

Tax holidays are available for investors in free trade zones, unless tax credits are available in an investor's home country for taxes paid in Costa Rica. In 2000, Costa Rica ceased granting financial investment subsidies and tax holidays to new exporters. Under CAFTA-DR, Costa Rica may not adopt new duty waivers or expand existing duty waivers conditioned on the fulfillment of a performance requirement (e.g., the exportation of a given level or percentage of goods). Costa Rica may maintain existing duty waiver measures through 2009 provided such measures are consistent with its WTO obligations.

INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

The U.S. continues to have concerns over Costa Rica's inadequate enforcement of its intellectual property laws. Consequently, Costa Rica remained on the 2005 Special 301 "Watch List". While many elements of Costa Rican intellectual property laws appear to be in line with international standards, the country's criminal codes have certain weaknesses that limit effective deterrence of intellectual property crimes.

The most recent significant step the Costa Rican government has taken to improve intellectual property protection was to increase police raids on individuals and organizations that pirate CDs, DVDS, and sell "knock-off" goods. However, the police have become reluctant to continue such raids because of the lack of will to pursue prosecution. Other initiatives, including the formation of an inter-governmental intellectual property rights commission and the training of judges and prosecutors on intellectual property laws, have not produced significant improvements in the prosecution of IPR crimes. Further, the lack of political will to aggressively prosecute these criminals, due in part to scarce resources, has undercut deterrence. For example, during 2005 the Attorney General instructed prosecutors to make a priority only of trademark, patent, and copyright cases that might negatively affect health.

Costa Rica is currently considering meaningful changes to its existing IPR laws to address limitations and loopholes that currently prevent effective enforcement. For example, there is a draft bill in Congress to modify the Intellectual Property Enforcement Law by deleting the "insignificance principle" which sets out a threshold of infringement significance below which prosecutors will not prosecute infringements. However these efforts seem to have stalled in the legislature.

According to industry, this threshold currently provides a loophole that prevents prosecution of retail-level piracy. Several proposals to strengthen IPR laws have languished in the Legislative Assembly during the past two years. IPR reforms will be needed to comply with the requirements of CAFTA-DR but have not yet been submitted for consideration by Legislative

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Assembly. Complying with CAFTA-DR obligations would strengthen Costa Rica's IPR protection regime. Implementation of CAFTA-DR obligations would also provide stronger deterrence against piracy and counterfeiting by criminalizing end user piracy and requiring Costa Rica to authorize the seizure, forfeiture, and destruction of counterfeit and pirated goods and the equipment used to produce them – something that the government is not currently capable of doing in an expeditious or effective manner. CAFTA-DR also mandates both statutory and actual damages for copyright and trademark infringement, helping to ensure that monetary damages can be awarded even when it is difficult to assign a monetary value to the violation.

Patents, Plant Protection and Data Protection

Costa Rica acceded to the Paris Convention for the Protection of Industrial Property in 1995. Patent amendments made at that time extended the term of protection for a patent from 12 years to 20 years from the date of the filing of the application for all inventions. Costa Rica does not provide protection to pharmaceutical and agricultural chemical companies seeking to protect undisclosed data submitted for regulatory approval, from unfair commercial use by unauthorized third parties. Implementation of CAFTA-DR obligations would require Costa Rica to protect such test data against unfair commercial use for a period of 5 years following the issuance of the market approval for pharmaceuticals and 10 years for agricultural chemicals. In addition, there is no effective means of providing protection for plant varieties under Costa Rica's current law. The CAFTA-DR obligations require that Costa Rica accede to the UPOV Convention (International Union for the Protection of New Varieties of Plants, 1991) by June 1, 2007, and make best efforts to provide patent protection for plants.

Copyrights

Costa Rica's copyright law is generally adequate, but not uniformly enforced. Long delays in copyright enforcement cases continue to be a serious problem. The copyright regime was revised in 1994 to provide specific protection for computer software and in 1999 to protect integrated circuit designs. In addition, Costa Rica became party to the WIPO Copyright Treaty and the WIPO Performances and Phonograms Treaty in 2002. Though piracy of satellite television transmissions by the domestic cable television industry has been curtailed, U.S. industry continues to express concern that some apartment buildings and hotels, particularly in areas not served by major cable service providers, continue to engage in satellite signal piracy. Unauthorized sound recordings, videos, optical discs, and computer software are also widespread, although some progress has been made in reducing their presence in the market. Efforts in copyright protection are significantly hindered by the lack of adequate funding and personnel committed to IP enforcement. CAFTA-DR enforcement provisions are designed to help reduce copyright piracy.

Trademarks

Counterfeiting of well-known trademarks is widespread in Costa Rica. Legal recourse against these practices is available in Costa Rica, but may require protracted and costly litigation. Costa Rican authorities have recently intensified efforts to raid businesses and confiscate property, especially clothing, which is infringing registered trademarks.

FOREIGN TRADE BARRIERS

SERVICES BARRIERS

Costa Rica's insurance, telecommunications, electricity distribution, petroleum distribution, potable water, sewage, and railroad transportation industries are all state monopolies. In addition, there are restrictions on the participation of foreign companies in some private sector activities, such as customs handling, medical services, prison operation, and professional services. Under the CAFTA-DR, Costa Rica will accord substantial market access across their entire services regime, subject to a few exceptions. For example, liberalization in insurance will be achieved through a phased-in approach with an initial opening at entry into force, an opening of the vast majority of the market by 2008, and a total opening by 2011.

Costa Rican regulations restrict the ability of certain professions to practice on a permanent basis in Costa Rica, such as medical practitioners, lawyers, certified public accountants, engineers, architects, teachers, and others. Such professionals must be members of an association (colegio) that sets residency, examination, and apprenticeship requirements. However, under CAFTA-DR, Costa Rica agreed to allow the provision of certain professional services on a reciprocal basis and also agreed to provide for temporary licensing of professional services.

Costa Rica made specific commitments to open its telecommunications market in three key areas and to establish a regulatory framework to foster effective market access. The market openings are in private network services and Internet services starting in 2006 and wireless services starting in 2007. Under CAFTA-DR, Costa Rica agreed to enact a new legal framework to modernize telecommunications provider ICE, and establish an independent regulatory body and regulatory structure. This will require legislative and regulatory reform.

Costa Rica has ratified its commitments under the 1997 WTO Financial Services Agreement and accepted the Fifth Protocol of the GATS. Under this agreement, Costa Rica committed to allow foreign financial service providers to establish 100 percent-owned bank subsidiaries in Costa Rica to provide lending and deposit-taking services, leasing services, credit card services, and financial information services.

Costa Rica made no commitments in the WTO for the provision of securities trading, underwriting services or any type of insurance services. The CAFTA-DR, however, will provide for openings in all these areas (insurance openings to be phased in as noted above). Private commercial banks have been permitted to offer checking accounts and savings deposits of less than 30 days since 1995 and to access the Central Bank's discount window, since 1996. However, private commercial banks are required to open branches in rural areas of the country or to deposit with the Central Bank 17 percent of their checking account deposits for state-owned commercial banks that have rural branches in order to qualify for the benefits of the law. CAFTA-DR ensures that foreign banks are treated under the same rules as domestic private banks.

FOREIGN TRADE BARRIERS

INVESTMENT BARRIERS

Under the CAFTA-DR, all forms of investment will be protected, including enterprises, debt, concessions, contracts, and intellectual property. U.S. investors will enjoy in almost all circumstances the right to establish, acquire, and operate investments in Costa Rica on an equal footing with local investors. Among the rights afforded to U.S. investors are due process protections and the right to receive a fair market value for property in the event of an expropriation. The list of investor rights includes an effective, impartial procedure for dispute settlement that is fully transparent. Submissions to dispute panels and panel hearings will be open to the public, and interested parties will have the opportunity to submit their views.

Currently, in the World Bank's "Doing Business" index, Costa Rica ranks 141 in "enforcing contracts" and 134 in "protecting investors". Several U.S. investors have noted serious difficulties executing contracts made with the Costa Rican government, bringing into question the validity of such contracts. For example, a U.S. company has expressed concern that the Government of Costa Rica failed to honor the company's petroleum exploration permits rights in Costa Rica and has not been willing to negotiate a settlement of the company's claims. Another U.S. company has suffered financial losses because it has been denied the ability to fully exercise its concession rights to finance operations and capital improvements at Costa Rica's international airport. Ongoing negotiations with the Costa Rican government continue in an effort to resolve these issues.

While electricity generation and distribution remain a state monopoly, an electricity cogeneration law enacted in 1996 allowed some private-sector participation in the production of electricity, but not in its transmission. This law has since been modified to permit the private construction and operation of plants under build-operate-transfer (BOT) and build-lease-transfer (BLT) mechanisms, but the operator must have at least 35 percent Costa Rican equity. Legislative proposals to open the electricity and telecommunications sectors to private investment and competition were abandoned in 2000 in the wake of large-scale demonstrations against reform and a Constitutional Court ruling against specific legislation under discussion. Existing private power producers have had their long-term, fixed-rate contracts challenged by certain Costa Rican governmental organizations, but these contracts have been honored.

OTHER BARRIERS

The law regulating commercial representatives of foreign firms (Law No. 6209) grants local companies exclusive representation, even without a signed agreement, for an indefinite period of time. In most cases, foreign companies must pay indemnity compensation in order to terminate a relationship with the local company. Under CAFTA-DR, Costa Rica has committed to change this "dealer protection" regime. Under the existing regime, foreign firms may be tied to exclusive or inefficient distributor arrangements. Costa Rica committed to establish a new legal regime that will give U.S. firms and their Costa Rican partners more freedom to contract the terms of their commercial relations, which in turn will encourage the use of arbitration to resolve disputes between parties to dealer contracts.

FOREIGN TRADE BARRIERS

COTE D'IVOIRE

TRADE SUMMARY

The U.S. goods trade deficit with Cote d'Ivoire was \$1.1 billion in 2005, an increase of \$477 million from \$597 million in 2004. U.S. goods exports in 2005 were \$124 million, up 4.9 percent from the previous year. Corresponding U.S. imports from Cote d'Ivoire were \$1.2 billion, up 67.6 percent. Cote d'Ivoire is currently the 119th largest export market for U.S. goods.

The stock of U.S. foreign direct investment (FDI) in Cote d'Ivoire in 2004 was \$247 million, up from \$215 million in 2003.

IMPORT POLICIES

Tariffs

Cote d'Ivoire is a member of the WTO, the West African Economic and Monetary Union (known by its French acronym, UEMOA), and the Economic Community of West African States (ECOWAS). Cote d'Ivoire does not impose tariffs on imports from UEMOA member states. Imports from all other countries are subject to duty and tariffs based on the Common External Tariff Schedule of five percent on raw materials and inputs for local manufacture, 10 percent for semi-finished goods, and 20 percent for finished products. Since 2004, any goods entering UEMOA from non-member countries are ineligible to transit a UEMOA country duty-free en route to their final destination. Duties are now assessed at the first port of entry.

Non-Tariff Measures

A one percent statistical fee is levied on the CIF (cost, insurance, and freight) value of imports except those destined for re-export, transit, or donations for humanitarian purposes under international agreements. Other taxes on imports into Cote d'Ivoire are an ECOWAS community levy (solidarity tax), assessed at the rate of 0.5 percent of the CIF value of imported goods. There are special taxes on fish (20 percent), rice (between 5 and 10 percent based on category), poultry (700 CFA per kilo), alcohol, tobacco, cigarettes, certain textile products, and petroleum products. These special taxes are designed to protect national industries. Ivoirian Customs collects a value-added tax (VAT) of 18 percent on all imports. This tax computation is calculated on the CIF value plus the duty and the statistical fee. In 2005, the government accumulated a significant amount of arrears in VAT reimbursements to those domestic and foreign-owned companies that, under Ivoirian law, are entitled to duty-free imports because they export more than 50 percent of their production. In late 2005, the government instituted a system of uniform invoices in an effort to reduce VAT fraud. All transactions as of December 1, 2005 will require the use of the uniform invoices.

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Cote d'Ivoire reportedly continues to apply minimum import prices (MIPs) to imports of certain products. In the past, Cote d'Ivoire had a WTO waiver allowing it to apply MIPs for some products. The waiver expired in January 2003, but Cote d'Ivoire continues to apply MIPs, including on imports of products never covered by the WTO waiver.

There are no quotas on merchandise imports, although the following items are subject to import prohibitions, restrictions, or prior authorization: petroleum products, animal products, live plants, seeds, arms and munitions, plastic bags, distilling equipment, pornography, saccharin, narcotics, explosives, illicit drugs, and toxic waste. Textile products are subject to some authorization requirements by the Department of External Trade.

STANDARDS, TESTING, LABELING AND CERTIFICATION

All items imported into Cote d'Ivoire must have a certificate of compliance with applicable standards. The national standard and certification agency has mandated two European companies to carry out all qualitative and quantitative verifications of goods imported into Cote d'Ivoire with a value equal to or higher than CFA 1.5 million (approximately \$3,000). All merchandise must be clearly labeled showing the country of origin. Manufactured food products must be labeled in French and have an expiration date. Standards generally follow the French or European norm.

GOVERNMENT PROCUREMENT

Cote d'Ivoire is not a signatory to the WTO Agreement on Government Procurement. The government of Cote d'Ivoire regularly publishes notices of procurement tenders in the local press, and also publishes some tender notices in international publications. There can be a fee for the tender documents. The implementing agency is usually the ministry making the request or the ministry under whose oversight the office functions. The Bureau National d'Etudes Techniques et de Developpement (BNETD), the government's technical and investment planning agency and think tank, sometimes serves as an executing agency representing ministries for major projects to be financed by international institutions. (Note: In November 2004, the World Bank suspended disbursement on all projects, as Cote d'Ivoire fell into non-accrual status with the Bank. Until the arrears are cleared, the Bank will not finance projects in Cote d'Ivoire.)

The government has created a centralized office of public bids in the Finance Ministry to help ensure compliance with international bidding practices. While the procurement process is theoretically open, some well-entrenched European companies may retain a preferred position in securing bid awards through their relations with government officials. Many firms continue to see corruption as an obstacle that affects procurement decisions. Cote d'Ivoire is not a signatory to the WTO Agreement on Government Procurement.

FOREIGN TRADE BARRIERS

SERVICES BARRIERS

Banks and insurance companies are subject to licensing requirements, but there are no restrictions on foreign ownership or establishment of subsidiaries. Foreign participation currently is widespread in computer services, education, and training. However, prior approval is required for foreign investment in the health sector, travel agencies, and law and accounting firms. Majority foreign ownership of companies in these sectors is not permitted and foreigners must associate with licensed Ivoirian practitioners to obtain permission to work in these sectors. Foreign companies currently operate in all these sectors. One U.S. bank currently has branches in Cote d'Ivoire.

INVESTMENT BARRIERS

The government actively encourages foreign investment, but in recent years political instability has substantially undermined investor confidence. The negative effects of the 1999 coup d'etat, the ensuing 10-month military rule, and the upheavals surrounding the elections in October 2000 had not dissipated when another attempted coup and rebellion gripped the nation in September 2002. With the exceptions of offshore petroleum exploration and oil field development and the telecommunications sector, the turmoil in November 2004, during which businesses were destroyed and looted, and the subsequent loss of AGOA eligibility in January 2005, have further dampened near-term investment prospects.

Cote d'Ivoire requires majority Ivoirian ownership in some sectors. There has been no progress on privatization since 2002. The Ivoirian investment code provides tax incentives for investments higher than \$1 million, as well as land concessions for projects. The Center for the Promotion of Investment in Cote d'Ivoire (CEPICI) was established to act as a one-stop shop for investment. Concessionary agreements, which would exempt investors from tax regulations, require the additional approval of the Ministry of Finance and Economy and the Ministry of Industry. The clearance procedure for planned investments, if tax breaks are sought, is therefore time-consuming and confusing. Even when companies have complied fully with the requirements, plans are sometimes denied with little explanation, giving rise to accusations of favoritism and corruption.

INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

The Ivoirian Civil Code protects the acquisition and disposition of intellectual property rights. Cote d'Ivoire is a party to the Paris Convention (Stockholm Act, 1967), and the 1977 Bangui Agreement covering 16 Francophone African countries in the African Intellectual Property Organization (OAPI).

FOREIGN TRADE BARRIERS

Effective February 2002, changes were made to the Bangui Agreement in an effort to bring it into conformity with TRIPS. Under OAPI, rights registered in one member country are valid for other member states. Patents are valid for ten years, with the possibility of two five-year extensions. Trademarks are valid for ten years and are renewable indefinitely. Copyrights are valid for 50 years.

In 2001, Ivoirian experts drafted a new law in an effort to bring Cote d'Ivoire into conformity with TRIPS. The new law adds specific protection for computer programs, databases, and authors' rights with regard to rented films and videos. The National Assembly, however, has not yet approved this legislation and there appears little likelihood that it will do so in the near future.

The government's Office of Industrial Property is charged with ensuring the protection of patents, trademarks, industrial designs, and commercial names. The office faces an array of challenges, including inadequate funding, lack of political will, and the distraction of the ongoing political crisis. As a result, enforcement of IPR is largely ineffective. Foreign companies, especially from East and South Asia, flood the Ivoirian market with a broad range of counterfeit goods. Government efforts to combat piracy are modest. The Ivoirian Office of Author's Rights (BURIDA) established a new sticker system in January 2004 to protect audio, video, literary and artistic property rights in music and computer programs. BURIDA's operations remain hampered by a long-running dispute over policy and who should direct the agency, but the agency does help to promote IPR enforcement with lawyers and magistrates.

ELECTRONIC COMMERCE

Electronic commerce is in its very early stages in Cote d'Ivoire but is expected to grow over time. There are a number of cultural barriers to growth, including the custom of paying with cash and the absence of widespread issuance and use of credit cards. Furthermore, Internet access is gained mostly through cyber cafes, as Internet access is still uncommon in private residences. A few individuals and small businesses, however, have begun experimenting with electronic commerce, and interest in the medium continues to gain ground.

OTHER BARRIERS

Corruption

Many U.S. companies view corruption as an obstacle to investment in Cote d'Ivoire. Corruption has the greatest impact on judicial proceedings, contract awards, customs, and tax issues. Reportedly, it is common for judges to distort the merits of a case due to financial influence. Corruption and the recent political crisis have affected the Ivoirian government's ability to attract and maintain foreign investment.

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Some U.S. investors have raised specific concerns about the rule of law and the government's ability to provide equal protection under the law.

In 1997, the government of Cote d'Ivoire authorized the creation of an arbitration court. Since then, the court has examined 45 cases (five in 2005). In July 2004, the governing body was strengthened with the added participation of local Chambers of Commerce, and the rules governing enforcement of arbitral awards were modified to allow for a quicker enforcement of awards. The business community has welcomed the 2004 revisions and hopes that the Arbitration Board can act as an alternative vehicle for businesses in disputes. In addition to its local arbitration board, Cote d'Ivoire is also a member of the International Center for the Settlement of Investment Disputes.

DOMINICAN REPUBLIC

TRADE SUMMARY

The U.S. goods trade balance with Dominican Republic went from a trade deficit of \$169 million in 2004 to a trade surplus of \$105 million in 2005. U.S. goods exports in 2005 were \$4.7 billion, up 8.0 percent from the previous year. Corresponding U.S. imports from Dominican Republic were \$4.6 billion, up 1.7 percent. Dominican Republic is currently the 30th largest export market for U.S. goods.

The stock of U.S. foreign direct investment (FDI) in Dominican Republic in 2004 was \$1.0 billion, up from \$816 million in 2003. U.S. FDI in Dominican Republic is concentrated largely in the manufacturing, and wholesale sectors.

IMPORT POLICIES

Free Trade Agreement

The United States concluded free trade agreement negotiations with El Salvador, Guatemala, Honduras, and Nicaragua in December 2003 and with Costa Rica in January 2004. In May 2004, the six countries signed the United States–Central America Free Trade Agreement. During 2004, the United States and the Central American countries integrated the Dominican Republic into the free trade agreement. On August 5, 2004, the seven countries signed the Dominican Republic – Central America – United States Free Trade Agreement (CAFTA-DR).

All of the signatory countries except Costa Rica have ratified the agreement. CAFTA-DR will enter into force between the United States and other signatories on a rolling basis as the United States determines that countries have taken sufficient steps to implement their commitments under the Agreement.

CAFTA-DR will remove barriers to trade and investment in the region and will further regional economic integration. CAFTA-DR will also require the Central American countries and the Dominican Republic to undertake needed reforms to provide market liberalization, transparency and certainty in areas including: customs administration; protection of intellectual property rights; services, investment, financial services; government procurement; sanitary and phytosanitary (SPS) barriers; and to liberalize other non-tariff barriers.

Tariffs

Tariffs on imported agricultural and non-agricultural goods range from zero percent to 20 percent.

Responding to urgent fiscal needs, the Dominican Republic's monetary authorities raised an exchange surcharge (*recargo cambiario*) from 1.75 percent to 10 percent in late 2003 and then to

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13 percent in January 2005. This levy is currently applied to all imports. In November 2004, in response to a complaint filed by Honduras, a World Trade Organization (WTO) panel found the exchange surcharge to be inconsistent with the Dominican Republic's WTO obligations. Because the levy is not compliant with CAFTA-DR obligations, authorities in the Dominican Republic intend to repeal it upon the entry into force of the agreement. The IMF standby agreement includes elimination of the levy.

A luxury tax (*Impuesto Selectivo al Consumo*) ranging from 15 percent to 60 percent applies to selected categories of goods. This consumption tax for luxury items applies equally to locally manufactured and imported "non-essential" goods, including perfume, alcoholic beverages, motor vehicles, and tobacco.

Once the CAFTA-DR goes into effect, about 80 percent of U.S. industrial goods will enter the region duty-free, with the remaining tariffs phased out over ten years. Nearly all textile and apparel goods that meet the Agreement's rules of origin will be duty-free and quota-free immediately, promoting new opportunities for U.S. and regional manufacturers of fiber, yarn, fabric, and apparel manufacturing. The agreement's tariff treatment for textile and apparel goods may be made retroactive to January 1, 2004.

Most tariffs on agricultural goods will be eliminated within 15 years and all tariffs on goods from CAFTA-DR countries will eventually be eliminated. The phase-out period for rice, chicken leg quarters, and dairy products is 20 years. For the most sensitive products, tariff rate quotas will permit some immediate duty-free access for specified quantities during the tariff phase-out period. These amounts will increase over time as the out-of-quota duties are eliminated.

Non-Tariff Measures

Bringing goods into the Dominican Republic can be a long process. Customs Department interpretations often provoke complaints by businesses and arbitrary clearance procedures sometimes delay the importation of merchandise for lengthy periods. The Customs Director General is committed to eliminating corruption from the Customs Department and instituting clear and transparent customs procedures.

The use of "negotiated fee" practices to gain faster customs clearance continues to put some U.S. firms at a competitive disadvantage in the Dominican market.

Under CAFTA-DR, the Dominican Republic has committed to provide greater transparency and procedural certainty in administering customs procedures. In May 2005, the Customs Director announced plans for more efficient, accelerated customs clearances for a greater number of hours each day, and the Director informed express courier services and others that he planned to implement a surcharge to offset the increased costs of these services. This fee would apply to both national and international express courier services. Express Delivery companies have been working with the Dominican Customs service in an effort to agree to a reasonable non-discriminatory fee structure. Personnel from the U.S. Embassy have been engaged throughout the dispute. The Customs Director emphasized to the Embassy officials that his aim was to assure transparent and honest administration of the customs function.

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Express companies agree in principle to pay a fee for service but their view is that the fee should not be calculated as a percentage of their billings. As of December 2005, discussions continue and the Dominican Republic's Customs service has not yet begun to assess the fee.

The Dominican government requires importers to obtain from a Dominican consulate in the United States a consular invoice and "legalization" of documents accompanied by attendant fees and delays. Importers can pay a fine of approximately \$400 if they lack these consular documents, and some choose to do so rather than deal with Dominican Republic consulates in the United States. Elimination of the consular invoice is required by CAFTA-DR.

On October 31, 2005, the United States and the Dominican Republic signed a Customs Mutual Assistance Agreement (CMAA) that allows customs officials to exchange information, intelligence, and documents designed to help prevent customs offenses. The agreement provides a basis for cooperation and investigation in the areas of trade fraud, money laundering, smuggling, export controls, and related security.

U.S. cinema companies have also expressed concern over recent increases in the Transfer of Industrialized Goods and Services Tax (ITBS) on cinema tickets. Box office taxes are scheduled to increase from 6 percent to 16 percent by 2006 and may represent an impediment in the industries development of the market.

STANDARDS, TESTING, LABELING AND CERTIFICATION

Sanitary permits are used in the Dominican Republic as import licenses to control import levels of selected commodities and products. The lengthy and unpredictable approval process for sanitary permits for shipments of U.S. meat and dairy products has been a serious problem for importers. In addition, the Ministry of Agriculture and Livestock (MAG) enforces sanitary measures that appear to be inconsistent with international standards and not based on science (e.g., zero tolerance for salmonella on raw meat and poultry products and for *Tilletia* sp. on shipments of U.S. rice).

When the United States and Central America launched the free trade agreement negotiations, they initiated an active working group dialogue on SPS barriers to agricultural trade that met in parallel with the negotiations to facilitate market access. The objective was to leverage the impetus of active trade negotiations to seek changes to the Central American countries' SPS regimes. Through the work of this group, the Dominican Republic has committed to resolve specific measures restricting U.S. exports to the Dominican Republic. In particular, for meat, dairy, and poultry, the Dominican Republic agreed to recognize the equivalence of the U.S. food safety and inspection system, thereby eliminating the need for plant-by-plant inspections.

GOVERNMENT PROCUREMENT

The Dominican Republic is not a party to the WTO Agreement on Government Procurement. Dominican government procurement is still not conducted in a clear and transparent way, despite assurances from the highest levels of government that it would change its procurement practices. Some steps have been taken to enhance transparency, but corruption is still widespread.

FOREIGN TRADE BARRIERS

CAFTA-DR requires the use of fair and transparent procurement procedures, including advance notice of purchases and timely and effective bid review procedures, for procurement covered by the Agreement, which includes almost all government acquisition of goods, services and construction services.

Under the CAFTA-DR, U.S. suppliers will be permitted to bid on procurements by most Dominican government entities, including key ministries and state-owned enterprises, on the same basis as Dominican suppliers. The anti-corruption provisions in the Agreement require each government to ensure that bribery in trade-related matters, including in government procurement, is treated as a criminal offense or is subject to comparable penalties under its law.

EXPORT SUBSIDIES

The Dominican Republic does not have export promotion schemes other than the tariff exemptions for inputs given to firms in the free trade zones. Under the CAFTA-DR, the Dominican Republic may not adopt new duty waivers or expand existing duty waivers conditioned on the fulfillment of a performance requirement (e.g., the exportation of a given level or percentage of goods). The Dominican Republic may maintain existing duty waiver measures through 2009 provided such measures are consistent with its WTO obligations.

INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

While the Dominican Republic has laws with sanctions adequate to protect copyrights and has improved the regulatory framework for patent and trademark protection, U. S. industry representatives continue to cite lack of IPR enforcement as a major concern. The Dominicans committed in a side letter to CAFTA-DR to make stronger efforts to halt television broadcast piracy and agreed to report on their efforts in this regard in a quarterly report to USTR. The Dominican government has delivered these quarterly reports on time since January 2005. There has been improved coordination in this regard among various government agencies including the Secretariat of Industry and Commerce, the Attorney General's Office, the Patent Office and the Copyright Office. The authorities advised cable television operators of their legal responsibilities regarding copyright, secured a formal agreement with the operators' association in August 2005, and in September seized equipment from six operators found to be infringing the laws. The Attorney General's office instituted proceedings against several television broadcasters in the first half of 2005 for infringement of the copyrights of the owners of various U.S. film titles.

CAFTA-DR will obligate the Dominican Republic to strengthen its IPR protection regime, in particular, requiring stronger deterrence against piracy and counterfeiting by criminalizing end user piracy and requiring the authorities to seize, forfeit, and destroy counterfeit and pirated goods and the equipment used to produce them. CAFTA-DR mandates both statutory and actual damages for copyright and trademark infringement, measures to help ensure that monetary damages can be awarded even when it is difficult to assign a monetary value to the infringement.

FOREIGN TRADE BARRIERS

Patents and Trademarks

The U.S. pharmaceutical industry has expressed concern that the sanitary authority of the Dominican Republic Department of Health continues to approve the import, export, manufacture, marketing, and/or sale of pharmaceutical products that are infringing copies of patented products registered in the Dominican Republic.

The revised Industrial Property Law and regulations have not yet been applied in legal proceedings, so the effectiveness of those measures has not been tested. CAFTA-DR requires that test data submitted to the Dominican government for the purpose of product approval be protected against unfair commercial use for a period of 5 years for pharmaceuticals and 10 years for agricultural chemicals. Several Dominican pharmaceutical manufacturers have repeatedly sought changes to proposed implementing laws and procedures to avoid this requirement. Complying with the requirements for data protection will necessitate close and more effective coordination between licensing authorities and the Patent Office.

Copyrights

Despite a strong copyright law passed in 2000, the appointment of a specialized IPR prosecutor with nationwide jurisdiction in 2003 and some improvement in enforcement activity, piracy of copyrighted materials is common. Audio recordings and software are often copied without authorization. The authorities have made efforts to seize and destroy such pirated goods.

The U.S. Government continues to receive complaints concerning broadcasting of signals and copyrighted material without licenses from the copyright owners. U.S. industry representatives point to lengthy delays when cases are submitted for prosecution, a complaint that characterizes the general judicial process in the Dominican Republic.

SERVICES BARRIERS

Over the last few years, the Dominican Republic has taken steps to reform and liberalize the financial services sector. In October 2002, the Dominican Republic passed a monetary and financial law that provides for national treatment of investors in most of the financial services sector. The law establishes a regulatory regime for monetary and financial institutions, and provides for participation of foreign investment in financial intermediary activities in the Dominican Republic.

The Dominican Republic ratified the 1997 WTO Financial Services Agreement and its monetary and financial law appears to go beyond the commitments of the WTO agreement. The Dominican Republic has committed to allow foreign banks to establish branches or local companies with up to 100 percent foreign equity to supply services in deposit-taking, lending, and credit cards. Branches of foreign banks have a phase-in period of six years from 2004 to establish sufficient locally held capital to meet the same requirements that are applied to domestic banks.

FOREIGN TRADE BARRIERS

A foreign insurance company can establish a wholly owned subsidiary. Under the CAFTA-DR, U.S. financial service suppliers will be allowed to establish subsidiaries, joint ventures or branches for banks and insurance companies. In addition, U.S.-based firms will be permitted to supply insurance on a cross-border basis, including reinsurance; reinsurance brokerage; marine, aviation, and transport (MAT) insurance.

INVESTMENT BARRIERS

Existing Dominican legislation does not contain effective procedures for settling disputes arising from the government's actions. Dominican expropriation standards are not consistent with international law standards and numerous U.S. investors have had disputes related to expropriated property. Subsequent to U.S.-Dominican Trade and Investment Council meetings in October 2002, the Dominican government set out to examine outstanding expropriation cases for possible resolution under a 1999 law. With assistance from USAID, the Dominican government identified and resolved 248 cases.

The Dominican Republic implemented the New York Convention on Recognition and Enforcement of Foreign Arbitral Awards (the New York Convention) in August 2002. The New York Convention provides courts a mechanism to enforce international arbitral awards.

In a case that was recently concluded, Dominican lower courts had declined to recognize the authority of an international arbiter specified in a contract between a U.S. firm and a Dominican consulting firm. The case was on appeal to the Supreme Court when the parties decided to settle out of court.

Under the CAFTA-DR, all forms of investment will be protected including enterprises, debt, concessions, contracts and intellectual property. In almost all circumstances U.S. investors will enjoy the right to establish, acquire, and operate investments in the Dominican Republic on an equal footing with local investors. Among the rights afforded to U.S. investors after entry into force will be due process protections and the right to receive a fair market value for property in the event of an expropriation. Investor rights will be backed by an effective, impartial procedure for dispute settlement that will be fully transparent. Submissions to dispute panels and panel hearings will be open to the public and interested parties will have the opportunity to submit their views.

ELECTRONIC COMMERCE

Law 126-02 enacted in 2002 regulates electronic commerce, documents, and digital signatures. However, shipping costs, an effectively non-existent public postal system, customs difficulties with customs, and import duties present practical constraints to the development of electronic commerce in the form of on-line merchandising. Major private air parcel express services serve the capital and major cities, providing generally speedy service.

FOREIGN TRADE BARRIERS

With CAFTA-DR, the Dominican Republic has agreed to provisions on electronic commerce that reflect the issue's importance in global trade and the importance of supplying services by electronic means. The Dominican Republic is committing to non-discriminatory treatment of digital products and agrees not to impose customs duties on such products and to cooperate in policy areas related to e-commerce.

OTHER BARRIERS

U.S. companies continue to complain about a lack of transparency and corruption in many sectors. Lack of predictability in the judicial process, which can also be lengthy, presents problems for U.S. companies seeking to resolve contract disputes. The CAFTA-DR will enhance transparency, predictability, and the rule of law in virtually all areas of trade and investment. Further, the anti-corruption provisions in the agreement require each government to ensure that bribery in trade-related matters is treated as a criminal offense or is subject to comparable penalties under its law.

Dealer Protection

U.S. companies have expressed concern that the Dominican Dealer Protection Law 173, which applies only to foreign suppliers, makes it extremely difficult to terminate contracts with local agents or distributors without paying exorbitant indemnities. Under the existing system, foreign firms may be tied to exclusive or inefficient distributor arrangements.

Several U.S. companies have lost lawsuits brought under this law and have suffered significant financial penalties. By limiting the ability of a foreign firm to change its local agent without severe penalties and compensation, this law has had a negative impact on market access and on consumer welfare. CAFTA-DR requires the Dominican Republic to change this dealer protection regime to provide more freedom to contract the terms of commercial relations and to encourage the use of arbitration to resolve disputes between parties to dealer contracts.

ECUADOR

TRADE SUMMARY

The U.S. goods trade deficit with Ecuador was \$3.8 billion in 2005, an increase of \$1.2 billion from \$2.6 billion in 2004. U.S. goods exports in 2005 were \$2.0 billion, up 18.6 percent from the previous year. Corresponding U.S. imports from Ecuador were \$5.8 billion, up 34.4 percent. Ecuador is currently the 46th largest export market for U.S. goods.

The stock of U.S. foreign direct investment (FDI) in Ecuador in 2004 was \$814 million, down from \$1.1 billion in 2003. U.S. FDI in Ecuador is concentrated largely in the mining sector.

FREE TRADE NEGOTIATIONS

In May 2004, the United States initiated free trade negotiations with Colombia, Ecuador, and Peru. To date, the United States has concluded free trade agreements with Peru and Colombia. Negotiations with Ecuador will resume in late March 2006. Bolivia has participated as an observer and could become part of the agreement at a later stage. The United States has significant economic ties to the region. Total two-way goods trade with the Andean countries of Peru, Colombia, and Ecuador was approximately \$24 billion in 2004. The stock of U.S. foreign direct investment in these countries in 2004 was \$7.7 billion.

IMPORT POLICIES

Tariffs

When Ecuador joined the World Trade Organization (WTO) in January 1996, it bound most of its tariff rates at 30 percent or less. Ecuador's average applied MFN tariff rate is 11.9 percent. Ecuador applies a four-tiered structure with levels of 5 percent for most raw materials and capital goods, 10 percent or 15 percent for intermediate goods, and 20 percent for most consumer goods. A small number of products including planting seeds, agricultural chemicals, and veterinary products are duty free.

As a member of the Andean Community (CAN), Ecuador grants and receives exemptions from tariffs (i.e., reduced *ad valorem* tariffs and no application of the Andean Price Band System) for products from the other CAN countries (Bolivia, Colombia, Peru and Venezuela). Currently, these countries have an Andean Free Trade Zone and apply Common External Tariffs (CET), as stated in CAN Decision 370. On January 31, 2006, the CAN trade ministers decided to postpone the coming into effect of a new CET with a four-tiered structure (percent tariff levels of 0, 5, 10, and 20) for one year, until January 31, 2007. Until then, Peru will apply its own tariff schedule while Ecuador, Colombia, and Venezuela will apply the structure permitted by Decision 370.

FOREIGN TRADE BARRIERS

Ecuador maintains the Andean Price Band System (APBS) on 153 agricultural products (13 “marker” and 140 “linked” products) imported from outside the CAN. The 13 “marker” products are wheat, rice, sugar, barley, white and yellow corn, soybean, soybean meal, African palm oil, soy oil, chicken meat, pork meat, and powder milk. Under this system, the *ad valorem* CET is adjusted (increased or reduced) according to the relationship between international reference prices, established floor and ceiling prices, and the importation price of the commodity. Upon accession to the WTO, Ecuador bound its *ad valorem* tariffs (including the additional levy from the APBS) for these commodities at between 31.5 percent and 85.5 percent.

As part of its WTO accession, Ecuador committed to phase out its price band system, starting in January 1996, with a total phase out by December 2001. No steps have been taken to comply with this commitment. The United States Government is seeking through the free trade negotiations to eliminate Ecuador’s tariffs and other barriers to trade in agricultural products, while providing reasonable adjustment periods and safeguards for producers of import-sensitive agricultural products.

Non-Tariff Measures

Ecuador has failed to eliminate several non-tariff barriers since its WTO accession. Importers must register with the Central Bank through approved banking institutions to obtain an import license. Ecuador requires prior authorization from various government agencies, *e.g.*, the Ministry of Agriculture (MAG), for importation of most commodities, seeds, animals and plants. Also, the Ministry of Health must give its prior authorization (*i.e.*, sanitary registration) before processed, canned and packed foods, food ingredients, beverages, cosmetics, and pharmaceutical products may be imported. Another administrative hurdle agricultural importers must overcome is the MAG’s use of “Consultative Committees.” These committees, mainly composed of local producers, often advise the MAG against granting import permits to foreign suppliers. The MAG often requires that all local production be purchased at high prices before authorizing imports. If this barrier was removed, it is estimated that U.S. corn and soybean meal exports could increase by \$10 million to \$25 million each.

Ecuador assesses a special consumption tax (ICE) of 32 percent on imported and domestic spirits. However, the taxable base upon which Ecuador assesses the ICE is arbitrary and complicated and differs for domestic and imported spirits. For imported spirits, the ICE is applied to the ex-Customs value, which then is arbitrarily marked-up 25 percent (*i.e.*, taxable base = [c.i.f. value + tariff + VAT] x 25 percent); the ICE is assessed on this inflated value. In contrast, for domestic spirits, the ICE is assessed on the basis of an arbitrary reference that has been determined by the government and the 25 percent mark-up is not applied. In both cases, the excise tax is based on arbitrary values and not on actual transaction values. The U.S. will address Ecuador’s discriminatory tax policies for imported distilled spirits in the free trade negotiations.

Ecuador also continues to maintain a pre-shipment inspection (PSI) regime for imports with an f.o.b. value of more than \$4,000. Pre-shipment inspection by an authorized inspection company (both before shipment and after specific export documentation has been completed at the intended destination) results in delays far exceeding the time saved in customs clearance.

FOREIGN TRADE BARRIERS

Customs authorities perform random spot-checks causing further delays. These practices generally add between six and eight weeks to shipping times. In the free trade negotiations with Ecuador, the U.S. government is seeking to establish transparent and efficient custom procedures and specific commitments to expedite the release of goods.

Ecuador maintains bans on the import of used motor vehicles, tires, and clothing and applies a 27 percent excise tax (ICE) on imported distilled spirits. As excise taxes on imports are calculated on CIF value plus import duties, the effective rate is higher for imports than domestic products. Ecuador has not equalized the application of excise taxes between imported and domestic products.

In December 1999, the MAG, through the Ecuadorian Animal and Plant Health Inspection Service (SESA), issued a requirement that all importers must present a certificate stating that imported agricultural products (plants, animals, their products, or byproducts) have not been produced using modern biotechnology. In November 2002, the President issued Executive Decree 3399 creating the National Commission for Biosafety as an office of the Ministry of Environment. It is responsible for biotechnology-related products and regulations issues. However, no rules have yet been enacted.

The United States is seeking the removal of Ecuador's non-tariff measures that impede U.S. exports through the free trade negotiations.

STANDARDS, TESTING, LABELING AND CERTIFICATION

SESA is responsible for administering Ecuador's sanitary and phytosanitary controls. According to Ecuadorian importers, bureaucratic procedures required to obtain clearance still appear to discriminate against foreign products. Ecuador is bound by the WTO Agreement on the Application of Sanitary and Phytosanitary (SPS) Measures, yet denials of SPS certification often appear to lack a scientific basis and to have been used in a discriminatory fashion to block the import of U.S. products that compete with Ecuadorian production. This occurs most often with poultry, turkey and pork meats, beef, dairy products, and fresh fruit. The ability to import some products, such as rice, corn, soybeans, and soybean meal depends entirely on the discretion of the MAG which will often look to the Consultative Committees for advice. Ecuador has yet to fulfill its notification obligations under the WTO SPS Agreement. The impact of removing this barrier would mean an increase of U.S. exports of up to \$10 million.

SESA follows the CAN's "Andean Sanitary Standards." Some standards applicable for third countries are different from those applied to CAN members. For example, there can be differences in the requirements for CAN and third countries for the importation of live animals, animal products, and plants and plant by-products. SESA also requires certifications for each product stating that the product is safe for human consumption or, in the case of live animals, that the animal is healthy and that the country of origin or the area of production is free from certain exotic plant or animal disease. Industry sources assert that this process has been used unreasonably by SESA to prevent entry of animal products - especially poultry - that compete with local producers.

FOREIGN TRADE BARRIERS

Sanitary registrations are required for imported as well as domestic processed food, cosmetics, pesticides, pharmaceuticals, and syringes as well as some other consumer goods. However, in a side agreement to its WTO Accession Agreement, Ecuador committed to accept the U.S. Certificate of Free Sale authorized by the U.S. Food and Drug Administration, instead of the Government of Ecuador's Sanitary Registration. In August 2000, the Government of Ecuador passed a law (*Ley de Promocion Social y Participacion Ciudadana*, Segunda Parte – also known as Trolley II), followed by regulations issued in June 2001, to reform the issuance of sanitary permits for food products. This is a step towards modernizing the issuance of sanitary registrations with new regulations that allow the acceptance of free sale certificates, require that the government, issue sanitary permits within 30 days of the receipt of the request, and reduce the number of documents required to obtain a permit. However, it does not appear that these regulations are being applied consistently and export losses are estimated to be around \$5 million.

U.S. firms report that the Izquieta Perez National Hygiene Institute (INHIP - the Ministry of Health's executive arm responsible for granting the sanitary registration certificate) office in Guayaquil accepts the U.S. Certificates of Free Sale, but continues to apply the old regime for sanitary permits. In addition, non-transparent bureaucratic procedures and inefficiency have delayed issuance beyond 30 days and in some cases have reportedly blocked the entry of some imported products from the United States. Agricultural exporters estimate that the removal of this delay could mean an increase in U.S. exports of about \$5 million.

U.S. companies have expressed concerns regarding regulations issued by Ecuador's public health ministry requiring foreign food manufacturers to disclose confidential information such as formulas of imported food and pharmaceutical products. This requirement appears to go beyond the requirements of the Codex Alimentarius Commission on International Standards and Labeling. Pharmaceutical and agrichemical industry sources estimate that lost exports due to this problem amount to \$10 million to \$25 million.

GOVERNMENT PROCUREMENT

Government procurement is regulated by the 2001 public contracting law. Foreign bidders must be legally represented in Ecuador in order to participate in government procurements. The law does not discriminate against U.S. or foreign suppliers. However, bidding for government contracts can be cumbersome and relatively non-transparent. This can lead to multiple cancellations of bid solicitations, unnecessarily adding to the costs of submitting bids and opening the process to possible manipulation by contracting authorities. Ecuador is not a signatory to the WTO Agreement on Government Procurement. In the free trade negotiations with Ecuador, the U.S. Government is seeking reciprocal opportunities for U.S. companies to bid on Ecuadorian government procurement. If the government procurement process was made more transparent and less cumbersome, exports by U.S. companies could increase by \$10 million to \$25 million.

FOREIGN TRADE BARRIERS

EXPORT SUBSIDIES

Ecuador has created a semi-independent agency, the Corporation for the Promotion of Exports and Investments (Corpei), to promote Ecuadorian exports. Using a European Union loan, Corpei offers matching grants to exporters to help fund certain expenses including international promotional events and export certifications.

INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

In 1998, Ecuador enacted a comprehensive law that significantly improved the legal basis for protecting intellectual property including patents, trademarks and copyrights. The intellectual property law provides greater protection for intellectual property; however, it is deficient in a number of areas and the law is not being adequately enforced.

Ecuador's current intellectual property regime is provided for under its IPR law and Andean Pact Decisions 486, 345, and 351. Ecuador is a member of the World Intellectual Property Organization (WIPO), the WIPO Copyright Treaty, and the WIPO Performances and Phonograms Treaty. Furthermore, Ecuador has ratified the Berne Convention for the Protection of Literary and Artistic Works, the Geneva Phonograms Convention, the Paris Convention for the Protection of Industrial Property, and the WIPO Patent Cooperation Treaty.

The United States is negotiating IPR provisions in the free trade negotiations with Ecuador to improve protection and strengthen enforcement of IPR. The U.S. Government is seeking to address specific U.S. industry concerns related to the protection and enforcement of copyrights and related rights, patents, proprietary data for pharmaceutical and agricultural products, trademarks and geographical indications.

Copyrights

The Government of Ecuador, through the National Copyright Office's Strategic Plan against Piracy, has committed to take action to reduce the levels of copyright piracy, including implementation and enforcement of its 1998 Copyright Law. However, enforcement of copyrights remains a significant problem, especially concerning sound recordings, computer software, and motion pictures. The Government of Ecuador has taken no action to clarify Article 78 of the 1999 Law on Higher Education, which could be interpreted to permit software copyright violations by educational institutions.

Patents and Trademarks

Ecuador's 1998 IPR law provided an improved legal basis for protecting patents, trademarks, and trade secrets. However, concerns remain regarding several provisions, including a working requirement for patents, compulsory licensing, and the lack of enforcement in the protection of test data. U.S. companies are also concerned that the Ecuadorian government does not provide patent protection to new uses of previously known or patented products.

FOREIGN TRADE BARRIERS

Government of Ecuador health authorities continue to approve the commercialization of new drugs that are the bioequivalent of patented drugs, thereby denying the originator companies protection against unfair competition for their pharmaceutical test data. In effect, the Government of Ecuador is allowing the test data of registered drugs from originator companies to be used by others seeking approval for their own pirate version of the same product. The U.S. Government is seeking provisions against such reliance by another on an innovator's test data in the free trade negotiations with Ecuador.

Enforcement

There continues to be an active local trade in pirated audio and video recordings, computer software and counterfeit brand name apparel. The International Intellectual Property Alliance estimates that piracy levels in Ecuador for both motion pictures and recorded music has reached 90 percent, with estimated damage due to music piracy of \$26.3 million. At times, judges in IPR cases, before issuing a preliminary injunction, demand a guaranty and evidentiary requirements that exceed legal requirements and in effect limit the ability of rights holders to enforce their rights. Ecuador has made no progress in establishing the specialized IPR courts required by Ecuador's 1998 IPR law. The national police and the customs service are responsible for carrying out IPR enforcement, but do not always enforce court orders. Some local pharmaceutical companies produce or import pirated drugs and have sought to block compliance with Ecuador's Intellectual Property law and improvements in patent protection. U.S. industry estimates damage due to the failure to provide data exclusivity is at least \$5 million. The U.S. Government is supporting provisions to enhance enforcement of IPR in Ecuador in the free trade negotiations.

SERVICES BARRIERS

Ecuador has ratified the WTO Agreement on Financial Services. The 1993 Equity Markets Law and the 1994 General Financial Institutions Law significantly opened markets in financial services and provided for national treatment of foreign suppliers. Foreign professionals are subject to national licensing requirements. The Superintendent of Banks must certify accountants.

In the area of basic telecommunications, Ecuador only subscribed to WTO commitments for domestic cellular services. It did not make market access or national treatment commitments for a range of other domestic and international telecommunications services, such as voice telephony and data. In addition, Ecuador does not adhere to the pro-competitive regulatory commitments of the WTO Reference Paper. Several U.S. telecommunications companies have had their international circuits disconnected without proper notice of alleged infractions.

The U.S. Government is seeking in the free trade negotiations with Ecuador greater access for U.S. providers of cross-border services to the Ecuadorian market, including in the areas of financial and telecommunications services.

FOREIGN TRADE BARRIERS

INVESTMENT BARRIERS

Ecuador's foreign investment policy is governed largely by the national implementing legislation for Andean Pact Decisions 291 and 292 of 1991. Under Ecuadorian law, foreign investors are accorded the same rights of establishment as Ecuadorian private investors, may own up to 100 percent of enterprises in most sectors without prior government approval, and face the same tax regime. There are no controls or limits on transfers of profits or capital. U.S. companies are sometimes reluctant to resolve commercial disputes in the Ecuadorian legal system, fearing a prolonged process and a lack of impartiality.

The U.S.-Ecuador Bilateral Investment Treaty (BIT), which entered into force in May 1997, includes obligations relating to national and most-favored-nation treatment; prompt, adequate and effective compensation for expropriation; the freedom to make investment-related transfers; and access to binding international arbitration of investment disputes. These and other core provisions of the BIT would also be included in the investment chapter of a free trade agreement between the U.S. and Ecuador.

In early 2005, Ecuador's Congress modified the Arbitration and Mediation Law to prohibit international arbitration of investment disputes if the national interest could be affected. Depending on how it is interpreted and applied, this modification of Ecuador's law could conflict with Ecuador's standing consent to binding arbitration under the U.S.-Ecuador BIT and under the investment chapter of the free trade agreement. At a minimum, the new law will create confusion among investors regarding their arbitration rights and may also reinforce negative impressions among investors of Ecuador's commitment to international arbitration.

Certain sectors of Ecuador's economy are reserved to the state. All foreign investment in petroleum exploration and development must be carried out under contract with the state oil company. U.S. and other foreign oil companies produce oil in Ecuador under such contracts.

Several oil companies are involved in a dispute with the government of Ecuador relating to the refund of value-added taxes. In 2004, one of the disputing U.S. companies won a \$75 million international arbitration award against the government of Ecuador. The government has requested a judicial review of the arbitration award. After notice of the award, Ecuador's solicitor general (Procurador General) initiated an investigation of the company for allegedly transferring assets to another foreign company without obtaining the required government authorization. The Ecuadorian government has since threatened the nullification of the company's contract and seizure of the company's considerable assets in Ecuador.

Foreign investment in domestic fishing operations, with exceptions, is limited to 49 percent of equity. Foreign companies cannot own more than 25 percent equity in broadcast stations. Foreigners are prohibited from owning land on the borders or the coast.

Effective compensation for expropriation is provided for in Ecuadorian law but is often difficult to obtain. The extent to which foreign and domestic investors receive prompt, adequate, and effective compensation for expropriations varies widely. It can be difficult to enforce property and concession rights, particularly in the agriculture, oil, and mining sectors.

FOREIGN TRADE BARRIERS

Foreign oil, energy, and telecommunications companies, among others, have often had difficulties resolving contract issues with state or local partners. The transparency and stability of the country's investment regime are significantly weakened by the existence of numerous investment-related laws that overlap or that appears to have mutually inconsistent provisions. This judicial complexity increases the risks and costs of doing business in Ecuador.

The U.S. Government has worked with the Government of Ecuador both before and in parallel with the free trade negotiations to ensure a fair resolution of U.S. investor disputes, consistent with Ecuadorian law.

ELECTRONIC COMMERCE

Ecuador passed an electronic commerce law in April 2002 that makes the use of electronic signatures in business transactions on the Internet legally binding and makes digital theft a crime. Ecuador has initiated a program for e-government services and to promote public access to information technology through funding from international financial institutions. The U.S. is seeking in the free trade negotiations with Ecuador to include rules prohibiting duties on and discrimination against digital products, such as computer programs, videos, images, and sound recordings, based on where they are made or the nationality of the firms or persons making them.

EGYPT

TRADE SUMMARY

The U.S. goods trade surplus with Egypt was \$1.1 billion in 2005, a decrease of \$716 million from \$1.8 billion in 2004. U.S. goods exports in 2005 were \$3.2 billion, up 3 percent from the previous year. Corresponding U.S. imports from Egypt were \$2.1 billion, up 63 percent. Egypt is currently the 38th largest export market for U.S. goods.

The stock of U.S. foreign direct investment (FDI) in Egypt in 2004 was \$4.2 billion, up from \$3.5 billion in 2003. U.S. FDI in Egypt is concentrated largely in the mining sector.

IMPORT POLICIES

Over the past decade, the Government of Egypt (GOE) has gradually implemented a number of import policies to promote greater trade liberalization. Progress in economic reform was halting during the last several years, but received renewed impetus with the appointment of Prime Minister Ahmed Nazif and a new ministerial economic team in July 2004. Under the leadership of Prime Minister Nazif, the GOE has adopted a wide range of significant reform measures, but problems still remain that add to the cost of doing business. The GOE will have to continue efforts to reduce red tape, reduce corruption, reform the cumbersome bureaucracy, and eliminate unreasonable and excessive Egyptian health and safety standards.

Tariffs

On September 8, 2004, the GOE announced a new tariff structure. The government removed services fees and import surcharges, reduced the number of *ad valorem* tariff rates from 27 to 6, dismantled tariff inconsistencies, and rationalized national sub-headings above the six-digit level of the Harmonized System (HS). The new tariff structure includes six tariff rates, pegged to the degree of processing of the good that range from 2 percent on raw materials, spare parts, and primary feeding products to 40 percent on durable consumer goods. The changes in tariffs reduced the officially announced weighted average tariff rate from 14.6 percent to 9.1 percent. The government also eliminated services fees and import surcharges ranging from 1 percent to 4 percent. The GOE replaced its 13,000-line ten-digit tariff structure with a six-digit structure with less than 6,000 tariff lines. This change should reduce disputes over product classification for customs purposes. Additionally, the GOE eliminated export duties on 25 products that were in short supply on the domestic market. Although the Finance Minister announced his intention to reduce tariffs further by mid-2005, to date, no further reductions have been made. Meanwhile, a number of high tariffs still exist, including duties on poultry, alcoholic beverages, tobacco and cigarettes, and passenger vehicles with a cylinder capacity (cc) above 2,000.

FOREIGN TRADE BARRIERS

All goods are subject to sales tax ranging from 5 percent to 25 percent. Egypt applies a sales tax of 10 percent on high-quality imported flour that is not applied to locally produced flour. In December 2004, the Ministry of Finance passed an amendment to the sales tax law aimed at reducing prices and attracting new investment opportunities. In early 2005, Law No. 9 was issued, which exempted capital goods from the sales tax. The Finance Minister has emphasized that some additional amendments to the sales tax will be introduced in 2006 to unify sales tax categories, establish new tax rebates, and raise the minimum requirement for sales tax registration to exempt small producers and traders.

The current minimum registration amounts are annual sales of LE 150,000 (approximately \$26,100) for traders and LE 54,000 (approximately \$9,400) for producers and service-providers.

In January 2004, the GOE formally repealed a long-standing ban on commercial clothing and fabric imports and replaced per-piece tariffs on clothing (which the United States had challenged in the WTO in December 2003) with *ad valorem* tariffs consistent with Egypt's WTO commitments. In December 2004, Egypt reduced tariffs for certain textile and apparel products and committed to a further round of tariff cuts for additional textile and apparel products that is expected to take place during the first parliamentary session in mid-2006. Currently the tariff rate on apparel is 40 percent. A February 2004 ministerial decree required companies wishing to export to Egypt to register with the Egyptian General Organization for Import and Export Controls (GOIEC) and to certify their compliance with international labor, health, and environmental standards through on-site inspections by GOIEC inspectors. The decree was amended in October 2004 to remove the inspection obligation, but maintained the registration requirement.

Tariffs on passenger cars with engines under 1,600cc were reduced in September 2004 to a maximum of 40 percent, while cars with engines over 1,600cc now have a tariff rate of 135 percent. The tariff rate on poultry was reduced to 32 percent; although the GOE maintains a ban on U.S. poultry imports citing Halal concerns (see below). There is a 300 percent duty on wine for use in hotels, and a tariff ranging between 1,200 percent and 3,000 percent on alcoholic beverages for general importers. Foreign movies are subject to duties and import taxes of about 46 percent of the value of a film (32 percent for a copy of the movie, 12 percent on posters and 2 percent on the movie reel), as well as a 10 percent sales tax and a 20 percent box office tax (compared to a five percent box office tax for local films).

High tariffs restrict the competitiveness of U.S. food products such as U.S. apples and pears, which face a 40 percent *ad valorem* duty and U.S. exporters report that Egypt's application of sanitary and phytosanitary measures to these products are non-transparent and burdensome.

In March 2005, the Parliament passed legislation that included provisions to reduce taxes on soft drinks from a high of 60 percent to an effective sales tax rate (after government-approved deductions) of about 18 percent. Customs Procedures Egypt adopted the WTO customs valuation system in July 2001. The system has not been fully implemented, and thus importers sometimes face a confusing mix of the new (invoice-based) and old (reference price) valuation systems depending on the type of imports.

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The Ministry of Finance is trying to assist customs officials by translating and simplifying the WTO valuation system, which uses seven valuation methods. The Ministry of Finance has committed to a comprehensive program to reform Egypt's customs administration, and a priority is to complete implementation of the WTO Customs Valuation Agreement. USAID is funding a six-year, \$30 million customs reform project to support the Ministry of Finance's efforts. The Ministry of Finance is also working with other donors, including the European Union, on customs reform issues. In this context, a comprehensive amendment of the Executive Regulations of the Customs Law has been prepared by the Ministry and is now being circulated in the private sector for comment, after which it will be submitted to Parliament for discussion and ratification. The amendment would further address customs valuation and other problems. As of December 2005, however, the amendment had not been submitted to Parliament.

The September 2003 inauguration of the Cairo Model Customs and Tax Center was an important step in modernizing customs and tax administration in Egypt. Taxpayers registered in greater Cairo can use this "one-stop shop" to settle income taxes, sales taxes and customs duties for goods passing through any of Egypt's ports. Two model customs centers were opened in Alexandria and Suez in 2005, and two others (in Dekheila and Port Said) are expected to open in 2006.

Import Bans and Barriers

Passenger vehicles may only be imported within one year after the year of production. Egyptian regulations do allow investors to import a vehicle for private use without restriction on the year of manufacture, provided that an approval is obtained from the Chairman of the General Authority for Investments and Free Zones (GOIEC). Pending customs regulations would allow Egyptian expatriates who are returning to depreciate the value of their personal cars by ten percent of the FOB value for the first year after manufacture and five percent for every subsequent year.

According to the Egyptian Ministry of Health's regulations, natural products, vitamins, and food supplements are prohibited from importation into Egypt in their finished form. The only way these items can be marketed in Egypt is through a local manufacture under license, or by sending ingredients and premixes to a local pharmaceutical firm to be prepared and packed in accordance with the specifications of the Ministry of Health. Only local factories are allowed to produce food supplements and import raw materials to be used in the manufacturing process.

Egypt also bans the importation of used and refurbished medical equipment and supplies. The ban does not differentiate between the most complex computer-based imaging equipment and the most basic of supplies.

Egypt continues to block imports of U.S. poultry and poultry products based on concerns that U.S. industry does not meet Egyptian Halal requirements. Despite technical meetings and a June 2003 written submission on steps by U.S. industry to assure Halal treatment, the ban continues. The ban was discussed at Trade and Investment Framework Agreement (TIFA) meetings in November 2005, and the GOE gave assurances that it would address this issue in the near future.

STANDARDS, TESTING, LABELING AND CERTIFICATION

Standards are established by the Egyptian Organization for Standardization and Quality Control (EOS) in the Ministry of Trade and Industry. Verification of compliance, however, is the responsibility of agencies affiliated with various ministries, including the Ministry of Health, the Ministry of Agriculture and, for imported goods, GOIEC in the Ministry of Foreign Trade and Industry.

Egypt has increased efforts to bring mandatory regulations into conformity with international standards. Of Egypt's 3,387 standards, 387 are Egyptian technical regulations or mandatory standards. Of these, the majority concern food products, engineering goods and textiles and clothing. In the absence of a mandatory Egyptian standard, Ministerial Decree Number 180/1996 allows importers to choose a relevant standard among seven international systems: including ISO, European, American, Japanese, British, German and, for food, accepts Codex standards. Importers, however, report that despite having met international standards and/or displaying international marks, products often are subjected to standards testing upon arrival at the port. Product testing procedures are not uniform or transparent, and inadequately staffed and poorly equipped laboratories often yield faulty test results and lengthy delays. Procedures seem to be particularly cumbersome for the products falling under the purview of the Ministry of Health.

Egyptian standards are reviewed periodically, usually once every five years, to ensure their relevance to current requirements. In December 2004, Egypt embarked on a program to ensure that all its standards comply with international standards. The EOS completed the examination of all 387 mandatory standards and 2,000 of the voluntary standards in 2005. It began reviewing the remaining 1,000 voluntary standards in the beginning of 2006.

In addition to standards, the EOS also issues quality and conformity marks. The conformity marks are mandatory for certain goods that can affect health and safety. The quality mark is issued by the EOS upon request by a producer and is valid for two years. Goods carrying the mark are subject to random testing.

In October 2005, Egypt's testing requirements improved with the issuance of new import/export regulations, which completely replaced the old regulations with more transparent and liberalized rules designed to facilitate trade. The new regulations reduced the number of imported goods subject to inspection by GOEIC.

They also permitted importers to rely on certifications of conformity from any internationally accredited laboratory inside or outside of Egypt for those goods still subject to inspection by

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GOEIC. As noted above, although the inspection regime has been liberalized in practice, the new regulations are not applied consistently or uniformly.

The new import/export regulations also transferred responsibility for issuing and reviewing certificates of origin from GOEIC to the Egyptian Customs Administration, introduced a mechanism for enforcing intellectual property rights at the border, and extended the preferential inspection treatment given to inputs for manufacturing to include inputs for the service industry. An explicit list of the chemicals that cannot be imported into Egypt was issued with the new regulations, thus clarifying a previously ambiguous procedure.

In response to U.S. requests, in 2004 Egypt took steps to address barriers to imports of U.S. and other foreign textiles and apparel, including modifying costly and complicated labeling requirements and testing procedures. The new export/import regulations eliminated the previous factory inspection requirement for garment imports. Egypt also committed to expedite the customs clearance process for apparel and textile imports.

With respect to agricultural products, Egyptian tariff and non-tariff barriers adversely impact bilateral trade. While Egypt is a key U.S. agricultural export market and a major purchaser of U.S. wheat and corn, certain imports, like poultry parts, are banned. Others, including beef, apples and pears, are subject to sanitary and phytosanitary measures that are non-transparent and burdensome. Food imports are sometimes subject to quality standards that appear to lack technical and scientific justification, and exports may have to comply with burdensome labeling and packaging requirements. For example, meat products can only be imported directly from the country of origin and must include details in Arabic sealed inside and listed on the outside of the package. This labeling requirement raises processing costs and discourages some exporters from competing in the Egyptian market.

The Ministry of Trade and Industry is working with other ministries, especially with the Ministries of Health and Agriculture, to review sanitary and phytosanitary standards and the inspection of food products to ensure WTO compliance and prevent duplicative inspection. The new export/import regulations eliminated the requirement that perishable products have at least one-half of their shelf life remaining at the time of import, but further amendment of an Egyptian standard may be required before this can be fully implemented.

GOVERNMENT PROCUREMENT

Egypt is not a signatory to the WTO Agreement on Government Procurement. The 1998 law governing government procurement mandates that technical factors, not just price, be considered in awarding contracts. A preference is granted to parastatal companies when the bid of a publicly-owned firm is within 15 percent of other bids. In the Small and Medium-Sized Enterprises (SMEs) Development Law, issued in 2004, SMEs were given the right to supply 10 percent of the value of all government procurement denoted in any tender

Contractors receive certain rights under the law, such as speedy return of their bid bonds and an explanation of why a competing contractor won the bid. Many concerns about transparency

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remain, however. For example, the Prime Minister can authorize the method of tendering for specific entities according to terms, conditions, and rules that he determines.

In August 2004, the Prime Minister issued a decree stipulating strict adherence by all government ministries to the provisions of the Tenders and Auctions law that limit direct orders to cases of national security or emergency. An amendment to the Tenders and Auctions Law is being finalized that will require governmental authorities to fulfill 95 percent of the value of procurement within 60 days or pay compensation if they fail to do so. The amendment also stipulates compensating contractors for price fluctuations that might occur during the first year of the contract. Egypt supports discussion of transparency in government procurement in the WTO.

INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

Though Egypt is a signatory to many of the international intellectual property conventions, intellectual property rights (IPR) protection was well below international standards until 2002. In 2002, Egypt took important steps to strengthen its IPR regime through improvements in its domestic legal framework and enforcement capabilities. In May 2002, Egypt passed a comprehensive IPR law to protect intellectual property and to attempt to bring the country into line with its obligations under the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS). The law addresses IPR protection in areas such as patents, copyrights (with enhanced protection for sound and motion picture recordings and computer software), trademarks, geographical indications, plant varieties, industrial designs, and semiconductor chip layout design. With respect to certain violations, the law stipulates higher fines and prison sentences for convicted violators. Although the law has certain shortcomings, its passage demonstrated a marked improvement in Egypt's IPR regime, offering protection for the first time for several types of intellectual property. The executive regulations dealing with patents, trademarks, and plant variety protection were issued in June 2003. Regulations protecting copyright and related rights were also issued in June 2003. The U.S. government continues to work with the Government of Egypt to resolve remaining deficiencies in Egypt's IPR regime.

Responding to Egypt's improved IPR protection, in May 2003 the United States Trade Representative (USTR) moved Egypt from the Special 301 "Priority Watch List" (a designation that Egypt had retained since 1997) to the "Watch List." However, the U.S. government was deeply concerned by Egyptian government approval in late 2003 for local manufacturers to produce patent-infringing copies of several U.S. pharmaceutical products, an action that runs contrary to Egypt's obligations to protect the holder of the intellectual property rights of such products. As a result of these approvals, in 2004 USTR again elevated Egypt to the "Priority Watch List."

Egypt's inadequate protection of the intellectual property of U.S. and other foreign pharmaceutical firms continued to raise serious concerns during 2005. In late 2004 and early 2005, there were indications that the Egyptian Ministry of Health was preparing to approve a significant number of unauthorized copies of U.S. pharmaceutical products for marketing in Egypt based on reliance upon confidential test data submitted by U.S. firms. The U.S. government strongly expressed its concern that such approvals would violate Egypt's obligations under TRIPS, its own IPR law, Prime Ministerial Decree 2211, and assurances Egypt has given

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the U.S. government that it will provide strong data protection. The Health Ministry abstained from approving of unauthorized copies in 2005 until late December, when an unauthorized generic version of a flagship product of a U.S. pharmaceutical company was introduced to the Egyptian market. In another development, an Egyptian court rescinded a U.S. firm's exclusive marketing rights for a product pending patent approval. With patent approval in Egypt requiring at least two to three years and the Egyptian Government failing to assure protection of confidential test data and prevention of unauthorized copies of U.S. pharmaceutical products, this development further weakened protection of intellectual property in this sector.

Substantial and meaningful progress has been made in establishing and strengthening some of the government institutions necessary for an effective intellectual property protection regime, and the enforcement of IPR has improved in 2005 compared with 2004. Provisions of the new IPR Code allowing for the protection of pharmaceutical products became effective on January 1, 2005. A modern, computerized Egyptian Patent Office operating under the authority of the Ministry of Higher Education and State for Scientific Research has been working to improve its ability to receive and examine paper or electronically filed patent applications. This office has also significantly improved the quality and transparency of Egypt's trademark registration system.

Egypt has taken advantage of various technical assistance opportunities provided by both the USAID and the United States Patent and Trademark Office (USPTO) on topics such as patent and trademark examination, specialized pharmaceutical patent examination, and industrial design examination. The Patent Cooperation Treaty (PCT) entered into force in Egypt in September 2003. In 2005, Egypt began reviewing PCT patent applications filed for approval in Egypt. Currently, Egypt is the eighth largest filer of PCT patent applications among developing-country PCT members. In accordance with its TRIPS obligations, the Egyptian Patent Office opened the "mailbox" for pharmaceutical patent applications on January 1, 2005, and began examining the approximately 1,500 pharmaceutical patents that had been submitted for approval through this process. In addition, the World Intellectual Property Organization (WIPO) has designated Egypt as a regional patent training center. The Egyptian Patent Office also is in the process of adopting a manual of patent examination procedures to promote quality, consistency, and transparency.

The new IP law offers trademark protection for 10 years. Concerns remain, however, regarding key TRIPS obligations including the lack of a specific grant of trademark rights in accordance with Article 16.1 of TRIPS.

In addition, the new IP law lacks a specific provision implementing TRIPS Article 23, which requires members to provide the legal means to prevent the use of geographical indications for wines and spirits where the goods do not come from the place named, even if consumers are not misled.

The Egyptian Trademark and Industrial Designs Office, as well as market inspectors responsible for non-copyright related IPR enforcement are located in the Ministry of Trade and Industry. In 2005, the Trademark Office eliminated a five-year backlog of pending trademark applications. It currently takes one year to register a mark in Egypt. The Ministry relocated the Trademark and Industrial Designs Office to a modern facility in December 2005. The process of registration is

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being fully automated, and the new offices have access to the Internet for international searches for the first time, as well as other communications improvements. Industrial design applications are now being examined, and the offices are developing transparent procedures for filing and examination.

Infringement of trademarks, textile designs, and industrial designs remains a problem, but the GOE has taken steps to improve enforcement in this area by training civil inspectors in IPR enforcement, issuing improved inspections procedures and taking steps to implement measures at its borders to prevent the importation of counterfeit and pirated goods. New regulations and procedures to implement TRIPS border measures are also being developed.

In October 2004, the Ministry of Agriculture established a new Plant Variety Registration Office. However, articles still exist in the Egyptian 2002 IPR law that make it very difficult for applicants to meet the requirements to register for protection of their new, distinct, uniform, and stable plant varieties. As of December 2005, no new plant varieties have been registered by the office. The Ministry of Agriculture has formed a committee to resolve the problems associated with granting plant variety protection in Egypt, but no action has yet been taken. U.S. companies are still advised not to export new breeding material or new plant varieties to Egypt until the issues are addressed. Egypt is working on reforming the administration of its IPR laws, including protection of plant varieties, as part of its efforts to join the International Union for the Protection of New Varieties of Plants.

High levels of piracy adversely impact most of the copyright industries in Egypt, including motion pictures (in video cassette format), sound recordings, and books and other printed matter, and computer software. Improvements have occurred with regard to computer software protection, and the GOE took steps to ensure the authorized use of legitimate business software in civilian government departments and schools. Major U.S. software and computer companies operating in Egypt report a piracy rate in business software under 50 percent and improved enforcement in 2004 and 2005. Unfortunately, there continues to be a problem with false licensing, where a local distributor presents documents purporting to authorize the distribution of a work, but the documents are supplied by a party that lacks the authority to grant the authorization. Even when the Ministry of Culture is convinced that the documents are fraudulent, the distributor is permitted to rely upon Ministry of Culture approval and to distribute pirated software, music, and films. This practice undermines copyright protection in Egypt. The Egyptian government took steps to revoke such approvals for well-known pirates. The lack of further action against false licensing is reported to be a result of the government's inadequate human and physical resources in this area.

A USAID technical assistance program is working with several Egyptian Ministries to strengthen IPR enforcement and increase public awareness. Reports indicate an increase in police and ministry involvement in IPR protection in 2004 and 2005. The USAID program is also working with the Ministry of Justice on IPR enforcement issues, including on efforts to increase the legal awareness of judges on IPR issues and to build institutional capacity to handle infringement cases. In 2005, approximately 450 judges received local training in intellectual property rights enforcement through the project, and Egyptian judges also participated in IPR enforcement

training programs in the United States. In addition, 150 civil inspectors have been trained in IPR enforcement procedures.

SERVICES BARRIERS

GATS Commitments

Egypt participated actively in the Uruguay Round negotiations on services, but made commitments in only four sectors: construction, tourism, financial services, and international maritime transport. Egypt subsequently made commitments in the 1997 WTO Agreement on Financial Services. Egypt is gradually implementing its General Agreement on Trade in Services (GATS) commitments. Egypt supported launching a new round of trade negotiations, including trade in services, at the WTO Ministerial meeting in Doha in November 2001. In late June 2005, Egypt revised its services offer and included a number of new sectors: computer services, courier services, air transport services, some construction sub-sectors (building and finishing works), and some insurance sub-sectors.

Egypt has restrictions for most service sectors in which it has made GATS commitments. These restrictions place a 49 percent limit on foreign equity in construction and transport services. In the computer services sector, larger contributions of foreign equity may be permitted, such as when the Ministry of Communication and Information Technology determines that such services are an integral part of a larger business model and will add value to the country. With courier services, some cases require special authorization from the Egyptian National Postal Organization (ENPO). Egypt restricts the employment of non-nationals to 10 percent of the personnel employed by a company. Limitations on foreign management also apply to computer-related services (60 percent of top-level management should be Egyptian after three years of the start up date of the venture). Restrictions on the acquisition of land by foreigners for commercial purposes were amended in 2002 to allow the acquisition of land by non-Egyptians under certain criteria and procedures.

Insurance

Foreign firms may own up to 100 percent of Egyptian private insurance firms, although the market remains closed to foreign intermediaries. There are currently at least six foreign insurance companies operating in the market. There are eleven private sector insurance companies, three of which are joint ventures with U.S. firms.

The Egyptian market remains small and underdeveloped due to many factors including the excessive stamp duties and premium taxes. The market remains dominated by the four state-owned insurance companies that controlled over 75 percent of the non-life insurance market and 56.2 percent of the life insurance market in 2004. In September 2005, the Ministry of Investment announced that Egypt had commissioned an international consortium to restructure its four state-owned insurance companies, opening the way for their privatization. The ministry has selected the Paris-based BNP-Paribas, Egypt's Commercial International Bank (CIB), and the New York-based insurance consulting firm Milliman to do the job. The "privatization team" continues to work on a privatization plan for one or more of the state-owned insurance

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companies, but there is no timetable or absolute commitment and all the companies will not be privatized.

Banking

There are 61 banks in Egypt, 22 of which are joint ventures with foreign participation. As a result of its commitments under the 1997 WTO Agreement on Financial Services, Egypt does not limit foreign equity participation in local banks. Several foreign banks have majority shares in Egyptian banks, while other foreign banks are registered as branches of the parent bank (rather than subsidiaries). In all cases, these foreign banks can conduct all banking activities in Egypt. New foreign banking entrants face barriers, however. Because the government believes there are too many banks in Egypt, it has not issued a new banking license in at least ten years and it plans in the next five years to reduce the number of banks in Egypt to 21. As a result, the only way a foreign bank can enter the market in Egypt is to purchase an existing bank. The United States views licensing restrictions on U.S. financial institutions as a serious concern.

In 2002, the Central Bank of Egypt (CBE) required that banks raise their capital adequacy ratios to meet Basel II standards. The 2003 banking law substantially raised minimum capital requirements for all banks to LE 500 million (approximately \$ 87 million), mandating that banks unable to meet this requirement either merge with other banks or exit the market. The deadline of June 2005 for banks to meet the capital increase was finally adhered to after several postponements. Four banks failed to achieve the new threshold and are to undertake subsequent procedures such as merging with larger institutions. Although the government has advocated the merger of some smaller banks since early 2001, it was not until late 2004 that two banks merged and three applied for CBE approval. More progress was made in 2005 with the merger of two large state banks, Banque Misr and Banque du Caire, and the merger of the National Societe Generale Bank (NSGB) with Misr International Bank. The GOE has also been proceeding with plans to divest its shares in joint venture banks. To date, six joint venture banks have been divested of public shares.

Progress has been slow in the government's plans to privatize the four state-owned banks that control over 50 percent of the banking sector's total assets. In 2004, the government appointed new, western-trained senior management teams for the four banks. Government plans to privatize one public bank (the Bank of Alexandria) were announced following the appointment of a new Cabinet in July 2004. This privatization was expected to be completed by the end of 2005, but a revised forecast now anticipates that the privatization will occur in early 2006. The downsizing and privatization of Egypt's banking sector should strengthen it and improve implementation of market-based financial operations.

Securities

Egypt's WTO financial services commitment in the securities sector provides for unrestricted market access and national treatment for foreign companies. International investors are permitted to operate in the Egyptian stock market largely without restriction. Several foreign brokers, including U.S. and European firms, have established or purchased stakes in brokerage companies. In May 2002, the Minister of Finance issued a decree to establish the Primary

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Dealers System, which started operating in July 2004. The new system allows financial institutions that are registered with the Ministry of Finance, currently including 13 banks, to underwrite primary issues of government securities and to activate trading in the secondary market through sale, purchase, and repurchase of government securities. The government is using the primary dealers system to manage its public debt, secure non-CBE finance, and create a market-based yield curve for public debt.

Telecommunications

Telecommunications services have expanded rapidly in the past four years as the sector has been liberalized and opened to international competition. The impetus for the liberalization came from Egypt's accession in June 2002 to the WTO Basic Telecommunications Agreement and to the WTO Information Technology Agreement in April 2003. These agreements required the liberalization of telecommunication services, full autonomy of the National Telecommunications Regulatory Authority by January 2006, and the phasing out of tariffs on all information technology imports from WTO members. In February 2003, Egypt's parliament approved a new telecommunications law that established the framework for the government to meet these commitments. More progress, however, is needed in establishing full autonomy for the National Telecommunication Regulatory Authority. The 2003 law provides for the termination of Telecom Egypt's monopoly of domestic and international telephone service by January 2006. While domestic service is now open to competition and steps are underway to implement the 2003 law for international service, new entrants have yet to begin to operate in these areas of Egypt's telecommunications sector.

Egypt has made significant progress in meeting its WTO telecommunications-related commitments. The GOE began dismantling its state-owned Telecom Egypt monopoly in December 2005 by privatizing 20 percent of its assets. International firms actively participate in Internet and cellular services, and are eligible to bid on licenses for new telecommunications services and for contracts offered by Telecom Egypt to modernize its networks and switching equipment. Telecom Egypt has sought foreign participation in the management and operation of the national telecommunications grid, although no agreements have yet been signed.

In the cellular service market, which currently consists of two private GSM operators, the government plans to allow more competition by issuing a third license through public tender in 2006. The license will stipulate that the winner employ neutral second- or third-generation technology (either GSM or CDMA). The GOE has set the second quarter of 2007 as the target date for the third mobile company to be fully operational.

At least one major U.S. carrier reports serious difficulty in interconnecting its network with Egypt's monopoly carrier, Telecom Egypt (TE), based on TE reluctance to negotiate. USTR has requested that both Egypt's regulator and its Ministry of Communications work to resolve this issue.

Transportation

Maritime and air transportation services are being liberalized. A 1998 law ended the long-held government monopoly in maritime transport, and the private sector now conducts most maritime activities, including loading, supplying, ship repair, and, increasingly, container handling. The new Ain Sukhna port is the first privately owned and operated Egyptian port and East Port Said port, which was inaugurated in October 2004, is the second. Egypt Air's monopoly on carrying passengers has been curtailed, and several privately owned airlines now operate regularly scheduled domestic flights and international charter services, although the national carrier remains by far the dominant player in the sector. The United States Air Transport Agreement with Egypt was concluded in 1964 and has been changed only twice in the past 37 years. In 1991, a security article was added. In 1997, the delegations agreed to amend the agreement with the addition of limited cooperative marketing arrangements; some increased routing and operational flexibility, and a safety article. The agreement remains very restrictive, with no provisions on charter services, and Egypt has repeatedly declined our proposals to conclude an Open Skies air services agreement. Private and foreign air carriers may not operate charter flights to and from Cairo without the approval of the national carrier, Egypt Air.

Other Services

Egypt maintains several other barriers to the provision of certain services by U.S. and other foreign firms. Foreign motion pictures are subject to a screen quota and distributors are allowed to import only five prints of any foreign film. The GOE applies to private express mail operators a postal agency fee of 10 percent of annual revenue from shipments under 20 kilos, a fee that negatively affects their competitiveness.

Shipments weighing more than 20 kilos are treated as freight and are not subject to the 10 percent fee. According to the Egyptian labor law, foreigners cannot be employed as export and import customs clearance officers or tourist guides.

INVESTMENT BARRIERS

Under the 1992 United States-Egypt Bilateral Investment Treaty (BIT), Egypt committed to maintaining the critical elements of an open investment regime, including national and most-favored nation (MFN) treatment (with exceptions specified in the treaty), the right to make financial transfers freely and promptly, and international law standards for expropriation and compensation. The BIT also established formal procedures to enforce the treaty, including international arbitration.

In 1999, Egypt and the United States signed a Trade and Investment Framework Agreement (TIFA) that established a TIFA Council designed to facilitate the discussion of bilateral trade and investment issues. The Council met most recently in November 2005 to review the findings of 14 working groups that are examining technical issues related to every sector of the economy. The results of the TIFA process will be used to strengthen bilateral trade and investment relations, with the goal of establishing a solid foundation for any future trade negotiations.

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In June 2005, a new income tax law was passed by the Egyptian Parliament. The law reduced and simplified tax rates on corporate profits and personal income. The corporate tax rate was reduced from 42 percent to 20 percent (but maintained at 40.55 percent for oil companies). The new legislation also eliminated all previous exemptions and tax holidays. The law included provisions to expand the tax base, including incentives for people and companies working in the informal sector to legalize their status. The Investment Incentives Law No.8/1997 was extensively amended in June 2005, in order to conform to the new income tax law. The system of preferences and incentives that had been accorded to new investors in priority sectors, such as agriculture, housing, transportation, petroleum, and computer software, was eliminated. The amendments, however, allow for limited exceptions to be made for multinational firms or other large investors, subject to approval by the Prime Minister. Investment incentives granted to new investors before the law was amended continue under a “grandfather” clause.

ANTICOMPETITIVE PRACTICES

In January 2005, the Egyptian parliament approved an antitrust bill that does not focus on preventing monopolies *per se*, but on intentional monopolistic practices such as lowering prices or supply to the detrimental effect of smaller competitors. According to the law, a company holding 25 percent or more market share of a given sector may be subject to investigation, if suspected of illegal or unfair market practices. Penalties on companies found to have engaged in monopolistic practices range from LE 13, 000 (approximately \$ 2,260) to LE 10 million (approximately \$ 1.7 million). The law is implemented by an independent governmental body, The Egyptian Competition Authority that reports to the Prime Minister and is funded by direct government appropriations and/or donations from professional or academic bodies

However, the law will not be applied to utilities and infrastructure projects, such as water supply, sewage, electricity, telecommunications, transportation and natural gas. The executive regulations of the law were issued in August 2005 by Prime Ministerial decree.

ELECTRONIC COMMERCE

Egypt’s Electronic Signature Law 15 of 2004 regulates electronic signatures and establishes the information technology industry development authority. Egypt is deferring a broader e-commerce law that will address such issues as domain names, customs and duties, and creation of a certificate authority to verify e-signatures. The development of e-commerce in Egypt has been impeded by concern about network security, the relatively high cost of Internet access, and the limited number of Internet users in the country.

OTHER BARRIERS

Pharmaceutical Price Controls

The Egyptian government controls prices in the pharmaceutical sector and does not have a transparent mechanism for pharmaceutical pricing. The Ministry of Health reviews prices of various pharmaceutical products and negotiates with companies to adjust prices of pharmaceuticals based on nontransparent criteria. The Ministry has not allowed complete

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adjustment of pharmaceuticals prices to compensate for general inflation and depreciation of the Egyptian pound since 2000. For example, although the Egyptian pound has fallen 80 percent in value against the U.S. dollar since June 2000, the government has granted price increases for only some pharmaceutical products. Because both domestic and foreign pharmaceutical companies rely heavily on imported inputs, profitability has dropped sharply and some companies claim to be operating at a loss. In September 2004, the government cut customs duties on most imports of pharmaceutical inputs and products from 10 percent to 2 percent. The government claims this step will allow local pharmaceutical companies to compensate for some of their losses from the devaluation. In November 2004, the Ministry of Health lifted restrictions on exporting pharmaceuticals to encourage pharmaceutical investment and exports and announced its intention to create a fund to stabilize prices of local pharmaceutical products. Some reports indicate the fund will mainly support local companies' research and development efforts. Further details about the fund's operations are not available. During 2005, the government approved price increases on select foreign and domestic pharmaceutical products.

Export Restrictions

In August 2004, the Ministry of Agriculture removed restrictions on exporting cotton. The government had imposed restrictions on the export of long and medium-long staple cotton to make these cotton varieties more available for local mills, presumably sold at lower prices than in foreign markets. The Minister of Foreign Trade and Industry then announced that all types of cotton would be available for exporting in the 2004/2005 season, and that the government would not interfere in cotton pricing. However, the U.S. government continues to have concerns about Egypt's Alexandria Cotton Exporters' Association (ALCOTEXA), which controls all cotton export pricing and policies.

EL SALVADOR

TRADE SUMMARY

The U.S. goods trade deficit with El Salvador was \$143 million in 2005, a decrease of \$42 million from \$185 million in 2004. U.S. goods exports in 2005 were \$1.8 billion, down 1.2 percent from the previous year. Corresponding U.S. imports from El Salvador were \$2.0 billion, down 3.1 percent. El Salvador is currently the 50th largest export market for U.S. goods.

The stock of U.S. foreign direct investment (FDI) in El Salvador in 2004 was \$837 million, up from \$645 million in 2003.

IMPORT POLICIES

Free Trade Agreement

The United States concluded free trade agreement negotiations with El Salvador, Guatemala, Honduras, and Nicaragua in December 2003 and with Costa Rica in January 2004. In May 2004, the six countries signed the United States–Central America Free Trade Agreement. During 2004, the United States and the Central American countries integrated the Dominican Republic into the free trade agreement. On August 5, 2004, the seven countries signed the Dominican Republic – Central America – United States Free Trade Agreement (CAFTA-DR).

All of the signatory countries except Costa Rica have ratified the agreement. CAFTA-DR will enter into force between the United States and other signatories on a rolling basis as the United States determines that countries have taken sufficient steps to implement their commitments under the Agreement.

CAFTA-DR will remove barriers to trade and investment in the region and will further regional economic integration. CAFTA-DR will also require the Central American countries and the Dominican Republic to undertake needed reforms to provide market liberalization, transparency and certainty in areas including: customs administration; protection of intellectual property rights; services, investment, financial services; government procurement; sanitary and phytosanitary (SPS) barriers; and to liberalize other non-tariff barriers.

Tariffs

Most of El Salvador's tariffs do not exceed the maximum common external tariff of 15 percent established by the Central American Common Market (CACM), of which it is a member. However, there are several exceptions. Tariffs on new and used finished clothing are generally 25 percent, while tariffs on fabrics that are not covered by Caribbean Basin Initiative (CBI) benefits can be 20 percent or more. Vehicles are assessed a 30 percent duty. Agricultural products face the highest tariffs with dairy, rice and pork products are assessed a 40 percent duty.

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The poultry tariff is even higher. Alcoholic beverages are subject to a 20 percent to 40 percent import duty as well as domestic taxes that include a specific tax based on alcoholic content, a 20 percent sales tax, and a value-added tax (VAT) of 13 percent.

Under the CAFTA-DR, about 80 percent of U.S. industrial and commercial goods will enter El Salvador duty-free immediately, with the remaining tariffs being eliminated within ten years. Nearly all textile and apparel goods that meet the Agreement's rules of origin will be traded among CAFTA-DR countries and the United States duty-free and quota-free immediately, promoting new opportunities for U.S. and regional fiber, yarn, fabric, and apparel manufacturing companies. The Agreement's tariff treatment for textile and apparel goods is retroactive to January 1, 2004.

Under the CAFTA-DR, El Salvador will eliminate its tariffs on nearly all agricultural products within 15 years (18 years for rice and chicken leg quarters and 20 years for dairy products). For the most sensitive products, tariff rate quotas (TRQ's) will permit some immediate duty-free access for specified quantities during the tariff phase-out period, which will expand over time. El Salvador will liberalize trade in white corn through expansion of a TRQ, rather than by tariff reductions.

The FTA also requires transparency and efficiency in administering customs procedures, including the CAFTA-DR rules of origin. El Salvador committed to ensure greater procedural certainty and fairness, and all Parties agreed to share information to combat illegal transshipment of goods.

El Salvador also has free trade agreements with Chile, the Dominican Republic, Mexico, and Panama.

Non-Tariff Measures

Rice and pork are both subject to import quota systems in addition to 40 percent duties. Rice millers are required to buy rice locally in order to match import quantities, typically on a one-to-one basis. When there is insufficient local supply, the Ministry of Agriculture allows additional imports under the quota. If after the import quota has been exhausted, there is still a need for imported rice, rough or milled rice can be imported without limit, subject to a 40 percent duty. Pork importers face similar requirements to buy locally to match imports. If a shortage remains after domestic supplies are exhausted, imports are subject to a 40 percent duty. In addition, substantial tariff-rate quotas, which grow over time, were established under the CAFTA-DR for rice and pork to provide duty-free access for U.S. exports while the out-of-quota duties are phased-out.

STANDARDS, TESTING, LABELING AND CERTIFICATION

Although sanitary standards have generally not been a barrier in El Salvador, practices with respect to raw poultry are a notable exception. Since 1992, the Ministry of Agriculture has imposed arbitrary sanitary measures on U.S. poultry imports.

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The government of El Salvador applies these standards in a discriminatory manner with domestic production is not subject to the same requirements as imports. As a result of these measures, the United States has been unable to export raw poultry to El Salvador. The U.S. industry estimates the value of lost U.S. poultry exports at \$5 million to \$10 million per year. Resolution of this issue has been a priority for U.S. agencies, which continue to work with the Government of El Salvador.

In addition, the Salvadoran government requires that rice shipments be fumigated at the importers' cost unless they are accompanied by a U.S. Department of Agriculture certificate stating that the rice is free of *Tilletia barclayana*. However, because there is no chemical treatment that is both practical and effective against *Tilletia barclayana*, USDA cannot issue these certificates. El Salvador failed to notify the WTO under the Agreement on the Application of Sanitary and Phytosanitary Measures when it imposed this requirement.

All imports of fresh food, agricultural commodities, and live animals must have a sanitary certificate from the Ministry of Agriculture and the Ministry of Public Health. Basic grains must have import licenses from the Ministry of Agriculture, while dairy products require import licenses from the Ministry of Public Health. Consumer products require a certificate showing approval by U.S. health authorities for public sale.

Importers must deliver samples of all foods for laboratory testing to the Ministry of Public Health, which, upon approval, issues the product registration numbers that allow them to be sold at retail outlets. Some U.S. processed foods that were approved in the United States were rejected after analysis in El Salvador, thereby barring their sale. The United States and the Ministry of Public Health initiated discussions on this issue in 2002. U.S. products that were initially rejected by Ministry of Public Health testing have been approved for access on a case-by-case basis. At present, there is not yet a standard regulation allowing entry of U.S.-approved products. The CAFTA-DR provides an opportunity for the United States to engage El Salvador in several venues, including the SPS and Trade Capacity Working Groups established under the Agreement, which foster significant movement toward the establishment of standard regulations for the import of foreign food products. A prime example is the work being done on the recognition of the equivalence of the U.S. inspection system for meat and poultry (see below).

The United States has raised concerns regarding the potentially discriminatory effects of a proposed Salvadoran technical standard for distilled spirits. U.S. industry has expressed concern with El Salvador's proposed standards for rum and aguardiente. However, the five Central American countries, including El Salvador, are in the process of developing common standards for several products, including distilled spirits, which could serve to increase market access and facilitate trade. U.S. industry also welcomes El Salvador's commitment under CAFTA-DR to explicitly Bourbon and Tennessee whiskey as distinctive products of the United States.

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When the United States and Central America launched the free trade agreement negotiations, they initiated an active working group dialogue on SPS barriers to agricultural trade that met in conjunction with the negotiations to facilitate market access. The objective was to leverage the impetus of active trade negotiations to seek difficult changes to the Central American countries' SPS regimes. Through the work of this group, El Salvador has committed to resolve specific measures restricting trade between El Salvador and the United States. In particular for meat, poultry, and dairy, El Salvador will recognize the equivalence of the U.S. food safety and inspection system - eliminating the need for plant-by-plant inspection.

GOVERNMENT PROCUREMENT

El Salvador is not a party to the WTO Agreement on Government Procurement. However, government purchases and construction contracts are usually open to foreign bidders. The Legislative Assembly passed a new, more transparent procurement law in April 2000 that applies to the central government entities, as well as to autonomous agencies and municipalities. The CAFTA-DR requires the use of fair and transparent procurement procedures, including advance notice of purchases and timely and effective bid review procedures, for procurement covered by the Agreement. Under the CAFTA-DR, U.S. suppliers will be permitted to bid on procurements of most Salvadoran government entities, including key ministries and state-owned enterprises on the same basis as Salvadoran suppliers. The anti-corruption provisions in the Agreement require each government to ensure that bribery in trade-related matters, including in government procurement, is treated as a criminal offense or is subject to comparable penalties under its law.

EXPORT SUBSIDIES

El Salvador gives a six percent tax rebate on exports shipped outside the Central American area based on the free-on-board (FOB) port of exit value of the goods. The rebate is not granted to exports of coffee, sugar, or cotton unless these products have undergone a transformation process that adds at least 30 percent to the original value. Assembly plants outside of free trade zones (maquilas) are eligible if they meet the criteria for adding 30 percent Salvadoran value in the production process. Firms operating in free trade zones are not eligible to receive rebates as they already enjoy duty-free privileges and a 10-year exemption from income tax and duty-free privileges. Under the CAFTA-DR, El Salvador may not adopt new duty waivers or expand existing duty waivers conditioned on the fulfillment of a performance requirement (e.g., the exportation of a given level or percentage of goods). El Salvador may maintain existing duty waiver measures through 2009 provided such measures are consistent with its WTO obligations.

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INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

Criminal enforcement of IPR laws at the Attorney General's office is handled by the Crimes Against Private Property and Intellectual Property Unit, where 5 of the approximately 25 prosecutors are assigned to IPR cases, but not necessarily full time. The National Police established an IPR unit that supports the Attorney General's office, but also conducts its own investigations and raids. The National Health Council has administrative enforcement authority for cases involving pharmaceuticals and other intellectual property issues related to public health.

In January 2005, El Salvador created a government-wide commission including the Attorney General, National Civilian Police, and the National Registry Center to coordinate efforts to protect intellectual property rights. Through this commission, the Ministry of Economy has prepared legislative reforms to bring domestic IPR law into compliance with CAFTA-DR obligations and strengthen El Salvador's IPR protection regime. CAFTA-DR obligations would also provide stronger deterrence against piracy and counterfeiting by criminalizing end-user piracy and requiring El Salvador to authorize the seizure, forfeiture, and destruction of counterfeit and pirated goods and the equipment used to produce them. The CAFTA-DR text also mandates both statutory and actual damages for copyright and trademark infringement to help ensure that monetary damages can be awarded even when it is difficult to assign a monetary value to the violation.

Patents

The 1993 Intellectual Property Protection Law and El Salvador's acceptance of the disciplines in the WTO TRIPS Agreement addressed several deficiencies in the patent regime. The 1993 law lengthened patent terms to 20 years from the application filing date, but pharmaceutical patent terms were kept at 15 years. However based on Salvadoran Constitution provisions holding that international treaties supersede domestic law, on January 1, 2000 (when certain Salvadoran TRIPS obligations went into effect) the Salvadoran government's Registry for Intellectual Property began to authorize 20-year patent terms from the date of filing the application for pharmaceutical products. A major concern for U.S. pharmaceutical and agricultural chemical companies is the lack of data protection in El Salvador for undisclosed test data submitted for the marketing approval of a pharmaceutical or agricultural chemical product. Implementation of CAFTA-DR obligations will provide adequate and effective protection of such data from disclosure and unfair commercial use.

Copyrights

The piracy of optical media, both music and video, remains a concern in El Salvador. Optical media imported from the United States by pirates are being used as duplication masters. The Business Software Alliance estimates that the rate of software piracy is 79 percent.

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There has also been concern expressed about inadequate enforcement of cable broadcast rights and the competitive disadvantage it places on legitimate providers of this service. The police and Attorney General's Office seized 430,346 optical discs in 2005; however, there have been no successful prosecutions of pirates. Implementation of the CAFTA-DR IPR provisions should provide law enforcement with an enhanced capability to prosecute violators.

Trademarks

In 2002, El Salvador's Legislative Assembly passed the Law of Trademarks and Other Distinctive Signs. The law provides for new protections against bad-faith registration of famous marks. Under the law, the National Registry of Intellectual Property requires that applicants show that they either own or have permission to register the famous mark. During 2003, there was progress in a significant intellectual property dispute involving trademark and copyright infringement by an ex-franchisee. The case, however, is still not fully resolved, and in December 2005 an appeals court ignored important evidence to rule in favor of the ex-franchisee in a related contractual dispute. Judicial enforcement continues to be the weakest pillar of intellectual property protection in El Salvador, but implementation of the CAFTA-DR IPR enforcement provisions is expected to help reduce trademark infringement.

SERVICES BARRIERS

El Salvador maintains few barriers to services trade. El Salvador has accepted the Fifth Protocol to the WTO General Agreement on Trade in Services, which was necessary to bring its commitments on financial services into effect. Foreign investors are limited to 49 percent of equity in free reception television and AM/FM radio broadcasting. There are no such restrictions on cable television ownership. Notaries must be Salvadoran citizens. Under the CAFTA-DR, El Salvador will accord substantial market access in services across its entire services regime, subject to very few exceptions. In addition, U.S. financial service suppliers will have full rights to establish subsidiaries, joint ventures or branches for banks and insurance companies.

INVESTMENT BARRIERS

There are few formal investment barriers in El Salvador. However, U.S. investors complain that judicial and regulatory weaknesses limit their investment in El Salvador. The United States has raised concerns about the impact of re-regulation of the electric power sector and regulatory decision-making processes on U.S. electric energy investments in El Salvador. A U.S. long distance telephone service provider complained that the dominant fixed-line telephone company refuses to sign an interconnection agreement with it on terms already extended to another market entrant, as required by Salvadoran law. This issue has been pending before the Supreme Court since May 2004. The Supreme Court has not yet ruled.

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The first case of commercial arbitration in El Salvador involved a U.S. firm and the parastatal water company. The arbitration panel ruled in favor of the U.S.-owned firm, but a legal challenge by the water company relating to the bidding process led the Supreme Court to suspend the proceedings in August 2004 pending a review of the case. Judicial delays are common in El Salvador, and the Supreme Court has yet to review the case. The United States and El Salvador signed a Bilateral Investment Treaty (BIT) in 1999. The United States and El Salvador each ratified the BIT in 2001, but did not exchange the instruments of ratification necessary to bring the treaty into force. CAFTA-DR's investment chapter, however, provides for protection of U.S. investors comparable to those that were included in the 1999 BIT. Under the CAFTA-DR, all forms of investment will be protected including enterprises, debt, concessions, contracts and intellectual property. U.S. investors will enjoy, in almost all circumstances, the right to establish, acquire and operate investments in El Salvador on an equal footing with local investors. Among the rights afforded to U.S. investors are due process protections and the right to receive a fair market value for property in the event of an expropriation. Investor rights will be protected by an effective, impartial procedure for dispute settlement that is fully transparent. Submissions to dispute panels and panel hearings will be open to the public and interested parties will have the opportunity to submit their views.

EUROPEAN UNION

TRADE SUMMARY

The U.S. goods trade deficit with European Union (25) was \$122.4 billion in 2005, an increase of \$13.1 billion from \$109.3 billion in 2004. U.S. goods exports in 2005 were \$186.3 billion, up 7.9 percent from the previous year. Corresponding U.S. imports from European Union (25) were \$308.8 billion, up 9.5 percent. European Union (25) countries, together, would rank 2nd behind Canada as an export market for the United States in 2005.

U.S. exports of private commercial services (i.e., excluding military and government) to European Union (25) were \$114.8 billion in 2004 (latest data available), and U.S. imports were \$96.3 million. Sales of services in European Union (25) by majority U.S.-owned affiliates were \$238.7 billion in 2003 (latest data available), while sales of services in the United States by majority European Union (25)-owned firms were \$226.6 billion.

The stock of U.S. foreign direct investment (FDI) in European Union (25) in 2004 was \$965.2 billion, up from \$873.1 billion in 2003. U.S. FDI in European Union is concentrated largely in the manufacturing, finance, and wholesale sectors.

OVERVIEW

In most respects, the enormous U.S.-EU trade and investment relationship operates smoothly and to the great benefit of companies, workers, and consumers on both sides of the Atlantic. In recognition of this fact, leaders of the United States and the European Union agreed, in the context of the June 2005 U.S.-EU Summit, to pursue additional Transatlantic economic integration through a series of cooperative initiatives in areas such as regulatory cooperation, intellectual property rights enforcement, innovation, and trade and security, among other issues.

Despite the broadly positive nature of the U.S.-EU trade and investment relationship, U.S. exporters in some sectors continue to face chronic barriers to entering the EU market. A number of these barriers have been highlighted in this report for many years, despite repeated efforts to resolve them through bilateral consultations or, in some cases, the dispute settlement provisions of the WTO.

Over the course of the past year, U.S. concerns mounted regarding the EU's longstanding policy of subsidizing the development, production, and marketing of large civil aircraft. In general, barriers to access for U.S. agricultural exports continue to be a source of frustration for the United States. Even where formal EU agricultural tariff barriers may be relatively low, U.S. exports of leading commodities such as corn, beef, poultry, and

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pork are significantly restricted or excluded altogether due to restrictive non-tariff barriers or regulatory approaches that often do not reflect a sound assessment of actual risks posed by the goods in question and/or that rely on ill-defined concepts of precaution. In addition, the trade-distorting effects of various EU Member State policies governing pharmaceuticals and health care products are generating concerns related both to market access and to health care innovation. This year's report also outlines concerns of U.S. exporters with respect to a number of emerging EU policies that may threaten to disrupt trade in the future, such as the proposed new EU chemicals regulation.

IMPORT POLICIES

Customs Administration EU customs law is set forth principally in the Community Customs Code CCC, the CCC Implementing Regulation, and the Common Customs Tariff, as well as in other implementing regulations promulgated by the Council and the Commission. Notwithstanding the existence of this body of EU customs law, the EU does not operate as a single customs administration. Rather, there is a separate agency responsible for the administration of EU customs law in each of the EU's 25 Member States. The 25 separate agencies do not administer EU customs law in a uniform manner. No EU institutions or procedures ensure that EU rules on classification, valuation, origin, and customs procedures are applied in a way that remains the same from Member State to Member State. Moreover, no EU rules require the customs agency in one Member State to follow the decisions of the customs agency in another Member State with respect to materially identical issues. Additionally, differences between Member States exist in areas such as the type of automated systems used, risk criteria used by administrations to determine when to examine goods, VAT levels, and licenses required for food products, as well as disparities in certificate of origin requirements and treatment of express shipments. These differences are exacerbated by the absence of EU-wide administrative management of customs operations.

On some questions, where the customs agencies in different Member States administer EU law differently, the matter may be referred to the Customs Code Committee. The Committee is an entity established by the Community Customs Code to assist the Commission. It consists of representatives of the Member States and is chaired by a representative of the Commission. The Committee is sub-divided into 14 sections (e.g., Customs Valuation Section, Tariff and Statistical Nomenclature Section, Origin Section, etc.) While, in theory, the Committee exists to help reconcile differences and thereby help to achieve uniformity of administration, in practice its success in this regard has been limited. Only a Member State or the Commission may refer a matter to the Committee; a private party does not have the right to have a matter put on the Committee's agenda. Moreover, even once a matter is put on the Committee's agenda, interested parties have no right to present their views to the Committee. Private parties may present views only at the Committee's invitation. Even when a question is raised at the Committee, achieving consensus among the Member States on particular issues is time-consuming, and there is no guarantee that the Committee will address all elements of the question.

Not only is the Committee an ineffective tool for achieving the uniform administration of EU customs law, but the EU also lacks tribunals or procedures for the prompt review and EU-wide correction of administrative actions relating to customs matters, as is required by Article X:3(b) of the GATT 1994. Instead, review is provided separately by each Member State's tribunals. Thus, a trader encountering non-uniform administration of EU customs law in multiple Member States must bring a separate appeal in each member state whose agency rendered an adverse decision. Different Member States have different rules governing the review process. Some require a party to seek administrative review first before seeking court review. Others permit a party to proceed immediately to a court for review of administrative action. The number of layers of review and time for review also varies significantly between Member States.

Ultimately, a question of interpretation of EU law may be referred to the Court of Justice of the European Union (ECJ). The judgments of the ECJ have effect throughout the EU. However, referral of questions to the ECJ generally is discretionary. Only a court from which there is no recourse (a court of last resort) is ordinarily (though not always) required to refer a question of EU law to the ECJ. Obtaining corrections with EU-wide effect for administrative actions relating to customs matters may take years. The concern also has taken on new prominence in light of the focus of the Doha Development Agenda on trade facilitation.

Given the growing negative consequences of deficiencies in the EU's customs administration and review procedures, the United States in September 2004 initiated WTO consultations on these matters. Subsequently, in March 2005, a dispute settlement panel was formed to consider U.S. complaints. The panel's report is expected in spring 2006.

Poland: U.S. companies have requested that the Polish government issue an executive order or pass legislation allowing bonded warehouses in Poland. Prior to Poland's EU accession, transactions within bonded warehouses were not taxed. Post-accession, bonded warehouses are considered to be in the territory of Poland and are taxed – although there is a provision in EU law that provides an exemption for bonded warehouses. Bonded warehouses or free zones are currently allowed in a number of other EU Member States. The existence of a bonded warehouse in Poland would assist U.S. companies that are switching to just-in-time inventory systems. This would allow changes in inventory ownership to take place without tax consequences until the goods leave the warehouse.

EU Enlargement

The 10 EU member states that acceded in 2004 -- Estonia, Latvia, Lithuania, Poland, Slovakia, the Czech Republic, Slovenia, Hungary, Cyprus and Malta -- were required to change their tariff schedules to conform to the EU's common external tariff schedule, resulting in increased tariffs on certain imported products. Under General Agreement on Tariffs and Trade 1994 (GATT 1994) Articles XXIV:6 and XXVIII, the United States is entitled to compensation from the EU to offset some of these changes. The expansion of EU quotas to account for the addition of 10 new countries and more than 75 million new EU consumers was another key element of the negotiations.

On November 30, 2005, the United States and the European Commission initialed a bilateral enlargement compensation agreement. As part of the agreement, the EU will permanently reduce tariffs on protein concentrates, fish (hake, Alaska Pollack, surimi), chemicals (polyvinyl butyral), aluminum tube, and molybdenum wire. The EU also will open country-specific tariff-rate quotas for U.S. exports of boneless ham, poultry, and corn gluten meal. Finally, the EU will expand existing global tariff rate quotas for beef, poultry, pork, rice, barley, wheat, maize, sugar, fructose, preserved fruits, fruit juices, pasta, chocolate, food preparations, petfood, live bovine animals and sheep, and various cheeses and vegetables. The United States and European Commission signed the agreement on March 22, 2006.

As part of broader discussions on EU enlargement, the EU had earlier agreed to expand the maximum quantities allowed in licensing applications for imports into the EU of pork. This measure went into force in March 2005.

Restrictions Affecting U.S. Wine Exports

Since the mid-1980s, U.S. wines have been permitted entry to the EU market through temporary exemptions from certain EU wine regulations governing permissible wine-making practices. The temporary nature of these derogations created continuous uncertainty for U.S. wine exporters. In 2002, the EU adopted a new wine labeling regulation (Commission Regulation No. 753/2002). The United States, along with a number of other WTO Members, raised serious concerns about the lack of clarity in the new regulation and its WTO-consistency and urged the EU to withdraw the regulation. The regulation appeared to be more trade restrictive than necessary to meet any

legitimate objective, as it would prohibit the presentation on imported wine of information important for the marketing of wine unless certain conditions are met (e.g., the marketing information used must be regulated in the producing country). In addition, the EU imposed restrictions on the use of traditional terms listed in the regulation, in some instances granting exclusive use of a term to an EU wine in a manner akin to treating it like intellectual property. Traditional terms are, for the most part, terms used with certain other expressions (often geographical indications) to describe wine or liqueur, and in many cases the terms are merely descriptive (e.g., “ruby” and “tawny”). The United States does not recognize the concept of traditional terms as a form of intellectual property, nor is this a form of intellectual property recognized by the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS).

On March 10, 2006, the European Union and the United States signed an agreement on certain aspects of wine trade, as a first phase to a broader agreement on trade in wine. This agreement is intended to eliminate the uncertainties caused by the previous temporary exemptions and to provide more stable market conditions for the wine sector. The pact will simplify export procedures for American wine-makers hoping to increase their share of a trade currently worth around \$2.8 billion annually. It provides for mutual acceptance of current wine-making practices and sets up a consultative process for accepting new wine-making practices. It also addresses some of the concerns raised by the EC’s wine labeling regulation, including a provision for the use of certain EC-regulated terms on U.S. wine. The two sides have also undertaken to build on the agreement by starting to negotiate a second-phase accord 90 days after the entry into force of this initial pact.

Bananas

Acting against the backdrop of agreements that in 2001 resolved the long-running U.S.-EU dispute regarding trade in bananas, the EU instituted a new banana import regime on January 1, 2006. The EU has stated its new regime has been designed to replace the pre-2006 system of tariffs and license-based quota arrangements with a WTO-consistent system.

In the fall of 2005, the EU made two proposals for a new tariff rate for bananas. Both of these proposals were subject to review by a WTO arbitrator, which found that both proposals failed to satisfy the EU’s obligation to at least maintain total market access for non-preferential suppliers of bananas to the EU market. EU consultations and negotiations with a number of Latin American banana exporting countries throughout 2005 yielded no agreement on the shape of the EU’s post-January 1, 2006 regime. The EU ultimately put in place a regime that combined a 176 euro/metric ton most-favored nation (MFN) tariff level with a continued zero duty tariff-rate quota for bananas originating in Africa, Pacific and Caribbean (ACP) countries, with whom the EU maintains a preferential trading relationship. However, in the face of objections and some emerging WTO legal challenges against its new regime from various Latin countries, (the continued existence of a preferential TRQ for ACP suppliers calls into

question the WTO-compatibility of the new arrangement), the EU has vowed to continue negotiating with its trading partners in hopes of finding a mutually satisfactory resolution. The United States is concerned that the EU's import regime must uphold the EU's multilateral commitment to put in place a WTO-compatible structure that at least maintains total market access for non-preferential banana suppliers. While the United States does not directly export bananas to the EU, this is an issue of considerable importance to U.S. companies involved in the production, distribution, and marketing of bananas.

Market Access Restrictions for U.S. Pharmaceuticals

U.S. pharmaceutical companies encounter persistent market access problems throughout countries of the European Union due to the price, volume, and access controls placed on medicines by national governments. In most cases, Member State governments administer medicine reimbursement programs as part of their healthcare programs, which cover a significant segment of the market. The procedures for getting a product on the reimbursement list and the price controls maintained for those products that are on the list have a strong impact on U.S. exports. These price controls limit patient access to innovative products and may diminish EU expenditures on pharmaceuticals research and development.

While the EU's single market ensures that pharmaceuticals, like other goods, can move freely within the EU, Member States' controlled prices vary greatly from one country to another. This situation permits intermediaries to buy medicines, often in bulk quantities, in EU countries where the government-determined price is lower and sell them in other EU countries where the price is set at a higher level.

Austria: Austria maintains an overly bureaucratic pharmaceutical approval process that limits market access for innovative products. A pharmaceutical firm seeking to include a product on the list of reimbursable drugs without prior authorization must first obtain the approval of the umbrella organization of social insurance funds (Hauptverband/HVB). Almost all new innovative pharmaceuticals must be approved by HVB physicians, who remain reluctant to prescribe them. A reform of the reimbursement system came into effect January 1, 2005, but the situation has not improved. U.S. companies operating in Austria report cumulative losses between \$25 million and \$100 million due to these practices.

Belgium: Pharmaceutical companies consider Belgium among the most inhospitable markets in Europe. Taxes, pricing policies, and patient access problems discourage investment in research and development. Despite Belgian government statements to industry in 2003 that pharmaceutical price controls would be lifted, prices on pharmaceuticals reimbursed through the Belgian healthcare system remain at well below European averages. There is also strong government pressure on doctors not to prescribe drugs under patent. Further, in addition to the turnover and profit taxes applied exclusively in this sector, pharmaceutical companies are required to fund most of the chronic gaps between budgeted and actual government spending on pharmaceuticals.

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In combination, these tax measures amount to a 10 percent to 11 percent additional levy on the sector. Draft legislation that offers lower sales tax rates to firms with higher numbers of employees in Belgium appears discriminatory and not a fair way of providing incentives for local investment.

Cyprus: The Cypriot pharmaceuticals market suffers from several distortions that have resulted in unnecessary barriers to trade and retail shortages of many pharmaceuticals. Of the 3,300 drugs sold in Cyprus prior to May 1, 2004, only 1,629 were available in October 2005. Of these, only around 1,000 were registered.

Since acceding to the EU on May 1, 2004, the Government of Cyprus (GoC) imposed retail price cuts for pharmaceuticals of around 25 percent. The mechanism used by the GOC to set pharmaceutical retail prices involves using a basket of prices of the same drug in eight other EU countries (identified as two high price, four medium price, and two low price countries). However, local representatives of pharmaceutical companies believe the selected countries are not representative, pushing the benchmark price downward.

Cyprus (like other EU countries) requires re-registration of pharmaceuticals every five years. However, Cypriot requirements for re-registration are much more onerous than in other EU countries. Specifically, the GoC requires older pharmaceuticals to conform to the same test documentation requirements (including toxicological and clinical studies) as newer drugs. This causes additional expenses since more extensive testing is required today than a few years ago. Furthermore, the additional documentation is often unavailable for many older drugs. In practice, most other EU countries accept documentation available at the time when the drug was originally patented. The result is that many companies do not bother to re-register older drugs in Cyprus because it is not worth the expense.

Czech Republic: U.S. and European pharmaceutical companies complain that the process of setting reference prices for reimbursement of medicines prescribed by the national health insurance system in the Czech Republic lacks transparency and limits market access for patented medicines. Reimbursement levels are set at the price of the lowest-priced medicine in each therapeutic category, which is usually a generic and is often a domestically produced product. In many cases, the entry of a generic drug (oftentimes manufactured by a Czech company) onto the market immediately results in a sharply reduced reimbursement price. Low-priced pharmaceuticals from the Czech Republic are beginning to be sold in other EU Member States, affecting pharmaceutical companies' sales in those countries. In October 2005, the European Commission sent a letter to the Czech cabinet, claiming that Czech law does not correctly implement the EU regulation on setting rules for pharmaceutical costs, and giving the Czechs two months to respond to the complaint.

Denmark: The Danish government has failed to provide reimbursement for new innovative medicines or has delayed reimbursement for long periods. Within the context of the Danish socialized health system, this has the practical effect of preventing the sale

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and use of such medicines. The government, which continues to press for further decreases in prices and sales of innovative pharmaceutical products, introduced a new reimbursement system on April 1, 2005. Under the new rules, reimbursements are determined on the basis of the cheapest generic medicinal product in each category, which means that the patient's own contribution increases if the cheapest product is not chosen. Generally, the pharmaceutical industry complains that the Danish reimbursement standards lack objective and verifiable criteria and do not meet even minimal standards of transparency. If these barriers were lifted, U.S. exports would increase by up to \$10 million based on current export levels. However, not all of the medicines affected by the policy are produced in the United States. Thus, an additional benefit of an improved reimbursement policy would be higher revenue to subsidiaries of U.S. firms.

Estonia: There has been some discussion within the Government of Estonia, which is dealing with the country's increasing HIV/AIDS burden, on establishing price controls for anti-retroviral drugs and on the possibilities of introducing generic anti-retroviral medications into the Estonian marketplace. This issue merits on-going monitoring.

Finland: Innovative pharmaceutical companies in Finland have raised concerns that government regulations have resulted in an uncompetitive environment marked by pricing policies that place low ceilings on pharmaceutical prices and limit the price differentials allowed between generic and innovative products. Further, industry claims that it takes more than three years for a pharmaceutical product to be approved for full reimbursement under the national insurance scheme.

In early 2004, Finland's Ministry of Social Affairs and Health (MoSAH) began preparing legislation that would extend the time that brand name drugs are protected from competition by generic alternatives. Research-based pharmaceutical companies, legislators and civil servants at MoSAH and Ministry of Trade and Industry worked closely together and produced a report to the Minister of Social Affairs and Health. Parliament approved an amendment to the Finnish Medicine Act in late 2005 that prevents the inclusion of patent-infringing generic pharmaceuticals on national mandatory generic substitution lists. This amendment entered into effect on January 1, 2006.

France: The French government is implementing a reorganization of its health care system, which should allow the government's pricing committee to enjoy greater independence. For the most innovative products, the new fast track procedure implemented in 2004 has led to positive results, with faster access to the market and prices set at levels comparable to other European countries. The industry, however, still faces tax increases. The government is also aggressively promoting increased use of generics.

Germany: As part of a broader health-care reform package, Germany introduced a reference pricing scheme on generic and patented pharmaceuticals on January 1, 2005. U.S. firms contend that they bear the brunt of cost-containment by virtue of their dominance (25 percent) of the German market. U.S. pharmaceutical companies have

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raised serious concerns about the transparency and fairness of the decision-making process related to the new reference pricing scheme, which does not provide a fair rate of return for patented, innovative medicines. Additional cost constraint measures were imposed through the combining of patented, innovative products with generic products, known as “jumbo groups”. Both reference pricing and its variant, jumbo groups, are strongly opposed by U.S. pharmaceutical companies. The U.S. Government has raised this issue repeatedly with the German government, including during the visits of interagency U.S. health policy delegations to Berlin in June 2005 and February 2006.

Hungary: The Hungarian government and various pharmaceutical companies signed a contract in June 2004 that ended a price freeze and returned prices to the March 2004 levels (before the last price cut). The government promised no more price freezes until December 31, 2006. In exchange, producers agreed to make payments into a subsidy fund that were matched by funds from the government. While the government originally agreed, as part of this contract, to annual increases in its health budget by only five percent in 2005 and 2006, the actual figures will reflect much higher increases. In October 2005, the government agreed to a cap on company payments to the health budget, while discussions with the pharmaceutical companies continue on how to address future shortfalls.

In addition to this, as part of the government’s “100 steps” program, a generic drug program was started in June 2005. Under this framework, the Ministry encourages doctors to prescribe the cheaper generic alternatives of an active compound. As a result of further negotiations with the pharmaceutical producers, a new support scheme entered into force, locally termed “fixing.”

Italy: U.S. companies have raised concerns about Italian government measures that they believe will have a deleterious impact on their business. Among these are: (i) an across-the-board decrease in reimbursement prices for almost 300 drugs now on the reimbursement list; (ii) an increase in the amount that industry must “pay back” to the central government for regions’ annualized overspending on pharmaceuticals; and (iii) additional discounts on certain classes of drugs that will disproportionately disadvantage U.S. research-based companies. U.S. companies are seeking a dialogue with the Italian government to improve transparency in Italy’s cost-containment measures and to factor in the impact of those measures on U.S. industry.

Lithuania: Some pharmaceutical products in Lithuania are sold at very low prices to consumers. The government reimburses pharmaceutical manufacturers the difference between this price and a price set by the health insurance law. The Lithuanian government amended this law on July 5, 2005, to change the formula used to calculate this price. The new formula yields a price that is five percent less than the average price of the drug in six Central and Eastern European countries. Pharmaceutical manufacturers are not required to participate in this system, and outside of this system, they are free to market their products and charge a price of their choosing.

The Netherlands: The Dutch Ministry of Health views pharmaceuticals as a prime target for savings in its national healthcare budget. Industry asserts that the Ministry does not fully recognize the added value of incremental innovation. Various measures are in force, or planned, which delay the reimbursement of new compounds or favor generic drugs. The current multi-party agreement between the Ministry of Health, insurers, pharmacists, and generic manufacturers was extended for another year in 2005. Nefarma, the association representing the innovative industry, joined the agreement on January 1, 2005. Under the current agreement, Nefarma members will reduce their prices of multi-source brands (out-of-patent products for which there are generics available) by an average of 40 percent. This reduction affects older products, while new, innovative products are protected. Discussions among the same stakeholders now have the objective of extending the multi-party agreement to the end of 2006.

Poland: For several years, the Polish government has alleged that foreign pharmaceutical companies charged excessive margins for drugs and owe hundreds of millions of dollars in fines under a 2000-2002 ordinance related to pharmaceutical pricing. Although this ordinance was subsequently struck down by Polish courts, the issue remains unsettled and subject to potential legal action by both the National Health Fund and Finance Ministry. Poland has thus far ignored requests for EU arbitration of this issue. The uncertainty and amount of the potential fines threaten not only future investment, but also the existing investments of foreign innovative pharmaceutical firms in Poland.

Portugal: U.S. pharmaceuticals companies face a host of systemic problems in Portugal, including: 1) a slow government system to approve drugs for inclusion on reimbursement lists; and 2) a substantial delays in the government payment of debts to the healthcare sector (approaching \$1 billion). Industry is very concerned about several new government austerity measures or proposals that could limit expenditures, increase claw-back amounts, penalize new product entry, and mandate that Portugal have the lowest reference prices in Europe. U.S. pharmaceutical firms are also concerned about a proposal that would require them to contribute to the total cost of new hospital construction, not just related pharmaceutical costs.

Spain: A pharmaceutical must go through a lengthy and costly approval and registration process with the Spanish Ministry of Health unless it was previously registered in another EU Member State or with the European Medicines Agency. This process delays the entry of innovative pharmaceuticals into the Spanish market. Further delays are caused by a lengthy administrative pricing process, coupled with onerous government reimbursement procedures. Industry argues that effective patent protection for some older U.S. pharmaceuticals sold in Spain is limited as they are protected under the former pharmaceutical process patent regime. Legislative revisions to Spanish medicines and patent laws now under consideration may pose new challenges in 2006.

A July 2002 regulation requires consumers to obtain special approval from a state inspector before pharmacies can fill prescriptions for two specific drugs produced by U.S. pharmaceutical manufacturers under the “visado” system. This measure resulted in sharply decreased sales for both drugs. In 2003, the regional government of Andalusia

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followed suit and imposed a special approval requirement on all anti-psychotic drugs, which affected several U.S. pharmaceutical companies. In October 2005, the European Commission issued a reasoned opinion relating to the visado system, seeking more transparent decision-making procedures for the reimbursement of drugs.

Slovenia: Innovative U.S. drug manufacturers continue to face pricing issues in Slovenia, with the government setting price limitations based on a percentage of “European average prices”, thereby inhibiting Slovenian consumers’ access to new drugs. Slovenian regulations require health professionals to prescribe drugs with the lowest price in their group as stated on the Interchangeable Drug List (IDL). Drugs on the IDL are the only one that are fully reimbursed under the state insurance plan. This regulation directly and unfairly benefits the two Slovenian manufacturers of pharmaceutical products.

Slovakia: U.S. and European pharmaceutical companies complain that a recent Slovakian Ministry of Health decree (No. 723/2004), which was published in July and went into effect on October 15, 2005, further reduces the transparency of government decisions regarding the pricing and reimbursement decisions for medicines prescribed by national health insurance. The decree specifies the rules to be applied in determining the price of the medicinal product and level of reimbursement. The original decree provided detailed rules for calculation of the price and level of reimbursement. However, recent amendment of the decree cancelled the detailed rules for determination of the reimbursement amount and, instead, provided the Ministry of Health, as the deciding authority, with a wide scope of discretion to decide on the amount of reimbursement without setting a clear set of guidelines for such decisions.

Uranium Imports

The United States is concerned that EU policies may restrict the import into the EU of enriched uranium, and possibly downstream goods such as nuclear fuel, nuclear rods, and assemblies. Since 1992, the EU has maintained strict quantitative restrictions on imports of enriched uranium to protect its domestic producers. Since 1994, these restrictions have been applied in accordance with the terms of the Corfu Declaration, a joint European Council and European Commission policy statement that has never been made public or notified to the WTO. The Corfu Declaration appears to impose explicit quotas on imports of enriched uranium, limiting imports to only about 20 percent of the European market. The United States has raised concerns about the import quotas and the non-transparent nature of the Corfu Declaration and its application. Further, the United States is closely monitoring whether any future EU agreements with Russia under negotiation in the nuclear area will follow WTO rules on import quotas and transparency.

STANDARDS, TESTING, LABELING, AND CERTIFICATION

Overview

With the decline of traditional trans-Atlantic trade barriers, EU regulatory measures are increasingly viewed as impediments for U.S. exporters of manufactured and agricultural products. Compliance with divergent technical regulations and standards for products sold in the United States and the EU imposes additional costs on U.S. exporters (e.g., duplicative testing, product redesign) and increases the time required to bring a product to market. Such costs for U.S. exporters are compounded by a lack of transparency in the development of EU regulations and a lack of meaningful opportunity for non-EU stakeholders to provide input on draft EU regulations and standards. To address these systemic concerns, the United States continues to promote greater U.S.-EU regulatory cooperation and enhanced transparency in the EU regulatory system.

Despite often sharing similar regulatory objectives, U.S.-EU dialogue frequently is unable to promptly resolve regulatory-based trade problems. In particular, many U.S. exporters view the EU's growing use of a so-called "precautionary principle" to restrict or prohibit trade in certain products, in the absence of full scientific justification for doing so, as a pretext for market protection. Further, EU regulatory barriers are often compounded by multiple and/or overlapping measures affecting particular products. Poultry, Agricultural Biotechnology Products, and wine are examples of products that confront multiple layers of restrictive regulation in the EU marketplace. To illustrate:

- U.S. efforts to reopen the EU to U.S. poultry exports have been hindered by multiple obstacles. As a result, resolution of any one obstacle (e.g., the EU allowing the use of alternative antimicrobial treatments on poultry meat) would not necessarily result in reopening of trade due to the existence of other obstacles (such as requirements regarding on-farm practices for raising poultry).
- U.S. exporters of Agricultural Biotechnology Products have been harmed not only by the *de facto* moratorium on approving new products, but also by the existence of certain Member State prohibitions on products already approved for marketing within the European Community.
- Despite the recent conclusion of a U.S.-EU agreement on wine trade, U.S. wine exporters are still confronted not only by the uncertainty surrounding the EU's restrictions on geographical indicators and labeling practices, but also by high tariffs and heavy subsidization of EU wine producers.

Standardization

Given the massive U.S.-EU trade relationship and the volume of EU standardization work in regulated market segments, European standards activities are of considerable importance to U.S. exporters. A number of problems continue to impede U.S. exports, including a general inability to participate in the formation of EU standards and the

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occasional reliance on design-based, rather than performance-based, standards. Disparities between the practices of some European conformity assessment bodies add to the frustration and cost for American exporters. In addition, there are concerns related to the respective procedures, responsibilities (e.g., accountability, redress), and lack of transparency in the Member States, the European Commission, and the European standards bodies that require careful monitoring. In the case of some sectors, European directives and their relevant standards pose a significant barrier to American exports.

Pressure Equipment: In May 2002, the EU Pressure Equipment Directive (PED) entered into force, imposing new requirements on manufacturers of such equipment. Previously, pressure equipment manufacturers could demonstrate conformity based on standards for material specifications, including the U.S. ASME Code. Manufacturers using the ASME Code may now be excluded from the EU market because the European standards incorporate material specifications slightly different from those found in the ASME Code. In the absence of a full set of harmonized EU standards, the PED permits manufacturers to file for an EAM (European Approval of Materials); however, few requests for EAMs have been approved so far. Another option, the Particular Material Appraisal (PMA), is a costly process for which there are no clearly defined procedures in the PED. In light of these factors, U.S. manufacturers seek continued acceptance of materials that meet the ASME code that have been widely used in Europe for decades prior to the PED. In an effort to bring the two sides closer together, U.S. and EU officials and stakeholders agreed to a pilot project to eliminate redundant testing requirements for materials. The two sides are working on the beginnings of technical cooperation, starting with an attempt to harmonize several testing standards.

Care Labeling Standard: The U.S. apparel industry continues to raise concerns about care labeling requirements for textile and apparel products sold within the EU. While there is no harmonized EU legislation that requires care labeling when exporting to the EU, individual EU Member States may have specific requirements. However, if a care label is attached it should incorporate care symbols, which are published in the European standard EN 23758 (1994). These symbols are trademarked and their use is regulated by GINETEX, a European-based association. Requirements for the use of the GINETEX care symbols differ by Member State, and in some countries may require a membership fee or royalty payment. The fees associated with the use of the GINETEX care symbols can be costly to U.S. firms and the differing use requirements in Member States can be confusing and burdensome. At the same time, the use of care labels on textile and apparel products is recommended because the manufacturer can be held liable under the EU Product Liability Directive if a problem occurs.

The Netherlands: The Dutch Parliament is considering an amendment to the Environmental Management Act affecting (sustainably produced wood) that could have a significant impact on U.S. exports because it requires assessment criteria to be equivalent to one particular certification program (the Forest Stewardship Council - FSC) to the exclusion of others. FSC is only one of a number of internationally-recognized certification programs for sustainable forest management. The three certification programs that are widely used in the United States – the Sustainable Forestry Initiative,

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the American Tree Farm System, and FSC – cover certification of over 76 million acres (about 10 percent) of U.S. forestland. However, less than two percent was FSC-certified in 2004. Thus, a significant portion of the \$34.5 million of wood products that the U.S. producers exported to the Netherlands in 2004, could potentially be affected by this legislation. The proposed legislation would also require that any person who places wood on the market in the Netherlands, provide a declaration noting where the wood is produced, and accompanied by an auditor’s report confirming delivery to the person placing the wood products on the market. This would be overly burdensome for both producers and governments and would be extremely difficult, if not impossible, for manufacturers of panel products and other further processed wood products.

Agricultural Biotechnology Products

Since 1998, the European Council has not managed to assemble a qualified majority of EU Member States in support of agricultural biotechnology product approvals, despite the lack of any legitimate health or safety reason to reject them. While the European Commission has recently granted approval for a limited number of biotechnology products under its legislative authority, the U.S. considers that the EU continues to lack a predictable, workable process for approving these products in a way that reflects scientific, rather than political, factors. At the level of the EU Council, it is clear that a moratorium policy continues to exist.

In May 2003, the United States initiated a WTO dispute settlement process related to the EU’s *de facto* moratorium on approvals of biotechnology products and on the existence of individual Member State marketing prohibitions on previously approved biotechnology products. The panel hearing this dispute delivered its interim report in February 2006.

Several Member States have imposed marketing bans (safeguard measures) on some biotechnology products that had been previously approved at the EU level. On June 24, 2005, the Environment Council rejected by a qualified majority the eight Commission proposals to lift safeguard measures imposed by five Member States against biotechnology maize. On October 5, 2005, the European Court of Justice ruled against Upper Austria’s effective ban on growing biotechnology crops since there was no scientific evidence to back up this ban. In addition, there has been a recent movement within the Environment Council, largely led by Luxembourg, to review the present decision-making process on biotechnology approvals, apparently with a view to limiting the European Commission’s authority to act on approvals in the absence of a qualified majority among EU Member States.

Co-existence: In accordance with the European Commission’s guidance document on the co-existence of biotechnology and conventional crops, which recommends a regional approach to co-existence issues, a number of Member States (including Spain, Denmark, Germany, Italy, the Netherlands and most regions in Austria) have drafted new co-existence laws, or have chosen to provide industry guidance. While the decrees/laws

vary substantially from country-to-country, they generally require extensive control, monitoring and reporting of biotechnology crops.

The European Commission may initiate infringement proceedings against a Member State's co-existence law if it is judged to be incompatible with EU law. However, there is no time limit on how quickly the Commission must act.

Traceability and Labeling: In April 2004, EC Regulations 1829/2003 and 1830/2003 governing the approval, traceability and labeling of biotechnology food and feed became effective. The regulations include mandatory traceability and labeling for all biotechnology and downstream products. Among the traceability rules are requirements that information that a product contains or consists of biotechnology products must be transmitted to each operator throughout the entire supply chain. Operators must have a standardized system in place to keep information about biotechnology products and to identify the operator by whom and to whom it was transferred for a period of five years from each transaction.

The requirements include an obligation to label appropriate products and to indicate if the food is different from its conventional counterpart in composition, nutritional value, intended use or health implications.

In some cases, these burdensome directives have already severely restricted market access for U.S. food suppliers, because food producers have reformulated their products to eliminate the use of biotechnology products. Food producers have indicated concern about needing to find expensive or limited alternatives. The Directives generally are anticipated to have a negative impact on a wide range of U.S. exports, including processed food exports.

Austria: Recent amendments to the Austrian Biotechnology Law allow, in principle, the planting of biotechnology crops. However, strict and complicated rules on liability and compensation still represent a *de facto* barrier against all EU-approved biotechnology crops. Under current Austrian rules, unapproved biotechnology events must not be detected in conventional seeds ("zero tolerance"), but EU-approved events may be present in conventional and organic seeds up to 0.1 percent.

Driven by political rather than scientific factors, the Government of Austria has effectively banned most agricultural biotechnology applications apart from research. All major Austrian supermarket chains have banned biotechnology products, even those labeled according to EC regulations, from their shelves.

Cyprus: Cyprus has adopted increasingly tough standards for biotechnology products, which in some cases exceed minimum EU requirements. For example, (a) GOC application requirements for new agricultural biotechnology crops are more arduous than in other EU countries, (b) permits for such crops must be renewed every five years, and (c) the GOC has declared as "GMO-free" areas under the Natura 2000 project (corresponding to 14 percent of Cyprus territory). Biotechnology products that are

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already licensed in the EU may circulate in Cyprus freely. However, biotechnology organisms must be approved, even if they are already licensed in other EU countries.

France: France has implemented EU regulations on agricultural biotechnology, notably those covering traceability and labeling. In France, a majority of imported products that are labeled “biotechnology” are soybeans and soybean meal from the United States, Brazil, and Argentina. There are almost no food products labeled as derived from biotechnology available on the market, due partly to a generalized hostility and pressure from anti-biotechnology activists and consumer organizations.

The government has drafted a Biotechnology Law, including the transposition of EU directive 2001/18, national rules on co-existence, and a new evaluation procedure for biotechnology products. However, the text has been under review at the inter-ministerial level because no agreement was found on co-existence. A vote on the bill is expected in early 2006. If the EU directive 2001/18 is not transposed into French law by October 2006, France will have to pay penalties set by the European Court of Justice.

Germany: Germany has suspended the approvals for planting certain biotechnology crops. In November 2004, Germany passed its new version of the geneteck law, which went into effect on February 4, 2005. This law contains strict regulations for liability and requires the creation of co-existence regulations. The new law is expected to hinder the importation, use, and development of Agricultural Biotechnology Products. Some biotechnology companies have already decided to stop their agricultural research efforts in Germany.

Greece: Greece has not been responsive to applications to introduce biotechnology seeds for field tests, despite support for such tests by Greek farmers and Greece’s agricultural science community.

Hungary: Extensive biotechnology research is taking place in Hungary, and the Hungarian government has allowed field tests for herbicide resistant corn, wheat and other crops. Although Hungary is mandated to adopt all relevant EU biotechnology legislation, Hungary has not yet prepared the national application rules for the EU biotechnology regulations on food and feed and traceability and labeling. In January 2005, the Government of Hungary (GoH) introduced a moratorium on corn varieties containing the Mon 810 event by invoking a “safeguard clause”. The temporary measure bans the production, use, distribution, and import of hybrids deriving from the MON 810 maize lines. The ban applies to seed producers and distributors as well as farmers. The moratorium is being addressed in the context of the co-existence legislation, a draft of which is expected by the end of the year. Hungary shares with other EU countries a relatively high level of public resistance to introduction of biotechnology food stocks, which has delayed the introduction of these products.

Italy: There are varying positions on Agricultural Biotechnology Products among Italy’s Ministries of Health, Agriculture, and Environment. The Ministry of Agriculture is trying to minimize the risk of adventitious presence by imposing rigorous thresholds for

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seed purity, which have hurt U.S. conventional corn and soybean seed exports, which fell from \$27 million in 2000 to \$1 million in 2004. Current regulations permit only the minimum detectable 0.05 percent of biotechnology seeds to be present. In the case of soybeans used for animal feed, the Ministry of Agriculture allows the use of imported biotechnology beans, as the Ministry is unable to meet Italian feed demand from non-biotechnology sources. On November 29, 2004, the Regional Administrative Tribunal (TAR) of Lazio (which includes Rome) annulled the decree banning the commercialization of four EU-approved biotechnology corn varieties (BT11, MON 810, MON 809, and T25). On January 25, 2005, the Senate passed a law, which criminalizes biotechnology cultivation in Italy through July 28, 2006, by which time each of Italy's regions must devise regional plans for the co-existence of biotechnology, non-biotechnology, and organic crops. Under the law, farmers and/or seed companies may be liable for fines between 5,000 and 50,000 euros (\$6,000 - \$60,000) or imprisonment of up to two years for "biotechnology" contaminating.

Luxembourg: Luxembourg continues both to ban marketing or growing of biotechnology crops in the country, and to be unsupportive of approving new biotechnology products for EU use. Luxembourg acknowledges that their ban is a problem for the EU with regard to WTO obligations, but the issue remains politically explosive with a "vocal minority" that vehemently opposes biotechnology products. Despite the EU Commission's continued efforts in 2005 requesting Luxembourg to withdraw its national ban, the law remained in effect. Luxembourg continued throughout 2005 to defend its national ban and also is encouraging an EU-wide discussion about decision-making on these products. Legislation which would regulate growing of biotechnology crops in Luxembourg remained in a parliamentary committee at year's end.

Portugal: The EU's (de facto) moratorium on new biotechnology-approvals led to U.S. losses in the Portuguese corn market of \$56 million in 2004. The EU Traceability and Labeling Regulation (1830/03) and the EU Food and Feed Regulation (1829/03) resulted in the immediate decline of Portuguese demand for U.S. soybeans and led to \$21 million in losses in 2004. The Ministry of Agriculture's 1999 suspension of two biotechnology-corn seeds' inclusion in the National Seed Catalogue led to U.S. losses of \$688,000 in 2004. Only after the EU "unfroze" the EU seed catalogue this year, could Portuguese farmers plant biotechnology-seeds. In total, EU actions cost the United States an estimated \$78 million in lost revenue in 2004.

Spain: The Spanish inter-ministerial biotechnology commission (composed of the Ministries of Environment, Agriculture, Health, Education and Science, and Industry, Tourism and Trade) continues to accept new applications to permit biotechnology seed cultivation in Spain, most recently in July 2005, with the acceptance of the NK603 Roundup Ready corn variety. In addition, the Ministry of Agriculture was given the authority to approve new varieties derived from MON810. The inter-ministerial commission will likely continue case-by-case decisions with respect to future Spanish votes on EC biotechnology proposals.

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Barriers Affecting Trade In Cattle, Beef, Poultry, And Animal By-Products

A variety of EU measures, outlined below, have the effect of severely restricting U.S. exports of livestock products to the European Union market.

EU Hormone Directive

In 1988, the EU provisionally banned the use of substances that have a hormonal growth-promoting effect in raising food-producing animals. This action effectively banned the export to the EU of beef from cattle raised in the United States. The use of hormone implants is approved by the U.S. Food and Drug Administration and is a common practice in U.S. beef cattle production. The United States launched a formal WTO dispute settlement procedure in May 1996 challenging the EU ban. In 1999, the WTO ruled that the EU's ban is inconsistent with the WTO Agreement on Sanitary and Phytosanitary (SPS) Measures because it is imposed without a risk assessment based on scientific evidence of health risks and authorized the United States to impose sanctions on EU products with an annual trade value of \$116.8 million.

In September 2003, the EU announced the entry into force of an amendment (EC Directive 2003/74) to its Hormone Directive (EC Directive 96/22). The new Directive recodified the ban on the use of estradiol for growth promotion purposes and established provisional bans on the five other growth hormones included in the original EU legislation. With enforcement of this new Directive, the EU argued that it was now in compliance with the earlier WTO ruling.

At present, the United States continues to apply 100 percent duties on \$116.8 million of U.S. imports from the EU. In November 2004, the EU requested WTO consultations with the United States on this matter, claiming that U.S. sanctions were no longer justified. The United States maintains that the revised EU measure cannot be considered to implement WTO recommendations and rulings related to this matter, and that the U.S. sanctions therefore remain authorized.

Animal By-Products Legislation

In October 2002, the European Commission approved EC Directive 1774/2002, which regulates the importation of animal by-products not fit for human consumption. The regulation went into force in May 2004. During 2003, intensive technical discussions between U.S. and EU officials successfully addressed some issues and prevented trade disruption for a significant portion (at least \$300 million) of U.S. exports to the EU of animal by-products. However, it is estimated that with the publication of the final text, about \$100 million of U.S. animal by-product exports to the EU remain adversely affected to some degree. In particular, the United States remains concerned about various outstanding issues for which the EU has not provided risk assessments, such as a ban on the use of dead-in-transport poultry in pet food. The U.S. exports remaining most exposed to this regulation are dry pet food, other animal protein products, and some hides and skins. It is unclear as to the regulation's overall effect on further downstream

products such as certain in vitro diagnostic products that may use animal by-products. In October 2005, the Commission presented a report to the EU Parliament recommending amendments to EC Directive 1774/2002. Any agreed amendments would need to be voted on by the EU Parliament.

Poultry Meat Restrictions

U.S. poultry meat exports to the EU have been banned since April 1, 1997, because U.S. poultry producers currently use washes of low-concentration chlorine as an anti-microbial treatment (AMT) to reduce the level of pathogens in poultry meat production, a practice not permitted by the EU sanitary regime. U.S. concerns with respect to poultry intensified in 2004 as a result of EU enlargement and the application of EU restrictions in new Member States that had previously allowed entry of U.S. poultry meat. In 2004, the United States made significant progress in its work with the EU to address differences between U.S. and EU food safety rules for poultry meat.

The Commission audited a number of U.S. poultry plants that demonstrated the use of AMTs, and the United States developed an action plan to demonstrate the equivalency of U.S. and EU on-farm manufacturing practices.

In 2005, the two sides continued to discuss the final details of a series of steps, including approval by EU Member States of the use of AMTs, aimed at re-opening the EU market to U.S. poultry meat products.

Other Member State Measures

Finland and Sweden: The European Commission has granted both Finland and Sweden extensions of the derogations approved in their EU accession agreements, which allow both countries to continue to enforce stricter salmonella controls and stricter border controls for live animals (quarantine) than those enforced by other EU Member States. These countries also impose strict requirements regarding the importation of fresh (including frozen) meat, ground meat, and meat preparations, (with the exception of heat-treated meat) and table eggs.

Barriers Affecting Vitamins and Health Food Products

Denmark: A Danish statutory order requires companies to conduct tests on nutrition products for content, including on individual ingredients, which is not required in other EU countries. The tests must be analyzed by a Danish Veterinary and Food Administration (DVFA)-accredited laboratory.

France: As of this time, France does not apply the recently issued EU Directive on dietetics and maintains its own restrictive policy and practices with regard to limits in vitamin and mineral composition. However, France was expected to transpose the EU Directive by the end of 2005.

Greece: In implementing the EU Food Supplement Directive, Greece restricted the sale of protein-based meal replacement products to pharmacies and specialized stores, limiting the ability of U.S. companies to sell such products through direct sales.

Spain: Spain has restrictive practices with respect to the use of vitamins and health food products. Since March 2002, Ministry of Health inspectors have raided health food shops and removed 227 different types of health food products from the market. Although the EU passed a new Directive on dietetics, Spain maintains its restrictive policy with regard to limits in vitamin and mineral composition.

EMERGING REGULATORY BARRIERS

In addition to the previously mentioned trade barriers arising from EU policies regarding standards, testing, labeling, and certification, the United States has serious concerns about the ongoing development of new regulations that would appear to have serious adverse consequences for U.S. exporters in the future. The United States is actively engaging the European Union with respect to the issues outlined below.

EU Directive on Wood Packaging Material (WPM)

In February 2005, the EU suspended for one year until (March 1, 2006) its plan to implement a new Directive on wood packaging material (WPM) that could affect up to \$80 billion worth of U.S. agricultural and commercial exports to the EU that are shipped on wooden pallets or in wood packaging materials. The Directive, published by the European Commission on October 5, 2004, would place a debarking requirement, in addition to heat treatment fumigation, on WPM from the United States and other countries.

The EU Directive is more restrictive than the international standard established by the International Plant Protection Convention (IPPC), Guidelines for Regulating Wood Packaging Material in International Trade (IPSM-15). IPPC members, including the EU, approved ISPM-15 to harmonize and safeguard WPM requirements in world trade. IPPC members approved specific treatments and the marking of WPM, but did not support a debarking requirement in the absence of a scientific justification. The IPPC continues to assess emerging scientific studies related to this issue. On January 17, 2006, EU Member States approved a further postponement of its unilateral debarking requirement until December 2008, with a review of the issue scheduled for 2007.

Chemicals

In October 2003, the European Commission presented its proposal for a massive overhaul of existing EU chemicals regulation. The proposal, called REACH (Registration, Evaluation, and Authorization of Chemicals), would require all chemicals produced or imported into the EU in volumes above 1 ton per year affecting approximately 30,000 chemicals to be registered, by providing test results and other information on the substances and their uses, in a central database. Chemicals of very high concern would

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need an authorization for use in the EU. Virtually every industrial sector, from automobiles to textiles, could be affected by the new policy.

While the United States supports the EU's objectives of protecting human health and the environment, this approach appears to be costly, burdensome and could present significant obstacles to trade and innovation. Many of the EU's trading partners have expressed similar concerns. The European Council and the European Parliament have been examining the proposal under the EU's legislative co-decision process. On November 17, 2005, the European Parliament, in its first reading, adopted an amended proposal that the Council and the Commission will now review. The Council is expected to conclude its first reading in spring 2006. The U.S. Government has provided detailed comments on the REACH proposal and welcomes changes to the original Commission text that would make REACH a more balanced and cost-effective regulation.

Cosmetics

In January 2003, the EU formally adopted the seventh amendment to Directive 76/768/EEC on Cosmetics. EU Member States were required to transpose the Directive into national law by January 1, 2004, at which time a series of amendments came into effect. The amended Directive calls for an EU-wide ban on animal testing within the EU for cosmetic products and an EU-wide ban on the marketing/sale of cosmetic products that have been tested on animals, whether such testing has occurred inside or outside the EU. It will prohibit the sale in the EU of U.S. cosmetics products tested on animals as of 2009 or 2013 (depending on the type of test) or earlier if the European Community has approved an alternative testing method.

To minimize possible trade disruption, the U.S. Government and the European Commission have embarked on a joint project to develop harmonized, alternative, non-animal testing methods. The project involves cooperation between the U.S. Interagency Coordinating Committee on the Validation of Alternative Methods and the European Center for the Validation of Alternative Methods (ECVAM). The aim is to develop agreed alternative testing methods that would be submitted to the OECD process for international validation. The validation of alternative methods is a long and expensive process, taking on average seven years. The EC is actively encouraging ECVAM to pursue alternative methods in the near term.

Waste Management (WEEE and RoHS Directives)

In January 2003, the European Union adopted two Directives in an effort to address environmental concerns regarding the growing volume of waste electrical and electronic equipment. The Waste Electrical and Electronic Equipment (WEEE) Directive focuses on the recycling of electrical and electronic equipment waste. The Restriction of the Use of certain Hazardous Substances (RoHS) Directive addresses restrictions on the use of

certain substances in electrical and electronic equipment, such as lead, mercury, cadmium, and certain flame-retardants.

Under the WEEE Directive, producers are held individually responsible for financing the collection, treatment, and recycling of the waste arising from their new products as of August 2005. Producers have the choice of managing their waste on an individual basis or participating in a collective scheme. Waste from old products is the collective responsibility of existing producers based on their market share.

Member States were required to transpose the WEEE Directive into national law by August 13, 2004, and implement it by August 13, 2005. Some Member States still have not transposed the WEEE Directive and many are behind in their implementation and do not have their national WEEE registration systems in place. By December 31, 2006, the WEEE Directive requires that Member States ensure a target of at least four kilograms of electrical and electronic equipment per inhabitant per year is being collected from private households. The policy is intended to create an incentive for companies to design more environment-friendly products.

Under the RoHS Directive, as of July 1, 2006, the placing on the European market of electrical and electronic equipment containing lead, mercury, cadmium, hexavalent chromium, polybrominated biphenyls, and polybrominated diphenyl ethers will be prohibited, with some limited exemptions. The Commission Decision, published on August 18, 2005, established maximum concentration values of 0.1 percent by weight in homogenous materials for lead, mercury, hexavalent chromium, polybrominated biphenyls (PBB), and polybrominated diphenyl ethers (PDBE) and 0.01 percent by weight in homogenous materials for cadmium.

Some U.S. companies seeking to comply with the RoHS Directive claim to face significant commercial uncertainties. Firms assert that they lack sufficient, clear, and legally binding guidance from the European Commission on product scope and, in cases where technically viable alternatives do not exist, businesses face a lengthy, uncertain, and non-transparent exemption process. As of late 2005, the European Commission was considering additional RoHS exemption requests. Some exporters claim that the uncertainty about RoHS provisions is having an adverse impact on companies as they must make practical design, production, and commercial decisions without adequate information.

Given the substantial impacts of RoHS substance bans on international trade, the United States has urged the European Commission to provide sufficiently detailed, legally binding guidance to give companies seeking to comply with RoHS commercial certainty. The United States has also urged the Commission to make the exemption process more efficient and transparent so that companies can have definitive answers more promptly on whether and how the Directive will apply to their products. As an additional concern, the

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U.S. testing industry argues that the EU has not yet developed test methods for use in conformity assessment of the products covered by these directives.

Battery Directive

In 2003, the European Commission proposed a revised version of the 1991 EU Battery Directive. The aim of the new Directive is to collect and recycle all waste batteries and to prevent their incineration and disposal. Producers must finance the collection, treatment, and recycling of waste batteries. On the issue of nickel cadmium (NiCd), the Commission proposes to set high collection targets rather than a ban. The impact assessment carried out by the Commission identifies this approach for dealing with NiCd batteries as the best option from the environment and economic points of view.

In April 2004, the European Parliament rejected the Commission's approach and voted for a ban on nickel cadmium batteries, with a list of exemptions for some industrial and automotive batteries. In the common position of July 2005, the Council agreed upon a partial ban on the use of cadmium in portable batteries.

Emergency and alarm systems, medical equipment and power tools are exempt from the ban. The second reading in Parliament started in September 2005, with final adoption of the text expected in 2006.

Energy Using Products (EUP)

The EU framework directive promoting eco-design for energy-using products (EUP) became law on August 11, 2005, and EU Member States have until August 11, 2007, to transpose it into national law. Through this directive, the EU means to regulate the integration of environmental considerations at the design phase of a product with the objective of cutting energy use. Once in place for a product or a product feature, design requirements will become legally binding for all products put on the EU market, regardless of where they are designed or produced. The legislation commits the European Commission to draw up a three year working plan of "implementing measures" that will identify products and set specific standards by July 2007. Although there will be impact studies that will slow the implementation, the directive contains a list of products that are likely to be the first targets which includes: lighting, office equipment, heating equipment, domestic appliances, air conditioning, and consumer electronics, and the feature of stand-by energy losses, for which implementing measures may be issued even before July 2007. The directive sets out CE marking requirements for the items covered by implementing measures. The electronics industry in particular has raised concerns with EUP, noting producers already face other extensive new regulations. Industry is most concerned about the possible need for a complete product life cycle analysis, and fears adverse impacts on design flexibility, new product development and introduction, as well as increased administrative burdens.

Acceleration of the Phase-Outs of Ozone-Depleting Substances and Greenhouse Gases

As part of a wider climate change program to reduce emissions of greenhouse gases to meet its Kyoto Protocol objectives, the European Commission put forward a proposal in October 2003 to regulate the emission of fluorinated gases (f-gases). The aim of the proposal is to improve the containment of f-gases and introduces specific restrictions on their marketing and use in specific applications. During the first reading in fall 2004, EU environment ministers decided to split the proposal into two packages, one includes a Regulation on f-gases used in stationary applications and the other a Directive on fluorinated hydrocarbons (HFCs) in vehicle air conditioning. The first measure (the “stationary” Regulation) will impact U.S. manufacturers of stationary air conditioning and refrigeration equipment and the companies that produce the chemicals used within them. The second will impact U.S. car and parts manufacturers by phasing-out HFC 134a in vehicle air conditioning beginning in 2011 with a complete ban by 2017.

The “stationary” Regulation seeks to improve containment of f-gases by setting minimum standards for inspection and recovery, and, where containment is not feasible, proposes to ban marketing and use of certain applications. Examples of applications using f-gases the Regulation seeks to ban include vehicle tires, non-refillable containers, windows, footwear, one-component foams, self-chilling drinking cans, novelty aerosols and fire extinguishers. Despite the Environment Committee of the European Parliament (EP) voting to ban the use of HFCs in a range of appliances including small domestic refrigerators, commercial and industrial refrigerators, and stationary air-conditioning units, the EP Plenary did not adopt these bans in the October 2005 second reading. Nonetheless, the EP did adopt an amendment allowing Member States to maintain or introduce stricter protective measures in order to reach Kyoto targets. The United States will continue to closely monitor the remaining phases of EU consideration of this legislation by the Council of Ministers.

Other Member State Measures

Some EU Member States have their own national practices regarding standards, testing, labeling, and certification. A brief discussion of the additional national practices of concern to the United States follows:

Austria: Austria became the second EU country after Denmark to ban a range of uses of the three fluorinated gases controlled under the Kyoto protocol on climate change. An ordinance that took effect on November 22, 2002, prohibits the use in new sprays, solvents, and fire extinguishers of hydrofluorocarbons (HFCs), perfluorocarbons, and sulphur hexafluoride. The ordinance phases out their use in foams between mid-2003 and the end of 2007. It bans their use in new refrigeration and air-conditioning equipment by the end of 2007. The ban appears to exempt production of HFCs in Austria for the export market. If the upcoming EU f-gases regulation focuses on containment instead of bans, the government of Austria has indicated it will try to retain its own national HFC bans.

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Finland: A ban on the importation and sale of new appliances containing hydrochlorofluorocarbons (HCFCs) was imposed on January 1, 2000, and remains in place. The importation of the chemical HCFC is allowed when used for maintenance of old appliances using HCFC. New HCFC compounds used for maintenance of refrigeration equipment will be banned as of 2010 and use of all HCFC compounds, including recycled compounds, will be banned as of 2015.

GOVERNMENT PROCUREMENT

In an effort to open government procurement markets within the Member States, the EU in 2004 adopted a revised Utilities Directive (2004/17), covering purchases in the water, transportation, energy, and postal services sectors. Member States were mandated to implement the new Utilities Directive by the end of January 2006.

This Directive requires open, objective bidding procedures but still discriminates against bids with less than 50 percent EU content that are not covered by an international or reciprocal bilateral agreement. The EU-content requirement applies to U.S. suppliers of goods and services in the following sectors: water (production, transport, and distribution of drinking water), energy (gas and heat), urban transport (urban railway, automated systems, tramway, bus, trolley bus, and cable), and postal services. The Directive excludes the telecommunications sector, which means that the EU content requirement does not apply to procurement of telecommunications equipment from U.S. suppliers. This was a significant improvement over earlier versions of the Utilities Directive, which had included the telecommunications sector within its scope. The United States had imposed retaliatory sanctions in 1993 in connection with then-existing discrimination against U.S. firms in the EU telecommunications equipment market brought about by the 1993 Utilities Directive. That Directive's discriminatory provisions were waived for heavy electrical equipment manufactured in the United States under the May 1995 Memorandum of Understanding (MOU) on government procurement between the United States and the EU.

Following a review of the impact of the new 2004 Directive on access to the telecommunications market, USTR determined to terminate the 1993 sanctions imposed on certain EU Member States, effective March 1, 2006. This determination was based on assurances from the European Communities that EU telecommunications operators are no longer subject to the discriminatory requirements of the Utilities Directive, and that purchasing by EU telecommunications operators is now based solely on commercial considerations. In a reciprocal move, the EC lifted its counter-measures on March 1, 2006.

Other Member State Measures

Member States have their own national practices regarding government procurement. In some cases, they require offsets, or obligations that require companies to provide services, create jobs, or purchase local goods as a condition for the contract's award. A brief discussion of some of the national practices of particular concern to the United States follows.

Austria: U.S. firms continue to report a strong pro-EU bias and pro-Austrian bias in government contract awards and some privatization decisions. In major defense purchases, most government procurement regulations do not apply, offset requirements up to 200 percent of the value of the contract are common, political considerations remain important, and transparency remains limited. Austria's largest military procurement to date, the \$2 billion purchase of fighter jets in 2002, continues to be a source of concern regarding its lack of transparency, an apparent bias against a U.S. proposal, and flawed offset deals related to the purchase.

Czech Republic: U.S. and other foreign companies express great concern about the transparency of the public procurement process. Many U.S. bidders report that Czech (or other European) bidders are favored and usually win contract awards despite their higher bids and questions regarding those companies' ability to deliver on the terms of the tender. This has been a problem particularly in construction and the purchase of military equipment, as well as in the sale of state-owned industries. A draft law aimed at improving the process of government procurement is in the Parliament, but whether it is enacted and has a positive impact remains to be seen.

France: France has a strong and extremely competitive aerospace and defense manufacturing base. Having allowed only limited privatization in the sector; the French government continues to maintain shares in several major prime contractors. The French defense market remains generally closed to non-European competition. Even in the case of European competition, French companies are often selected as prime contractors. Nevertheless, U.S. firms do enjoy success as component and systems suppliers, if not as prime contractors. The Defense Ministry, which handles around 70 percent of the equipment budget, has a tendency to select non-American contractors, even if it costs more and takes longer to market. These factors have made it difficult for U.S. defense firms to take part in French/European programs.

Greece: Greece has the worst ranking in Western Europe for corruption and lack of transparency in relation to procurement decisions, according to Transparency International. However, the government is taking steps to improve the civil service and tackle corruption, although progress has been slow. For example, the Armaments Director in the Ministry of Defense put all pending contracts on hold until they can be reviewed. While this review of pending procurement has led to delays in payment and awarding of contracts - and in some cases cancellation of contracts - these steps to introduce greater transparency should ultimately improve the future climate for U.S. businesses.

Greece continues to insist on offset arrangements as a condition for the purchase of defense items. Although there is evidence that some decision-makers hold a bias against American products, on balance Greece is receptive to U.S. companies, technology, equipment, and services.

Ireland: Government procurements in Ireland generally are tendered under open and transparent procurement regulations. U.S. companies have raised concerns, however, that they have been successful in only a few national and regional government tenders, particularly for infrastructure-related procurements. U.S. firms complain that lengthy budgetary decisions delay procurements and that unsuccessful bidders often have difficulty receiving information on the rationale behind the tender award. Once awarded a contract, companies can experience significant delays in finalizing contracts and commencing work on the contract.

Italy: Italy's government procurement practices have created obstacles for U.S. firms. This is particularly true in the case of the Italian government's procurement of civilian helicopters, which a U.S. company has alleged favors a competing Italian supplier. This procurement has been unsuccessfully challenged in Italian administrative courts and is being pursued at the EU level. Reviews of other Italian procurements by the European Commission has encouraged Italy to increase the transparency of its procurement laws and regulations and update its public procurement laws to be more in line with EU Directives.

CONSIP, an agency of Italy's Finance Ministry, manages procurements of all goods on behalf of public administration entities and issues tenders that stipulate framework agreements for specific products and services. Framework agreements are executed between a supplier and CONSIP, but the eventual business transaction for a specific product or service is between the supplier and the ordering government entity. CONSIP monitors transactions to ensure that they are carried out. U.S. firms have mixed views on the effectiveness and transparency of CONSIP's operations. Reportedly, its role is gradually being diminished.

Lithuania: The public procurement process in Lithuania is not always transparent. Complaints persist that some tenders are so narrowly defined that they appear to be drafted with the intent that only one company can provide the good or service. The Ministry of Defense, for example, recently withdrew a tender for automobiles amid public charges that the tender's drafters specified it in such a way that it favored a particular European automobile manufacturer.

The Lithuanian government adopted a resolution in 2003 requiring offset agreements as a condition for the award of contracts for procurement of military equipment exceeding LTL 5 million (about \$1.8 million). The Government of Lithuania (GOL) purchases most U.S. military equipment using U.S. government grant money, which precludes offsets. In a couple of recent cases, however, the GOL requested offsets for purchases it made using its own funds.

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In one case, the GOL eventually dropped its request for an offset; in the other, the GOL reached an offset agreement with the provider that allowed the deal to go through. This offset requirement adds a level of complexity to exporting military equipment to Lithuania, but it has not yet scuttled a single U.S. export opportunity.

Portugal: According to U.S. firms, U.S. bidders with technically superior bids and lower prices have been passed over in favor of competitors from other EU Member States. Such cases have cost U.S. industry over \$170 million in just the past two years. A lack of transparency in procurement procedures and severe government budgetary problems are also hampering U.S. firms' ability to win procurement awards.

Slovenia: The Slovenian government has said that it intends to improve the transparency of its public procurement process. The Ministry for Public Administration has also said it will create an e-procurement system, although efforts in this area have stalled. American firms, however, continue to express concerns that the public procurement process in Slovenia is non-transparent. Many American bidders report that European firms are favored and usually win the bids in spite of more costly offers and questionable ability to deliver and service their products. This is a problem across the entire range of public procurement, but seems most prevalent in telecommunications and medical equipment procurement. For over one year, a U.S.-based firm has been seeking to participate in a public tender for a digital, hand-held radio network for use by police, military, rescue, and other professional emergency services.

The company, which has built similar networks in several neighboring countries, has expressed concern that it may not even have the chance to participate in a formal bidding process as it is unclear when, or if, a tender for this network will be published.

United Kingdom: There is an ongoing pattern in U.K. military procurements of non-competitive procurements and the overturning of decisions where a U.S. supplier was selected, and the subsequent award of the contract to a domestic supplier.

SUBSIDIES POLICIES

Government Support for Airbus

Over many years, the Governments of France, Germany, Spain, and the United Kingdom have provided subsidies to their respective Airbus member companies to aid in the development, production and marketing of Airbus large civil aircraft. These governments have financed between 33 percent and 100 percent of the development costs for all Airbus aircraft models ("launch aid") and provided other forms of support, including equity infusions, debt forgiveness, debt rollovers, and marketing assistance, including political and economic pressure on purchasing governments. The EU's aeronautics research programs are driven significantly by a policy intended to enhance the international competitiveness of the European civil aeronautics industry. EU governments have spent hundreds of millions of euros to create infrastructure needed for Airbus programs, including 751 million euros from the City of Hamburg to purchase land

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that Airbus is using for the Airbus A380 “superjumbo” project and 182 million euros from French authorities to create the AeroConstellation site, which contains the Airbus facilities for the A380. With more than \$6 billion in subsidies, the Airbus A380 is the most heavily subsidized aircraft in history. EU governments have also made legally binding commitments of launch aid for the new Airbus A350 aircraft, even though Airbus has not yet repaid any of the financing it received for the A380.

The Airbus Integrated Company - successor to the original Airbus consortium and representing a partnership of the European Aeronautic, Defense, and Space Company (EADS) (80 percent equity share) and BAE Systems (20 percent equity share) - is now the second largest aerospace company in the world. With more than half of worldwide deliveries of new large civil aircraft deliveries over the last few years, Airbus is a mature company that should face the same commercial risks as its global competitors.

In October 2004, following unsuccessful U.S.-initiated efforts to negotiate a new U.S.-EU agreement that would end subsidies for the development and production of large civil aircraft, the United States filed a WTO consultation request with respect to the launch aid and other forms of subsidies that EU governments have provided to Airbus. Concurrent with the U.S. WTO consultation request, the United States also exercised its right to terminate the 1992 U.S.–EU bilateral agreement on large civil aircraft. The consultations failed to resolve the U.S. concerns, however, and a renewed effort to negotiate a solution ended without success in April 2005.

Therefore, on May 31, 2005, the United States filed a WTO panel request. The WTO established the panel on July 20, 2005, and panel proceedings are currently ongoing. U.S. officials have consistently noted their willingness to negotiate a new bilateral agreement on large civil aircraft, even while the WTO litigation proceeds, but have insisted that any such agreement must end launch aid and other direct subsidies for the development and production of such aircraft.

Government Support for Airbus Suppliers

Belgium: The Federal Government of Belgium, in coordination with the three regional governments, subsidizes Belgian aircraft component manufacturers that supply parts to the Airbus Integrated Company. In November 2001, the Belgian federal government reached an agreement with the three regional governments, usually responsible for R&D and investment promotion, on a 195 million euro package for aviation research and development for Airbus A380 components. Belgium claims the program was structured in accordance with the 1992 bilateral agreement, and covers non-recurring costs. According to Belgian industry sources, about 160 million euros of the 195 million euro package remains available, and the costs covered to date have netted orders worth 1.3 billion euros for the A380. On October 14, 2005, the Belgian federal government made a decision in principle to create a program to assist Belgian aviation part producers’ work on the Airbus A350.

The program would provide 150 million euros of reimbursable public finance, available for non-recurring development costs. Because this program can only be started after a federal-regional government agreement, this A350 assistance may face significant delays.

France: In addition to the launch aid that the French government provided for the development of the Airbus A380 super-jumbo aircraft in 2005, France will continue to provide reimbursable advances for Airbus programs, engines, helicopters, and on-board equipment. Appropriations in 2006 total 218 million euros, of which 168 million euros are committed to the A380. Overall 2006 appropriations, including 55 million euros in support of research and development by industrialists in the sector, amount to 273 million euros. In 2006, budget authorizations for these items are limited to 284 million euros.

Spain: The recently completed Puerto Real factory in Spain's Andalucia region is responsible for constructing 10 percent of Airbus' A380 aircraft. Spain's Ministry of Science and Technology currently subsidizes A380 construction through its agreement to provide 376 million euros in direct assistance through 2013. Furthermore, the regional government of Andalucia has channeled an additional 13 million euros of State General Administration regional incentive funds and 17.5 million euros of its own funds to subsidize the A380 project. Spain has provided numerous additional grants to Airbus' parent company, EADS.

Government Support for Aircraft Engines

United Kingdom: In February 2001, the U.K. government announced its intention to provide up to 250 million pounds to Rolls-Royce to support development of two additional engine models for large civil aircraft, the Trent 600 and 900.

The U.K. government characterized this engine development aid as an "investment" that would provide a "real rate of return" from future sales of the engines.

The European Commission announced its approval of a 250 million pounds "reimbursable advance" without opening a formal investigation into whether the advance constituted an illegal (under EU law) state aid. According to a European Commission statement, the "advance will be reimbursed by Rolls-Royce to the U.K. government in case of success of the program, based on a levy on engine deliveries and maintenance and support activity." Detailed terms of the approved launch aid were not made public. To date, none of the launch aid for the Trent 600 and 900 has been repaid.

Continuing U.K. government support of Rolls-Royce raises serious concerns about U.K. and EU adherence to the WTO Subsidies and Countervailing Measures Agreement. U.S. engine suppliers have lost sales of engines and claim that they have encountered suppressed prices in the United States and world markets.

France: The French government-owned engine manufacturer SNECMA has merged with technology and communications firm Sagem to form Safran. The government supports the Safran SaM146 propulsive engine program with a reimbursable advance of 140 million euros.

Canned Fruit Subsidies

The EU continues to subsidize shipments of canned peaches as well as the production of apples, prunes, grapes, wine, cherries, and citrus. Although a 1985 U.S.-EU Canned Fruit Agreement brought some discipline to processing subsidies, significant fraud and abuse have undermined the discipline imposed by the Agreement. Growers and producers of peaches receive a range of assistance from producer aid, market withdrawal subsidies, sugar export rebates, producer organization aid, and regional development assistance. The United States will continue to monitor EU subsidies to this sector, evaluate their trade-distorting effects, and monitor other areas of interest to our agricultural sector, for example, horticulture, grains, pork, and beef.

Wood Industry Subsidies

Several EU Member States and regional governments within them provided state aid to pulp, paper, and wood processing projects. Germany, in particular, has given aid in the form of grants, loans, and loan guarantees for pulp and paper and wood processing operations, especially in Eastern Germany. These subsidy programs are part of the overall combined EU/national regional support programs, which are available to any industry. This has added substantial new capacity and has contributed to a substantial drop in U.S. pulp and paper exports to the EU and globally, while fostering a rise in European paper and lumber and wooden panel exports to the United States and third country markets. A combination of factors, namely robust growth in the construction sector and duties put on Canadian softwood lumber, has also increased the competitiveness of German construction lumber in the United States.

INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

The EU and its Member States support strong protection for intellectual property rights (IPR), and the importance of protecting IPR and US-EU cooperation on IPR enforcement was highlighted at the U.S.-EU summit in June 2005. During 2005, the European Commission issued a communication on strengthening the criminal law framework to combat intellectual property offenses and a communication from the Commission's taxation and customs directorate on improving IPR enforcement.

The United States has raised concerns regarding the IPR practices of several EU Member States, either through the U.S. Special 301 process or through WTO Dispute Settlement procedures concerning their failure to fully implement the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS). The United States continues to be engaged with the EU and individual Member States on these matters.

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In April 2004, the EU adopted a Directive on the enforcement of intellectual and industrial property rights, such as copyright and related rights, trademarks, designs, and patents. This Directive requires all Member States to apply effective and proportionate remedies and penalties that form a deterrent against those engaged in counterfeiting and piracy. Member States are required to have a similar set of measures, procedures, and remedies available for right holders to defend their IPR. The Directive includes procedures covering evidence and measures such as injunctions and seizures. Remedies available to rights holders include the destruction, recall, or permanent removal from the market of illegal goods, as well as financial compensation, injunctions, and damages. There is a right to information allowing judges to order certain persons to reveal the names and addresses of those involved in distributing illegal goods or services, along with details of the quantities and prices involved. Under the Directive, Member States will have to appoint national correspondents to cooperate and exchange information with other Member States and with the Commission. The Directive takes on additional importance because of the expansion through EU enlargement of the EU's borders to the east, which moves them closer to countries such as Russia that have been a persistent source of pirated CDs and DVDs. Member States, including the ten new Member States, have until April 2006 to implement the Directive.

Copyrights

In April 2001, the EU passed a Directive (known as the Copyright or "Information Society" Directive) to harmonize aspects of the copyright law and implement the World Intellectual Property Organization (WIPO) Internet Treaties. Some Member States, such as Belgium and Spain, have failed to meet the December 2002 deadline to implement the directive. France has announced it will complete the transposition by early 2006. In July 2004, the European Commission published a working paper on the EC's legal framework in the field of copyright and related rights. The European Commission will take into account the results of the consultations on the working paper, which closed in October 2005, in proposing further legislative amendments.

Designs

The EU adopted a Regulation introducing a single Community system for the protection of designs in December 2001. The Regulation provides for two types of design protection, directly applicable in each EU Member State: the registered Community design and the unregistered Community design. Under the registered Community design system, holders of eligible designs can use an inexpensive procedure to register designs with the EU's Office for Harmonization in the Internal Market (OHIM). The holders will then be granted exclusive rights to use the designs anywhere in the EU for up to 25 years. Unregistered Community designs that meet the Regulation's requirements are automatically protected for three years from the date of disclosure of the design to the public. Protection for any registered Community design was automatically extended to the 10 new EU Member States on May 1, 2004.

The European Commission has proposed amending the legal protection of designs Directive (98/71) by removing Member States' option to maintain design protection for "visible" replacement vehicle parts, such as hoods, bumpers, doors, lamps, rear protection panels, windcreens, and wings. The proposal would allow independent part manufacturers, not linked to the producers of finished vehicles, to compete throughout the EU market for visible replacement parts. Neither non-visible parts, like engine or mechanical parts, nor components in new vehicles would be affected by the proposal.

Patents

Patent filing and maintenance fees in the EU and its Member States are significantly higher than in other countries. Fees associated with the filing, issuance, and maintenance of a patent over its life far exceeds those in the United States.

In October 2004, the European Commission proposed a regulation to allow manufacturers of generic pharmaceuticals to produce medicines under patent for export to countries in need that cannot produce sufficient quantities themselves. The regulation would implement within the EU an August 2003 WTO decision, under which national authorities can grant compulsory licenses for such production if certain conditions are fulfilled. One requirement is that the destination country must have notified the WTO that it is seeking the medicine covered by the license. To help ensure that medicines get to the patients who need them and to protect patent holders, customs authorities will be able to prevent the re-importation into the EU of medicines produced under the system. The proposed regulation would set up a system for companies that wish to manufacture medicines for export to apply to national authorities for the grant of a compulsory license from a patent holder that has exclusive rights over the manufacture and sale of the products concerned. Before coming into effect, the proposed regulation would have to be discussed and approved by EU Member States and the European Parliament.

In some countries, such as Slovakia and Portugal, copies of medicines that are still under patent are allowed on the market by the Ministries of Health, which fail to coordinate with their domestic patent offices.

Data Exclusivity

In some of the new Member States in particular, there is a lack of protection for data submitted to obtain marketing approval for pharmaceutical and agricultural chemical products. Article 39.3 of the Trade-Related Aspects of Intellectual Property Rights (TRIPS) Agreement requires such protection.

Hungary: Hungary's 2001 ministerial decree on the protection of test data took effect on January 1, 2003. Retroactive protection exists for pharmaceutical products that received first marketing authorization in the EU or Hungary on or after April 12, 2001.

Poland: Although Poland is required to implement the EU data protection regime as part of its entry into the European Union, concerns remain over its request to delay implementation for 15 years. In addition, while the government has signaled that it is considering implementation of a coordination mechanism between the Health Ministry and the patent agency, no concrete actions have been taken to do so.

Portugal: Pharmaceutical firms continue to be adversely affected because there is no crosscheck for pre-existing patents before granting market access for generic versions of patented products. The courts are the only remedy and, due to a significant judicial backlog, legal recourse is time-consuming and expensive. It can take several months to obtain an injunction against continued production of a patented pharmaceutical product knock-off. Final rulings can take years, resulting in high legal fees and lost income for U.S. firms.

Slovakia: U.S. companies continue to have concerns about the weak enforcement of patent rights in Slovakia. The Ministry of Economy, at the urging of the U.S. government, initiated a process in March 2005 to address the outstanding complaints that have led to Slovakia's inclusion on the "Special 301" Watch list. However, insufficient progress has been made to date on the following issues:

- Inadequate storage of sensitive documents and confidential data: The Government of Slovakia (GOS) has stored sensitive registration data on the premises of a competing generic drug producer for years. The GOS claims to have moved some of the data to a neutral storage facility, but some of it still remains under the care of the generic drug producer. The name on the title of the storage facility changed, but the parties involved remain the same. The Minister of Health has indicated it will procure a new, dedicated storage facility for the proprietary registration data by the end of 2005.
- Registration of Generics: In several cases in recent years, the Drug Control Office in the Ministry of Health has approved applications for registration by generic manufacturers for drugs that are still under patent protection because they failed to check the status of the original patent with the Patent Office. Once a registration is granted to a generic manufacturer, it is very difficult for the patent owner to overturn the decision or obtain compensation through the courts. The Drug Control Office and Patent Office are working together to develop a coordinating mechanism to prevent future registrations of unauthorized patent-infringing products.

Patenting of Biotechnology Inventions

A 1998 EU Directive (98/44) on the legal protection of biotechnology inventions harmonizes EU Member State rules on patent protection for biotechnology inventions. Although Member States were required to bring their national laws into compliance with the Directive by July 2000, some had not yet fully met that obligation, and the European Commission has started legal proceedings at the European Court of Justice against them.

France: France brought its national law into compliance with Directive 98/44 in December 2004. The French law allows plant breeders making varietal selections to freely use (protected) plant varieties to create new varieties.

Trademarks

Registration of trademarks with the European Union's Office for Harmonization in the Internal Market (OHIM) began in 1996. OHIM issues a single Community trademark that is valid in all 25 EU Member States.

Madrid Protocol

On October 1, 2004, the European Community acceded to the World Intellectual Property Organization (WIPO) Madrid Protocol, establishing a link between the Madrid Protocol system, administered by WIPO, and the Community Trademark system, administered by OHIM. Community Trademark applicants and holders now are allowed to apply for international protection of their trademarks through the filing of an international application under the Madrid Protocol. Conversely, holders of international registrations under the Madrid Protocol will be entitled to apply for protection of their trademarks under the Community Trademark system.

Geographical Indications

The United States has long had concerns that the EU's system for the protection of geographical indications, reflected in Community Regulation 1493/99 for wines and spirits and Regulation 2081/92 for certain other agricultural products and foodstuffs, appears to fall short of what is required under the TRIPS Agreement.

As a result of a WTO dispute launched by the United States, the WTO DSB ruled on April 20, 2005, that the EC's regulation on food-related geographical indications (GIs) is inconsistent with the EC's obligations under the TRIPS Agreement and the GATT 1994. In its report, the DSB agreed that the EC's GI regulation impermissibly discriminates against non-EC products and persons and agreed with the United States that the regulation could not create broad exceptions to trademark rights guaranteed by the TRIPS Agreement. The DSB recommended that the EC amend its GI regulation to come into compliance with its WTO obligations. The EC has indicated intent to comply and, by agreement with the United States, has until April 3, 2006 to do so.

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Additional Member State Practices:

Belgium: Domestically pirated and parallel-imported DVDs are a growing problem in Belgium. An industry trade association estimates that 250,000 illegal downloads of DVDs occur daily, and illegal copies on VHS, CD-R and DVD-R media are distributed by specialty stores, retail outlets, and local and international Internet sites. The recording industry estimates that 85 percent of blank digital media sold in Belgium are used for illegal downloads of music or videos. Annual losses to the U.S. motion picture industry through IPR piracy in Belgium are estimated at over 15 million euros. The Belgian Anti-Piracy Foundation (BAF) focuses both on the purchase of hard goods and on combating illegal Internet distribution. In June 2005, the BAF helped broker a Protocol Agreement between the recording industry federation (IFPI) and the Internet Service Providers Association (ISPA) of Belgium to shutdown Internet sites used for illegal downloading of music and videos. Although only two ISPs have signed on to the Agreement, they encompass a majority of Belgian Internet subscribers. Belgium's 1994 Copyright Law provides deterrent penalties for piracy, but national legal procedures are cumbersome and the court system is overburdened, discouraging action to combat IPR fraud. Obtaining a judicial restraining order against Internet piracy, for example, takes two to three months, and judges demand proof of damages to assign more than token fines. Belgian judicial action, however, was helpful in 2005. An Appeals Court upheld a lower court judgment in favor of IFPI and rights collectors and against private copying rights. The Belgian government finally brought into force the EU Copyright/"Information Society" Directive (EC/29/2001) in May 2005.

Cyprus: IPR legislation in Cyprus is, on the whole, modern and comprehensive, although enforcement should be further improved. Cyprus has harmonized its IPR regime with EU requirements as part of its accession to the EU in 2004. According to industry sources, the level of optical media piracy continues at roughly 50 percent. Audio piracy (mainly CDs) is also fairly constant at around 40 percent. Software piracy, largely fueled by small PC assembly and sale operations, has declined to 53 percent but is still significantly above the European average. Piracy of textbooks is a growing concern.

Czech Republic: The Czech Republic is considered to have done an above-average job of implementing EU legislation in the area of IPR, but there remain significant issues when it comes to enforcement of these laws. Court cases on IPR issues can often stretch to five years, and even then the current systems for the calculation and collection of damages favor defendants according to legal experts who work in the field. A new law is being drafted to address some of these issues (specifically the seizure of accounting books from pirating companies and how to calculate the profits of IPR violators), but processing times and a lack of judicial interest in the area suggests change in this area is likely to be slow.

France: Although the French government has significantly stepped up its efforts to fight piracy, video piracy and unauthorized parallel imports continue to impose losses on U.S. industry, and cable piracy and Internet piracy continue to present further problems in this area. In June 2004, the government launched: 1) an ambitious plan to collaborate with

Asian countries on combating piracy; 2) a customs national action plan that strengthens customs training and places French government anti-piracy personnel in embassies abroad; and 3) an interagency “tracking center” called “Tracfin” that gathers information on sales and manufacturing of counterfeit products and their links with organized crime. The French government also is funding a large-scale public anti-piracy and counterfeiting campaign aimed at businesses and consumers.

Germany: Non-retail outlets (Internet, print media, mail order, open-air markets) represent Germany’s major piracy problem. Pirated videos, VCDs, and DVDs are sold primarily by residential mail-order dealers who offer the products via the Internet, newspaper advertisements, or directly sell them in flea markets. German copyright legislation allows the making of private copies, which, although it does not include sharing or downloading of music, has been sometimes misunderstood as being a broader exception than it actually is. In 2005, the German entertainment industry blanketed the country with commercials for an information campaign to educate the public regarding the problem of piracy, especially on the Internet. While German federal authorities have been receptive to U.S. IPR concerns, there have been mixed results at the German state-level, which can have broad impact due to Germany’s decentralized law enforcement structure. German authorities in several cases have prosecuted pirates who download music and videos from the Internet and then distributed burned CDs or DVDs and arrested four persons in October 2004 who ran a major ring selling pirated videos on the Internet. The German government in July 2003 enacted amendments to the German Copyright Act intended to bring it in line with the EU Copyright/“Information Society” Directive. The Ministry of Justice has introduced additional amendments to the copyright law that are likely to be considered by Parliament in 2006. U.S. publishers have expressed a concern that these amendments might result in insufficient protections for the copyrights of works, particularly in digital format. The United States is watching this issue closely, including by sending an interagency STOP delegation to Berlin in June 2005.

Greece: Although protection of intellectual property rights in Greece is better than it was five years ago, there are troubling signs that violations, particularly in copyrighted audiovisual products and apparel and footwear, are once again on the rise. The United States encourages the Government of Greece to strengthen the enforcement of anti-piracy laws to discourage this trend.

Hungary: On January 1, 2003, Hungary acceded to the European Patent Convention and has amended the Hungarian Patent Act accordingly. Act CII of 2003 modified the Hungarian Copyright Act and the Hungarian Design Act in order to bring them in line with the relevant EU legislation. The Hungarian Patent Office implemented the EU Copyright/“Information Society” Directive. In October 2004, Hungary implemented Council Regulation 1383/2003, concerning customs action against goods suspected of infringing certain intellectual property rights. Further, a government decree established a customs task to accept claims from producers whose trademarks or copyrights were infringed.

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Italy: Although Italy has enacted a robust set of anti-piracy laws, the lack of adequate enforcement remains a serious concern. Italy continues to possess one of the highest overall piracy rates in Western Europe. In April 2005, the Italian government created a new "High Commissioner" position with responsibility for coordinating IPR protection. This position was filled in November 2005. Italian authorities have stepped up seizures of counterfeit and pirated goods, though enforcement varies widely from region to region. A new law allows Italian police to impose a fine of up to 10,000 euros for possession of fake goods. This tough measure has served to increase public awareness of IPR crime, but has only been imposed sporadically. Street vendors continue to openly sell pirated and counterfeited goods on Italian street corners. Italy's judiciary rarely hands down meaningful jail sentences for even serious cases of IPR theft.

In 2005, the Italian parliament passed amendments to Italy's Internet piracy and copyright laws that reduce potential jail sentences for illegal Internet file sharing. Under the revisions, Internet piracy conducted for monetary gain remains subject to jail terms. Internet users who swap copyrighted material without a profit motive, however, can now avoid criminal prosecution by paying a fine, in most cases around 1,000 euros. While this represents a de facto roll back of potential penalties for "not-for-profit" Internet piracy, local representatives of the music, film, and business software industries are generally satisfied with the new law.

Lithuania: Piracy of optical media, software, and motion pictures remains a serious problem. The International Intellectual Property Alliance estimates that U.S. businesses lost \$27.5 million in 2004 because of copyright piracy in Lithuania. The Lithuanian government is considering draft legislation that would strengthen IPR protection and increase penalties for IPR piracy. In addition to this legislation, however, the Lithuanian government must demonstrate the political will to enforce IPR protection for any effort to reduce piracy to succeed.

Poland: Poland has shown progress on several elements of IP protection. As a result of EU accession, Poland published amendments to its copyright law on April 30, 2004, and the amendments contained several improvements which had been proposed by the copyright-related industries. Poland also published an Optical Disc Decree on June 2, 2004, although concerns over the lack of criminal sanctions remain. The Polish government has increased antipiracy efforts, improving enforcement at the Warsaw Stadium, as well as increased enforcement actions in the border bazaars frequented by German tourists and others. In addition, the Interministerial Antipiracy Group recently published an IPR strategy that emphasizes cooperation with industry. Although Poland has made some progress in strengthening border enforcement in conjunction with rights-holders, problems remain both along the Eastern and Western borders with importation and sale of pirate optical discs.

Spain: Copyright infringement has become an increasing problem in Spain's major urban centers. Street piracy remains a serious issue, although authorities are conducting raids. With respect to copyright, industry representatives stress the importance of Spain passing implementing legislation for the WIPO Internet Treaties and the EU Copyright Directive,

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because Internet piracy is becoming an increasingly serious problem. There is also a need to improve the tracking of imports of blank CDs.

On September 28, 2005, the United States and Spain conducted a roundtable that focused on copyright-related IPR concerns. Stakeholders criticized the Spanish government for not implementing an otherwise ambitious government anti-piracy plan. The audio-visual industry also strongly opposes Spain's draft legislation implementing to the EU's copyright directive that would allow three "private copies" of DVDs and CDs.

Sweden: Sweden is a major contributor to the worldwide problem of Internet piracy. Due to its widely known status as a piracy safe haven, significant Internet source piracy infrastructure and group membership has flourished in Sweden. Sweden is host to: 1) the world's largest Bit Torrent file-sharing tracker, ThePirateBay.org; 2) 52 out of the world's 200 known piracy "top sites"; 3) the largest number of DC++ file-sharing hubs and users; and 4) "Rizon", the most popular Internet relay chat piracy channel.

The legislative and enforcement framework in Sweden is generally effective against conventional hard goods piracy, but actual enforcement with respect to Internet piracy is weak. At least until recently, police and prosecutors have generally failed to act on complaints of Internet piracy made by the Swedish Anti-piracy Bureau (SAB or "APB" in Swedish). A cause for optimism are the two convictions in the fall of 2005, on complaints by the SAB, of two men for the offense of distributing single films using DC++ file-sharing hubs. The defendants were ordered to pay substantial fines and costs. These first convictions suggest that if the authorities give priority to prosecuting Internet piracy cases, the courts may be prepared to apply the law appropriately.

SERVICES BARRIERS

Concerns Related to EU Enlargement

On May 28, 2004, the European Commission notified members of the World Trade Organization of a proposed consolidation of the EU's schedule of specific commitments under the General Agreement on Trade in Services (GATS) pursuant to GATS Article V to reflect both the 1995 accession to the European Union of Austria, Finland, and Sweden, and the 2004 accession of Cyprus, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, the Slovak Republic, and Slovenia. As a result of this proposed consolidation, a number of previous GATS commitments by these countries have been modified in a way that may reduce sector-specific or horizontal market access commitments. Although not within the scope of the EU's GATS Article V notification, the EU's consolidation proposal also entails the extension to the new Member States of most-favored nation exemptions reflected in the EU's existing schedule of GATS commitments. As provided for under GATS rules, the United States has engaged in initial consultations with the European Commission to evaluate possible adverse consequences to U.S. services trade of the consolidation and the potential for EU compensation to the United States for such consequences. The two sides plan to consult further on this issue.

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Television Broadcast Directive (Television without Frontiers Directive)

The 1989 EU Broadcast Directive (also known as the Television without Frontiers Directive) includes a provision requiring that a majority of television transmission time be reserved for European-origin programs “where practicable and by appropriate means.” All EU Member States, including the ten new Member States, have enacted legislation to implement the Broadcast Directive. It remains important to ensure that the flexibility built into the Directive is preserved and that individual broadcasting markets are allowed to develop according to their specific conditions and needs.

The European Commission is currently reviewing the Directive. As a result of consultations held with stakeholders in 2003, the Commission adopted in April 2004, a communication on the future of the European regulatory audiovisual policy, calling for more legal certainty on television advertising and an update on the protection of minors, among other issues. Between September 2004 and February 2005, focus groups on regulation of audiovisual content, advertising, and the right to information discussed several topics. Viviane Reding, Commissioner for Information Society and Media, presented the final results of the focus groups’ work in May 2005. This proposal provides a set of current for all audio visual services and modernizes the rules of the current Directive for television services. The European Commission on December 13, 2005, adopted the legislative proposal for revision of the Television Without Frontiers Directive. In line with expert opinion, the Commission adopted an approach based on the introduction of obligations on two levels: a level of fundamental obligations (particularly the protection of minors and human dignity) applicable to all audiovisual services, and a sub-group level of "linear" audiovisual services based on scheduled programs that will be subject to simplified and modified secondary obligations comparable to those in the TVWF Directive.

Several EU Member States have specific legislation that hinders the free flow of some programming. A summary of some of the more salient restrictive national practices follows.

France: France continues to apply its more restrictive version of the EU Broadcast Directive, which was first introduced into French legislation and approved by the European Commission in 1992. In implementing the Directive, France chose to specify a percentage of European programming (60 percent) and French programming (40 percent), which exceeded the requirements of the Broadcast Directive. Moreover, these quotas apply to both the 24-hour day and prime time slots, and the definition of prime time differs from network to network. The prime time rules are a significant barrier to access of U.S. programs to the French market. In addition, the United States continues to be concerned that radio broadcast quotas, which have been in effect since 1996 (40 percent of songs on almost all French private and public radio stations must be Francophone) limit broadcasts of American music.

Italy: Legislation passed in 1998 making Italy's TV broadcast quota stricter than the EU Broadcast Directive remains in effect. The legislation makes 51 percent European content mandatory during prime time, and excludes talk shows from the programming that may be counted toward fulfilling the quota. A 1998 regulation also remains in effect that requires all multiplex movie theaters of more than 1,300 seats to reserve 15-20 percent of their seats, distributed over no fewer than three screens, to showing EU films on a stable basis. In May 2004, Italy enacted controversial media reform through the "Gasparri Law," under which the media/communications market is viewed broadly as one sector. Under this law, no single operator may receive more than 20 percent of overall revenues from the entire sector. In addition, the law provides for the gradual privatization of the state-owned radio and television broadcasting conglomerate, RAI.

Spain: Spain's theatrical film system has been modified sufficiently in recent years so that it is no longer a major source of trade friction. Government regulations issued in 1997 require exhibitors to show one day of EU-produced film for every three days of non-EU-produced film. Spanish law requires that the quotas issue be reviewed in 2006.

Postal Services

United States express and package service providers remain concerned that postal monopolies in many EU Member States restrict their market access and create unfair conditions of competition with the incumbents. In October 2001, EU Member States agreed to open additional postal services to competition beginning in 2003, including all outgoing cross-border mail. Depending upon the results of a European Commission study (scheduled to be completed by the end of 2006), full liberalization of the EU postal market could occur by 2009.

Belgium: In October 2005, the Belgian government announced the formation of a strategic partnership between the Belgian Post and two partners: Danish Post and CVC Capitol Partners (a U.K.-based independent buyout group founded in 1981). The move is aimed to modernize and make more competitive the Belgian Post. As of October 2005, the European Commission, in accordance with the EU Council Regulation 139/2004, must still approve this deal.

In October 2005, the Belgian Federal Council of Ministers approved a legislative draft related to the governance of the postal industry. Differing definitions of "universal service" have complicated the debate. Universal service can be understood as the right of customers or consumers to have, in this case, full postal delivery services at a reasonable price, no matter where they live in Belgium. Express delivery companies such as United Parcel Service (UPS) and FedEx contend that their service is "value added" (by providing tracking options, guaranteed delivery, etc). In its present draft form, an explanatory text added to the Royal Decree would exclude value-added services from the universal services definition. If that legislation were approved, express companies would be exempt from the licensing regime as well as the obligation to provide for a compensation fund for universal service. As of October 2005, the legislation must still be forwarded to the Conseil d'Etat for legal review.

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Germany: In February 2005, the German Federal Cartel Office took action against Deutsche Post AG (DPAG), in response to complaints from competitors. The ruling forbids DPAG from hindering or discriminating against rival small and medium-sized providers of postal services in their mail preparation services, especially the collection and presorting of letters and the feeding of mail items weighing under 100 grams into DPAG's sorting centers. This ruling follows an October 2004 move by the European Commission to initiate a treaty infringement procedure against Germany for failing to mandate that DPAG offer unbundled access to competitors. Some U.S. companies have indicated they might be interested in providing services such as sorting.

Professional Services

In the area of professional services, there are significant variations among EU Member State requirements for foreign lawyers and accountants intending to practice in the European Union. While many of these are not outright barriers, disparities among Member State requirements can complicate access to the European market for U.S. lawyers and accountants.

Legal Services

Austria: U.S. citizens can only provide legal advice on U.S. law and public international law (excluding EU law) on a temporary basis. Only an Austrian or other EU national can join the Bar Association. U.S. nationals cannot represent clients before Austrian courts and authorities, and cannot establish a commercial presence in Austria. However, informal cooperation with Austrian partners is possible.

Czech Republic: The Czech Republic requires that all attorneys be trained at Czech universities and be members of the Czech bar. U.S. firms are allowed to co-operate with local firms and lend them their name, so firms that operate in the country do so as independent Czech branches. They may have U.S. attorneys that are attached to the staffs as "advisors."

Finland: Foreigners from non-EU countries cannot become members of the Finnish Bar Association and receive the higher law profession title of Asianajaja (Attorney at Law). Persons holding the title of Asianajaja are subject to Asianajaja Law as well as bar regulations. While the title gives added prestige and helps solicit clients, it is not essential to practice domestic or international law or to represent a client in court.

France: Non-EU firms are not permitted to establish branch offices in France under their own names. Also, non-EU lawyers and firms are not permitted to form partnerships with or hire French lawyers.

Germany: U.S. lawyers that have joined the German Bar Association under their home title may practice international law (but not EU law) and the law of their home country. To be admitted to the bar to practice German law, individuals generally have to complete five years of study, then successfully complete the first of two state exams. After

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successfully completing the first exam they undertake two years of practical training. Individuals then take the second state exam, and upon passing, are admitted to the bar.

Hungary: Foreign non-EU lawyers may provide legal advice on legislation of their own country and international law. Lawyers registered in the EU may be admitted to the bar. Foreign lawyers from non-EU countries may establish a partnership with a Hungarian legal firm and provide legal services under a “cooperation agreement.”

Ireland: In general, lawyers with non-Irish qualifications who wish to practice Irish law and appear before Irish courts must either pass transfer examinations or retrain as lawyers under the direction of the Law Society of Ireland. Only lawyers who have either been admitted to the Bar of England, Wales, or Northern Ireland, practiced as an attorney in New York, California, Pennsylvania (with five years experience required in Pennsylvania), or New Zealand, or have been admitted as lawyers in either an EU or EFTA Member State are entitled to take the transfer examination.

Italy: In 2001, Italy passed a law implementing EU Directive 98/5 on EU lawyers’ freedom to establish themselves EU-wide and enabling Italian lawyers to practice jointly, including with EU lawyers, through a limited liability partnership or through the Italian branch of a partnership formed in another EU Member State, as long as the limited liability partnership is composed exclusively of Italian and EU lawyers. The status of non-EU lawyers is not explicitly addressed by the law. This omission leaves the status of international law firms with offices in Italy uncertain, insofar as they have Italian and non-EU lawyers as partners.

Lithuania: Only EU citizens may join the Lithuanian bar and establish law firms that provide the full range of legal services. Lithuanian law permits U.S. attorneys to establish law offices that provide paralegal services. These firms differ from traditional law firms, however, in that they cannot compel Lithuanian institutions to provide information, nor can they protect legally the lawyer-client privilege. U.S. firms can, however, easily partner with a local law firm to provide a full range of legal services.

Slovakia: Effective January 1, 2004, Act No. 586/2003 (the Advocacy Act) forces non-EU-based law firms to change their legal status from a branch partnership to a limited liability company (LLC). An LLC must be owned by an EU advocate registered in Slovakia or a Slovak national. As a result, non-EU law firms cannot market themselves under their internationally recognized corporate identities and incur extra costs to comply with the special rules.

The law also requires non-EU-based lawyers and law firms to register with the Slovak Bar Association to practice law in Slovakia. In 2005, no U.S. attorneys have been able to register. The United States is concerned that the Slovak Bar consistently has tried to limit foreign lawyers’ ability to practice law in Slovakia; the Advocacy Act appears to facilitate the Slovak Bar’s ability to deny foreign lawyers registration.

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In addition, the Slovak Bar approved internal rules (which are binding for all Bar members) in 2004 that restrict a firm's name to that of living partners. U.S. companies consider this a discriminatory measure as most of them bear names of their partners and/or founders who died long ago, but they want to keep the business name as it represents their brand and reputation.

Accounting and Auditing Services

France: There is a nationality requirement for the establishment of a practice, which can be waived at the discretion of the French authorities. An applicant for such a permit, however, must have lived in France for at least five years.

Greece: U.S. access to the Greek accounting market remains limited. A 1997 Presidential decree established a method for fixing minimum fees for audits and established restrictions on the use of different types of personnel in audits. It also prohibited auditing firms from doing multiple tasks for a client, thus raising the cost of audit work. The Greek government has defended these regulations as necessary to ensure the quality and objectivity of audits.

Hungary: Only Hungarian-certified accountants may conduct audits, but this individual may work for a foreign-owned firm.

Architectural Services

The U.S. National Council for Architectural Registration Boards and the E.U. Architect's Council of Europe are currently working to develop an agreement on mutual recognition of professional qualifications that would be valid for all 25 EU Member States.

Austria: Only citizens from EU and EEA Member States are eligible to obtain a license to provide independent architectural services in Austria. This restriction does not appear to be reflected in the European Communities' Schedule of Specific Commitments under the GATS.

Financial Services

Poland: Citibank and other service providers have requested that the Polish government treat independent legal persons as a single taxable person as allowed by the EU VAT Directive. VAT grouping is already employed by the U.K., the Netherlands, Ireland, Germany, Austria, Denmark, Finland, and Sweden. VAT grouping would allow financial service providers to recover VAT charges they incur upon making intra-company payments for supplies, including labor costs.

Telecommunications Market Access

Both the WTO commitments covering telecommunications services and the EU's Common Regulatory Framework for Electronic Communications Networks and Services (Framework Directive) have encouraged liberalization and competition in the European telecommunications sector. As part of the WTO Agreement, for example, all EU Member States made commitments to provide market access and national treatment for voice telephony and data services. The Framework Directive imposes additional liberalization and harmonization requirements, and the Commission has taken action against Member States that have not implemented the Framework Directive. However, implementation of these requirements has been uneven across Member States, and in many markets significant problems remain, including with the provisioning and pricing of unbundled local loops, line sharing, co-location, and the provisioning of leased lines. Partial government ownership of some Member States' incumbent telecommunications operators also has the potential to raise problems for new entrants.

In 2002, the EU issued a new regulatory framework for electronic communications that includes the EU Framework Directive and four specific Directives on: 1) licensing; 2) access and interconnection; 3) universal service and user rights; and 4) data protection.

This new regulatory framework requires Member States to update and adapt legislation to account for converging technologies and for future technological and market developments. It applies to all forms of electronic communications networks and associated services, not just traditional fixed telephony networks. The long-term goal is to phase out sector-specific, ex-ante regulation (for all but public interest reasons) in favor of reliance on general competition rules.

Beginning in December 2005, the European Commission began a process of reviewing the directives under the regulatory framework for electronic communications. This process will proceed throughout 2006 to analyze whether the framework needs to be updated further still in order to respond to the changing needs of the telecommunications sector based upon evolving communications technology.

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Enforcement of existing legislation by the National Regulating Authorities (NRAs) has been hampered by unnecessarily lengthy and cumbersome procedures in France, Italy, Austria, and Portugal, among others. The European Commission has also found that incumbents in Germany, Greece, Spain, Italy, Ireland, Austria, Finland, and Sweden have slowed the arrival of competition by systematically appealing their national regulators' decisions.

Austria: In general, Austria has moved toward a more open and competitive telecommunications market and has implemented the relevant directives. There are several outstanding concerns related to: 1) the market for public telecommunications transit services; 2) interconnection fees; 3) deficient procedures for the wholesale

broadband access market (including bitstream access); 4) problems with the wholesale line rental; and 5) the unbundling of the “last mile.” Generally, Austria’s NRA – the TKC – provides timely initial decisions, but follow-up on those decisions, including the appeals process for such decisions, remains uncertain and slow.

Belgium: Belgium has implemented the EU Framework Directive governing electronic communications, and it went into effect July 1, 2005. Businesses continue to complain of excessively high mobile termination rates. Under a new Regulatory Framework agreement, BIPT (the Belgian NRA for telecommunications and postal services) has the authority to regulate mobile termination rates for all three mobile providers in Belgium – Proximus, Mobistar, and Base. Of the three, Base’s rates are generally the highest and, at certain times of the day, can be as much as 50 percent above those of its two competitors. On February 24, 2006, BIPT issued a draft decision proposing to remedy excess rates charged by the three main mobile operators for terminating calls on mobile networks. BIPT recommended that these operators reduce their mobile termination rates by 10.7 percent to 12.9 percent every six months until 2008.

Finland: The Finnish government implemented a comprehensive reform effort in July 2003 – the Communications Act -- that aimed to improve the legislative environment for competition and the development of communications technology and innovations. The Act implemented four new Directives on electronic communications. Internet service providers are also included in the scope of the Act. The Act also applies specific requirements to telecommunications operators with significant market power. Regulation of smaller operators is less stringent. The Finnish NRA – Finnish Communications Regulatory Authority or FICORA – is in the process of conducting market analyses to determine whether there is sufficient competition within a particular market, and if so, what remedial requirements may be appropriate.

France: France implemented the EU Framework Directive in 2004, and the NRA – ARCEP – has made some progress in subsequently conducting the required market analyses of telecommunications sectors.

In the mobile termination market, the ARCEP designated both Orange (France Telecom) and SFR (Cegetel) as having significant market power and ordered them to reduce their rates by a total of 36 percent by the beginning of 2006. In addition, ARCEP remains concerned about France Telecom’s predatory pricing of broadband connections at the retail level and overpricing at the wholesale level, as high rates have made it difficult for new players to compete.

The French government continued to further privatize France Telecom in 2005, reducing state ownership of the company to 33.1 percent, which still gives the government a blocking minority share. The company continues to dominate the fixed line market and is a major player in mobile and Internet services through its subsidiaries Orange and Wanadoo.

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Germany: Germany has made slow progress in introducing competition to some sectors of its telecommunications market. However, new entrants continue to face difficulties competing with the partially state-owned incumbent Deutsche Telekom AG (DT), which retains a near-monopoly in a number of key services, including local loop and broadband connections. On the positive side, implementation of carrier selection and pre-selection for local calling has helped competitors gain close to 20 percent of the local calling market since 2003. The revised Telecommunications Act entered into force in June 2004 and most competitors to DT believe that it creates a structure that should facilitate enhanced competition. Currently, Germany's NRA – Bundesnetzagentur (BNetzA) of the Federal Network Agency (FNA) – is studying how it should regulate 18 individual market segments, as required by the Framework Directive. After more than a year, the BNetzA has completed twelve market studies.

Companies have complained that DT and other mobile providers charge excessive termination rates when fixed-line users call mobile phones. In June 2004, DT and other mobile producers agreed on a voluntary reduction of these fixed-to-mobile termination rates over 2004 and 2005. While other providers welcomed this as a step in the right direction, some questioned if the reductions go far enough. In October 2005, in response to complaints by competitors, Germany's Federal Networks Agency launched a probe into whether Deutsche Telekom is violating its dominant market position with the offer of a new low-cost ISDN Internet connection subscription fee.

Hungary: The Hungarian telecommunications market is almost fully liberalized. However, legal obstacles, as well as a lack of investors, have hindered competition. In May 2005, following the general policy of majority owner Deutsche Telekom (DT), the Hungarian “T-Brands” (Axelero, the Internet service provider; the business solutions branch; and the cable provider branch) merged with Matáv, the former monopolist and today's market leading telephony provider, under the name of Magyar Telekom Rt. In October, Magyar Telekom Rt. merged with T-Mobile Hungary, the leading mobile phone operator, which is also partially owned by DT. This involved changes in management and strengthened Magyar Telekom's leading position on the voice and communications market. UPC and TELE2, as new-fixed line providers, launched their services offering lower tariffs than Matav.

The number of fixed line subscriptions is constantly decreasing, at a rate of 50,000 per month. Mobile phone penetration reached 90 percent with three providers on the market (T-Mobile, Pannon GSM, and Vodafone).

Ireland: The government privatized the state monopoly, Telecom Eireann, in 1999. The new company, Eircom, retains an 80 percent share of the fixed lines in Ireland and dominates leased line services and national interconnection. Thus, while there are currently 69 operators authorized to provide publicly available telephone services/public voice telephony in the Irish market, these new entrants only account for a total of 20 percent of the fixed line market. While competition has significantly reduced prices for international business and residential calls, the price for local service remains high, discouraging both broadband development and Internet use. As of October 2005, only five percent of the population has broadband. Ireland has adopted EU local loop unbundling (LLU) legislation, and the government has initiated legal action to compel Eircom to complete LLU in order to promote competition and innovation in the DSL market.

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Significant competition is now emerging in the mobile phone market, with four licensed and active operators. The mobile penetration rate in Ireland in 2005 was 94 percent, with 3.9 million mobile subscribers.

Italy: Italy is widely viewed as having a sophisticated and liberalized telecommunications market. The Government of Italy has divested its shares of Telecom Italia, maintaining only an indirect, residual interest in WIND, Italy's second largest telecommunications company. Despite this development, the Ministry of Communications continues to overshadow Italy's NRA – the Italian Communications Authority – calling into question its independence.

Lithuania: The Lithuanian government still has not issued a tender for the two-way radio system referenced in the 2005 NTE. The government has not yet published specifications for the tender.

Luxembourg: In 2005, Luxembourg began undertaking revised administrative procedures to implement the EU Framework Directive to liberalize Member States' telecommunications markets and allow for more fair competition. Despite these efforts, state-owned P&T continues to dominate the nation's telecommunications market. In addition, despite a 1998 court ruling opening Luxembourg's small mobile phone market to competition, the wireless communications market remains dominated by only two companies, one of which is half-owned by the state company.

Poland: Over the past year, there has been a surge of activity related to both telecommunications and Internet investment in Poland. New competitors (Netia) have entered the cellular market, and well-known Internet presences, such as Google, are locating brick and mortar investments in Warsaw. Still, the ability of new entrants to compete may have been hindered by the failure of Poland's NRA – URTiP – to implement the EU Framework Directive in a timely manner.

Slovenia: Slovenia has harmonized its telecommunications legislation with EU's *acquis communautaire*, but it has failed to adopt many by-laws. In October 2005, the European Commission opened infringement proceedings against Slovenia to determine whether Slovenia's NRA – the Telecommunications, Broadcasting and Post Agency – is sufficiently independent from the industry players which it regulates.

U.S.-owned wireless operator Vega continues to face problems in the Slovenia and alleges that its small market share is driven by the unfair pricing practices of Mobitel (the wireless subsidiary of state-owned, fixed line provider Telekom Slovenije). In May 2005, Vega filed a lawsuit against Mobitel and the Government of Slovenia seeking in excess of Euro 200 million in damages.

Spain: Access to leased lines in Spain remains problematic because rates are not based on actual cost. Despite actions by CMT, Spain's NRA, wholesale prices are still above the European average and approximately 100 percent above U.S. prices. This has allowed the incumbent operator Telefónica to offer services to customers at substantially lower rates than competitive carriers.

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U.S. companies have complained that Spanish mobile operators are charging excessively high mobile termination rates and that they are squeezed out of the fixed-to-mobile communications market, because mobile operators offer their subscribers mobile-to-mobile and fixed-to-mobile calls at below wholesale rates. Spanish anti-trust authorities are considering penalizing these providers.

Evolution of the broadband market has been slow and problematic, and many operators have ceased offering these services. Telefónica's market share is being challenged though by two operators: Ya.com and Wanadoo. Both of these companies have established partnerships with Spanish fixed and mobile line carriers.

United Kingdom: There is limited competition in advanced data services over fixed-line incumbent British Telecom's (BT) infrastructure. The U.K.'s new NRA, Ofcom, was launched in late 2003. Ofcom recently concluded its Strategic Review of the U.K. telecommunications sector. One outcome is that Ofcom has required BT to undergo an internal reorganization to separate its retail and wholesale arms. The mandatory reorganization is aimed at increasing BT's competitors' access to BT's wholesale products. These structural changes are still being implemented.

INVESTMENT BARRIERS

Overview

The European Commission's mandate on investment issues is evolving. EU Member States negotiate their own bilateral investment protection and taxation treaties and generally retain responsibility for their investment regimes. In many areas, individual Member State policies and practices have a more significant impact on U.S. firms than do EU-level policies and practices. Under the 1993 Maastricht Treaty, free movement of capital became an EU responsibility, and capital controls both among EU Member States and between EU members and third countries were lifted. A few Member States' barriers remain in effect, although in particular cases EU law may supercede these. Right of establishment issues, particularly regarding third countries, are a shared competence between the EU and the Member States. The division of this shared competence varies from sector to sector, based on whether the EU has issued regulations in that sector. Direct branches of non-EU financial service institutions remain subject to individual Member State authorization and regulation.

The EU requires national treatment for foreign investors in most sectors. EU law, with a few exceptions, requires that any company established under the laws of one Member State must, as a Community undertaking, receive national treatment in all Member States, regardless of its ultimate ownership. However, some restrictions on U.S. investment do exist under EU law and others have been proposed (see below).

FOREIGN TRADE BARRIERS

Ownership Restrictions and Reciprocity Provisions

EU Treaty Articles 43 (establishment) and 56/57 (capital movements) have helped the EU to achieve one of the most hospitable climates for U.S. investment in the world, but some restrictions on foreign direct investment remain in place. Under EU law the right to provide aviation transport services within the EU is reserved to firms majority-owned and controlled by EU nationals. The right to provide maritime transport services within certain EU Member States is also restricted. EU banking, insurance, and investment services directives currently include "reciprocal" national treatment clauses, under which a financial services firm from a third country may be denied the right to establish a new business in the EU if the EU determines that the investor's home country denies national treatment to EU service providers. The right of U.S. firms to national treatment in this area was reinforced by the EU's GATS commitments, however.

After years of discussion, the Council of Ministers finally agreed in March 2004 on a directive on takeover bids, which is scheduled to enter into force on May 20, 2006. The original proposal would have banned any national legislation allowing companies to prevent hostile takeovers through the use of defensive measures (i.e., "poison pills" or multiple voting rights). The final directive makes it optional for Member States and companies to apply a regime that rules out these defensive measures or to opt out of such rules. The European Parliament debated whether to limit the benefits of the new directive to companies that apply the same provisions, (e.g., limiting the right of a board to take defensive measures or to mitigate the role of restrictions on share transfers or voting in a takeover bid). Article 12.3 of the final text is ambiguous as to whether the limitation would apply to non-EU firms, although the preamble of the legislation states that the application of the optional measures is without prejudice to international agreements to which the EC is a party.

Under the 1994 hydrocarbons directive (Directive 94/22/EC), the notion of reciprocity may have been taken further to require "mirror-image" reciprocal treatment, under which an investor may be denied a license to explore for and exploit hydrocarbon resources if its home country does not permit EU investors to engage in activities under circumstances "comparable" to those in the EU. These reciprocity provisions thus far have not affected any U.S.-owned firms.

Member State Practices

Austria: While European Economic Area (EEA) Member States' banks may operate branches on the basis of their home country licenses, banks from outside the EEA must obtain Austrian licenses to operate in Austria. However, if such a non-EEA bank has already obtained a license in another EEA country for the operation of a subsidiary, it does not need a license to establish branch offices in Austria.

Cyprus: Tertiary education investment restrictions: Cypriot legislation for foreign investment in tertiary education distinguishes between colleges and universities. Investment in universities, defined as institutions with no fewer than 1,000 students enrolled in a sufficiently diverse range of classes and curricula, is encouraged. Foreign (including non-EU) investors can set up or acquire a university in Cyprus by simply registering a company on the island and following a set

of non-discriminatory criteria. By contrast, non-EU investment in colleges is discouraged. Non-EU investors can set up or acquire a local college by registering a company in Cyprus or elsewhere in the EU provided that the company has EU-origin shareholders and directors. As a consequence, non-EU investors are not allowed to have any participation, whether as directors or shareholders, in the administration of local colleges.

Investment Restriction in Media Companies: Cyprus also restricts non-EU ownership of local mass media companies to 5 percent or less for individual investors, and 25 percent or less for all foreign investors in each individual media company.

Property Acquisition: Cypriot law imposes significant restrictions on the foreign ownership of real property. Persons not ordinarily resident in Cyprus (whether of EU or non-EU origin) may purchase only a single piece of real estate for private use (normally a holiday home). Exceptions can be made for projects requiring larger plots of land (i.e., beyond that necessary for a private residence) but are difficult to obtain and are rarely granted. The restriction on property acquisition for non-Cypriot EU residents will expire in May 2009. (Cyprus received a temporary derogation from the EU *acquis communautaire* on this issue, lasting for five years after accession.) The restrictions will continue to apply, however, to non-EU residents, including U.S. nationals.

France: There are generally no screening or prior approval requirements for non-EU foreign investment in France. As part of a November 2004 law that streamlined the French Monetary and Financial Code, however, the State Council was directed to define a number of sensitive sectors that would require prior approval for acquisition of a stake.

These areas have yet to be defined, but are expected to include national defense, public safety, nuclear energy, cryptology, and nanotechnologies. France continues to apply reciprocity requirements to non-EU investments in a number of sectors. For the purpose of applying these requirements, the French government generally determines a firm's residency based on the residency of its ultimate owners rather than on the firm's place of business or incorporation.

Germany: Germany's takeover law, which came into effect in 2002, has reintroduced measures that allow firms to ward off hostile takeover bids: first, at the stockholder level, where management may be given authority at the annual shareholders' meeting to take measures deemed necessary to guard against unwanted interest; and, second, at the management level, where the managing board can take protective measures, upon approval by the supervisory board, bypassing the need for stockholder approval altogether. These provisions may have negative consequences for outside investors and stockholders.

Germany passed legislation in July 2004, requiring notification by foreign entities of investments expected to exceed 25 percent of the equity of German firms engaged in the production of armaments and cryptology technology used for classified government communications. Following an inter-ministerial review, the government may veto such sales within one month of receipt of a notification. Chancellor Schroeder's cabinet expanded the scope of the law in 2005 to include tank and tracked vehicle engines to block a U.S. financial investor from buying a tank engine manufacturer.

FOREIGN TRADE BARRIERS

Greece: Greek authorities consider local content and export performance when evaluating applications for tax and investment incentives. Such criteria are not prerequisites for approving investments, however.

Greece has opened its telecommunications market and is in the process of gradually liberalizing its energy sector. At present, however, Greece's inhospitable regulatory framework has hampered efforts by U.S. firms to develop energy production facilities. U.S. and other non-EU investors receive less advantageous treatment in Greece than domestic or other EU competitors in the banking, mining, maritime, air transport and broadcast industries (which were opened to EU citizens due to EU single market rules). For reasons of national security, non-EU investors are restricted in their ability to purchase land in border regions and on certain islands.

Italy: With few exceptions, Italy provides national treatment to foreign investors established in Italy or in another EU member state, as required by Article 43 of the EU Treaty. The exceptions include limits on access to government subsidies for the film industry and additional capital requirements for banks from non-EU countries. U.S. and other firms from non-EU countries may operate with authorization from Italy's securities market regulator, CONSOB.

CONSOB may deny authorization to firms from countries that discriminate against Italian firms. Finally, foreign insurance firms must prove that they have been providing life and property insurance for more than ten years and must appoint a general agent domiciled in Italy.

Malta: Maltese law requires that anyone buying residential or commercial real estate must obtain a permit from the Minister of Finance. EU citizens and returning Maltese migrants who have lived in Malta for more than five years receive a waiver from these permits. Non-EU citizens are not entitled to this waiver. Despite the restriction, permission to purchase land for commercial or residential purposes is normally granted. No U.S. businesses appear to have been discouraged from investing in Malta because of these restrictions. The restrictions have, however, delayed certain business investment projects involving American businesses.

Electronic Commerce

U.S. businesses and the U.S. government continue to monitor potential problems related to data privacy regulation and legal liabilities for companies doing business over the Internet in the EU.

Data Privacy:

The EU Data Protection Directive (1995/46) allows the transmission of EU data to third countries only if those countries are deemed by the European Commission to provide an adequate level of protection by reason of its domestic law or of the international commitments it has entered into (Article 25(6)). U.S. companies can only receive or transfer employee and customer information from the EU by using one of the exceptions to the Directive's adequacy requirements or by demonstrating they can provide adequate protection for the transferred data. These requirements can be burdensome for many U.S. industries that rely on data exchange across the Atlantic.

Currently, the Commission has recognized Switzerland, Canada, Argentina, Guernsey, Isle of Man, the U.S. Department of Commerce's Safe Harbor Privacy Principles, and the transfer of Air Passenger Name Record to the U.S. Bureau of Customs and Border Protection as providing adequate protection. The U.S. Safe Harbor framework provides U.S. companies with a simple, streamlined means of complying with the adequacy requirement. The agreement allows U.S. companies that commit to a series of data protection principles (based on the Directive), and that publicly state their commitment by “self-certifying” on a dedicated website (www.export.gov/safeharbor), to continue to receive and transfer personal data from the EU. Signing up to the Safe Harbor is voluntary, but the rules are binding on signatories. A failure to fulfill the commitments of the Safe Harbor framework is actionable either as an unfair and deceptive practice under Section 5 of the FTC Act or, for air carriers and ticket agents, under a concurrent Department of Transportation statute.

The U.S. Government actively supports the Safe Harbor framework and encourages the European Commission and Member States to continue to use the flexibility offered by the Data Protection Directive to avoid unnecessary interruptions in data flows to the United States. Furthermore, we expect the European Commission and EU Member States to fulfill their commitment to inform us if they become aware of any actions that may interrupt data flows to the United States.

Brussels Regulation:

On December 22, 2000, the EU adopted the so-called Brussels Regulation which allows consumers to sue companies in the court of their country of residence, “when the website is directed to [his/her] Member State or to several countries, including that Member State.” Industry has complained that the practical effect of this regulation is that companies doing business on the Internet in the EU risk being sued in every EU Member State, as opposed to being subject to the jurisprudence of their country of origin.

OTHER BARRIERS

Health Insurance

Ireland: In the health insurance market, Ireland has espoused “risk equalization,” whereby private insurers are required by law to compensate the Voluntary Health Insurance (VHI) Board, a quasi-governmental body, for the additional risk that it accepts in offering community (or equal) rating for policy-holders of different ages and medical profiles. Compensation is to be paid once a certain threshold based on the number of insured is reached, but the Irish government has not clarified the formula for determining the threshold. This ambiguity has been a factor in discouraging U.S. insurance firms from entering the Irish market.

GHANA

TRADE SUMMARY

The U.S. goods trade surplus with Ghana was \$179 million in 2005, an increase of \$15 million from \$164 million in 2004. U.S. goods exports in 2005 were \$338 million, up 9.0 percent from the previous year. Corresponding U.S. imports from Ghana were \$158 million, up 8.9 percent. Ghana is currently the 89th largest export market for U.S. goods.

The stock of U.S. foreign direct investment (FDI) in Ghana in 2004 was \$258 million, down from \$268 million in 2003.

IMPORT POLICIES

Tariffs

Ghana is a member of the WTO and the Economic Community of West African States (ECOWAS). Along with other ECOWAS countries, Ghana adopted a common external tariff (CET) in 2005. Ghana, however, has not yet fully implemented the CET. The ECOWAS CET requires that members simplify and harmonize *ad valorem* tariff rates into four bands: 0 percent, 5 percent, 10 percent, and 20 percent.

The Ghanaian government continues to support domestic private enterprise with financial incentives and tax holidays in order to develop competitive domestic industries with export capabilities. Nevertheless, Ghanaian manufacturers and producers contend that the country's relatively low tariff structure puts them at a competitive disadvantage vis-à-vis imports from countries that enjoy greater production and marketing economies of scale. While tariff reductions have increased competition for local producers, the reductions have also reduced producer costs for imported raw materials and inputs. So there is, in fact, some local demand for further tariff reductions, especially on inputs used by local businesses. Ghana has responded by reducing the import duty on livestock ingredients, pharmaceutical raw materials, and inputs for textiles production. Tariff information is available on the Customs Excise and Preventive Service (CEPS) website (www.cepsghana.org).

Non-Tariff Measures

Importers are confronted by a variety of fees and charges in addition to tariffs. Since the end of 1998, a 12.5 percent value-added tax (VAT) has been added to the duty-inclusive value of all imports, with a few selected exemptions. In August 2004, Ghana introduced the National Health Insurance Levy of 2.5 percent, which in effect increases the VAT to 15 percent. In addition, Ghana imposes a 0.5 percent ECOWAS duty on all goods originating from non-ECOWAS countries and charges 0.4 percent of the sum of the free on board (FOB) value of goods and the value-added tax (VAT) for the use of the automated clearing system, the Ghana Community Network (GCNet). Importers have indicated that they would prefer a flat fee on each transaction. Further, under the Export Development and Investment Fund Act (Act 582), Ghana

FOREIGN TRADE BARRIERS

imposes a 0.5 percent duty on all non-petroleum products imported in commercial quantities. Imports of malt drinks, water, beer, and tobacco products are subject to excise taxes ranging between 5 percent and 140 percent.

The importation of used vehicles that are more than 10 years old is subject to taxes ranging from 5 percent to 50 percent of the C.I.F. (cost, insurance, freight) value of the used vehicles. All communications equipment is subject to import restrictions. Each year between May and October, there is a temporary ban on the importation of fish, except canned fish, to protect local fishermen during their peak season.

In May 2002, the WTO and Ghana's CEPS signed an agreement on customs valuation and trade facilitation to simplify customs procedures and facilitate swift clearance of goods. In April 2000, Ghana transitioned from using pre-shipment inspection to a destination inspection scheme. Four inspection companies currently have contracts with the government to perform the destination inspection.

STANDARDS, TESTING, LABELING AND CERTIFICATION

Ghana has issued its own standards for most products under the auspices of its testing authority, the Ghana Standards Board (GSB). The GSB has promulgated more than 250 Ghanaian standards and adopted more than 3,057 international standards for certification purposes. The GSB determines standards for all products. Authority for enforcing standards for food, drugs, cosmetics, and health items lies with the Food and Drugs Board. Ghana intends to adopt more internationally-recognized standards and move away from its mandatory domestic standards, except for products that raise environmental or human health or safety concerns.

Ghana prohibits the importation of meat with a fat content by weight greater than 25 percent for beef, 42 percent for pork, 15 percent for poultry, and 35 percent for mutton. It also restricts the importation of condensed or evaporated milk with less than 8 percent milk fat by weight, with the exception of imported skim milk in containers. Imported turkeys must have their oil glands removed. Industry reports that products with coded expiration dates, though accepted by the GSB, can cause delays at the border because of the lack of bar-code-reading devices.

Ghana instituted a "Standards Board Conformity Assessment Program," which resembles problematic conformity certification programs adopted by several Middle Eastern countries. A private testing body operates the program. Costly and redundant testing result from the fact that the standards that the program tests against are unknown, the fee schedules are not published, and independent third party certifications and marks may not be recognized.

GOVERNMENT PROCUREMENT

Ghana is not a signatory to the WTO Agreement on Government Procurement. In December 2003, however, Parliament passed a public procurement law that codified guidelines to enhance transparency and efficiency and assign administration of procurement to a central body. In August 2004, the government inaugurated the Public Procurement Board. Tender committees and tender review boards are being formed and national dailies are publishing more public

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procurement notices. Section 60 of the procurement law allows procurement entities to give preference to domestic suppliers of goods and services. The government, however, has not yet determined the margin of preference or passed procurement regulations. Notwithstanding the new procurement law, companies cannot expect complete transparency in locally funded contracts. There have been recent allegations of corruption in the tender process, and the government has in the past set aside international tender awards in the name of national interest.

EXPORT PROMOTION

The government uses preferential credits and tax incentives to promote exports. The Export Development Investment Fund administers financing on preferential terms using a 12.5 percent interest rate, which is below market rates. Agricultural export subsidies were eliminated in the mid-1980s. The Export Processing Zone (EPZ) Law, enacted in 1995, leaves corporate profits untaxed for the first ten years of business operation in an EPZ, after which the tax rate climbs to 8 percent (the same as for non-EPZ companies); however, business producing traditional exports, e.g. cocoa beans, logs and lumber, remain untaxed. Under the 2006 budget, submitted to Parliament in November 2005, the government reduced the corporate tax rate for non-exporting companies from 28 percent to 25 percent, effective January 1, 2006. The 2005 budget reduced this rate from 32.5 percent to the previous rate of 28 percent.

INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

Ghana is a party to the Universal Copyright Convention and a Member of the World Intellectual Property Organization (WIPO) and the African Regional Industrial Property Organization. Since December 2003, Parliament has passed six bills designed to bring Ghana into compliance with TRIPS requirements. The new laws address copyright, trademarks, patents, layout-designs (topographies) of integrated circuits, geographical indications, and industrial designs. In cases where trademarks have been misappropriated, the price and quality disparity is usually readily apparent. Piracy of copyrighted works is known to take place, though there is no reliable information on the scale of this activity. Holders of intellectual property rights have access to local courts for redress of grievances, although few trademark, patent, and copyright infringement cases have been filed in Ghana in recent years. Government-initiated enforcement is virtually non-existent.

SERVICES BARRIERS

The investment code excludes foreign investors from participating in four economic sectors: petty trading, the operation of taxi and car rental services with fleets of fewer than ten vehicles, lotteries (excluding soccer pools), and the operation of beauty salons and barber shops. Provision of services by professionals such as lawyers, accountants, and doctors requires membership in a professional body. Requirements for membership are identical for both Ghanaians and non-Ghanaians.

Ghana has committed to offering access to foreign telecommunications providers for most basic services, but has required that these services be provided through joint ventures with Ghanaian

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nationals. In 2004, the National Communications Authority (NCA) opened up the market by allowing additional carriers beyond the previous duopoly.

The NCA has yet to become an effective mechanism to resolve complaints of anti-competitive practices by Ghana Telecom, the partially state-owned national telecommunications operator.

Ghana allows up to 60 percent foreign ownership in the insurance sector. This cap does not apply to auxiliary insurance services. Ghana requires a high capital requirement for foreign firms to participate in the insurance sector, but allows them to provide a full range of services.

There are no limits on foreign participation in banking and other financial services. However, shares held by a single non-resident foreigner and the total number of shares held by all non-resident foreigners in one security listed on the Ghana Stock Exchange may not exceed 10 percent and 74 percent, respectively. The Central Bank must issue licenses for banking and leasing. For securities trading, a license is required from the Securities Regulatory Commission. Capital requirements for establishing a bank have been increased to 70 billion cedis (approximately \$7.7 million), and it is now the same for both foreign-owned banking businesses and Ghanaian-owned banks. Prior to implementing the Bank of Ghana's universal banking policy in 2004, foreign-owned banking businesses faced higher capital requirements than Ghanaian-owned banks (50 billion cedis versus 25 billion cedis, approximately \$5.6 million and \$2.8 million, respectively).

INVESTMENT BARRIERS

The 1994 Investment Code (Act 478) eliminated the need for prior approval of foreign investment projects by the Ghana Investment Promotion Center. Investment registration, which the government undertakes essentially for statistical purposes, is supposed to be accomplished within five working days. However, according to the "Administrative and Regulatory Cost Survey," conducted by the World Bank and IFC-funded Foreign Investment Advisory Service in 2003, the actual time reported by respondents averaged two weeks. The World Bank reported in its "Doing Business 2005" report that the total time to start a business in Ghana was 81 days, an improvement from 129 days prior to 2003, but still significantly longer than in many other countries at a similar level of development.

Investment incentives have been written into the corporate tax and customs codes. Incentives include exemption from import tariffs for manufacturing inputs and equipment and generous tax breaks. Work visa quotas for businesses are in effect. The following minimum equity requirements apply, in the form of either cash or its equivalent in capital goods, for non-Ghanaians who want to invest in Ghana: (1) \$10,000 for joint ventures with a Ghanaian; (2) \$50,000 for enterprises wholly-owned by a non-Ghanaian; and (3) \$300,000 for trading companies (firms that buy/sell finished goods) either wholly or partly-owned by non-Ghanaians. Trading companies must also employ at least ten Ghanaians.

The Ghanaian government at one point controlled more than 350 state-owned enterprises, but nearly 300 were privatized by the end of 2000 under the privatization program of former President Rawlings. The government of current President Kufuor reconstituted the Divestiture

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Implementation Committee. By the end of 2003, total divestiture transactions numbered 318, and 36 remaining state-owned enterprises are slated for divestiture. The divestment of Ghana Commercial Bank, which is Ghana's largest bank and represents a contingent liability for the government, is ongoing, with the government selling shares on the Ghana Stock Exchange.

U.S. direct investment in Ghana is predominantly in the mining and energy sectors, but there is also significant U.S. investment in the seafood, telecommunications, chemical, and wholesale trade sectors. Wage rates in the mining sector are substantially higher than in other industries. U.S. and other foreign firms in Ghana are required to adhere to Ghanaian labor laws, including restrictions on the number of expatriates employed.

ELECTRONIC COMMERCE

Barriers to electronic commerce are mainly due to inadequate telecommunications and financial infrastructure. The payment system in Ghana is largely cash-based. The legalization of foreign exchange bureaus has made foreign currency readily available for small transactions. Local banks can facilitate the transfer of foreign payments abroad. Transfers of large quantities of foreign currency, however, can run into significant delays. The government is drafting a new Foreign Exchange Act, with the goal of liberalizing the foreign exchange market.

OTHER BARRIERS

U.S. businesses interested in Ghana should be aware of other barriers, such as limited and costly credit facilities for local importers and freight rates that are higher than those for potential European competitors. There are frequent problems related to the complex land tenure system, and establishing clear title can be difficult. Non-Ghanaians can have access to land on a leasehold basis. Frequent backlogs of cargo at the port hurt the business climate. The Customs Service is still phasing in an automated customs declaration system that was established in the last quarter of 2002 to facilitate customs clearance. Although the new system has cut down the number of days for clearing goods from the ports, the desired impact has yet to be realized because complementary services from government agencies, banks, destination inspection companies, and security services have not been established.

The high cost of local financing (with short-term interest rates currently above 25 percent) is a significant disincentive for local traders, inhibiting the expansion of most Ghanaian businesses from their current micro-scale operations and constraining industrial growth. The high cost of credit in Ghana is a function of the high risks of doing business in Ghana and equally high reserve requirements (although the Bank of Ghana reduced these from 44 percent to 24 percent in 2005). They also reflect high labor costs as well as the oligopolistic structure of the banking sector and inefficient directed lending to state-owned enterprises. Ghanaian banks are among Africa's most profitable due to wide interest/deposit rate spreads. The residual effects of a highly regulated economy and lack of transparency in government operations create an element of risk for potential investors. Bureaucratic inertia is sometimes a problem in government ministries, and administrative approvals take longer than they should. Entrenched local interests sometimes have the ability to derail or delay new entrants, and securing government approvals may depend upon an applicant's local contacts. The political leanings of the Ghanaian partners

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of foreign investors are often subject to government scrutiny. Corruption historically has been an issue with which foreign firms have had to contend.

The government has indicated its intent to address this issue, particularly through the passage of Public Procurement, Financial Administration, and Internal Audit Acts. However, these Acts have not yet been fully implemented and are not yet effective in reducing or eliminating government corruption.

GUATEMALA

TRADE SUMMARY

The U.S. goods trade deficit with Guatemala was \$321 million in 2005, a decrease of \$281 million from \$603 million in 2004. U.S. goods exports in 2005 were \$2.8 billion, up 10.3 percent from the previous year. Corresponding U.S. imports from Guatemala were \$3.1 billion, down 0.6 percent. Guatemala is currently the 40th largest export market for U.S. goods.

The stock of U.S. foreign direct investment (FDI) in Guatemala in 2004 was \$419 million, up from \$305 million in 2003.

IMPORT POLICIES

Free Trade Agreement

The United States concluded free trade agreement negotiations with El Salvador, Guatemala, Honduras, and Nicaragua in December 2003 and with Costa Rica in January 2004. In May 2004, the six countries signed the United States–Central America Free Trade Agreement. During 2004, the United States and the Central American countries integrated the Dominican Republic into the free trade agreement. On August 5, 2004, the seven countries signed the Dominican Republic – Central America – United States Free Trade Agreement (CAFTA-DR).

All of the signatory countries except Costa Rica have ratified the agreement. CAFTA-DR will enter into force between the United States and other signatories on a rolling basis as the United States determines that countries have taken sufficient steps to implement their commitments under the Agreement.

CAFTA-DR will remove barriers to trade and investment in the region and will further regional economic integration. CAFTA-DR will also require the Central American countries and the Dominican Republic to undertake needed reforms to provide market liberalization, transparency and certainty in areas including: customs administration; protection of intellectual property rights; services, investment, and financial services; government procurement; and sanitary and phytosanitary (SPS) barriers; and to liberalize other non-tariff barriers.

Tariffs

Guatemala's tariffs on most goods from outside the Central American Common Market (CACM) are currently within the zero percent to 15 percent range. There are exceptions, however, including tariffs of up to 40 percent on alcoholic beverages and up to 20 percent on white corn, sugar, cigarettes, various types of vehicles, and firearms and munitions. Other exceptions include the higher tariffs applied to agricultural commodity imports in excess of any applicable tariff-rate quota (TRQ). The average applied rate on all products is approximately 5 percent to 6 percent. Once the CAFTA-DR goes into effect, about 80 percent of U.S. industrial and

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commercial goods will enter the region duty-free, with the remaining tariffs phased out over ten years.

Nearly all textile and apparel goods that meet the Agreement's rules of origin will be duty-free and quota-free immediately, promoting new opportunities for U.S. and regional fiber, yarn, fabric and apparel manufacturing. The Agreement's tariff treatment for textile and apparel goods may be made retroactive to January 1, 2004.

Under the CAFTA-DR, Guatemala will eliminate its tariffs on nearly all agricultural products within 15 years (18 years for rice and chicken leg quarters and 20 years for dairy products). For the most sensitive products, tariff-rate quotas will permit some immediate duty-free access for specified quantities during the tariff phase-out period, which will expand over time. Guatemala will slowly liberalize trade in white corn, a particularly sensitive product, through expansion of a TRQ projected to increase on a 2 percent annual rate, slightly to 24 percent by the end of 2025. Guatemala's imports of corn are currently limited to yellow corn, 90 percent of which is already coming from the United States (500,000 MT).

The Agreement requires transparency and efficiency in administering customs procedures, including the CAFTA-DR rules of origin. Under the CAFTA-DR, Guatemala committed to ensure greater procedural certainty and fairness in the administration of these procedures, and all Parties agreed to share information to combat illegal transshipment of goods.

STANDARDS, TESTING, LABELING AND CERTIFICATION

Guatemalan law requires that food products sold in the domestic market be tested, registered and labeled in Spanish, although stick-on labels are permitted. Products sold in bulk are exempt from the labeling requirement unless they are to be sold at the retail level as an individual unit. Enforcement of product registration and labeling requirements has been inconsistent but is improving. Labeling standards are required for food, pharmaceuticals, pesticides, footwear, and distilled beverages.

When the United States and Central America launched the free trade agreement negotiations, they initiated an active working group dialogue on SPS barriers to agricultural trade that met in conjunction with the negotiations to facilitate market access. The objective was to leverage the impetus of active trade negotiations to seek changes to the Central American countries' SPS regimes. Through the work of this group, Guatemala has committed to resolve specific measures affecting U.S. exports to Guatemala. In particular, for meat, poultry, and dairy, Guatemala will recognize the equivalence of the U.S. food safety and inspection system, thereby eliminating the need for plant-by-plant inspections. For distilled spirits, U.S. industry welcomes the trade-facilitative initiative of the five Central American countries, including Guatemala, to develop common standards for distilled spirits products. However, outstanding concerns remain, however, over issues such as alcohol content, brand registration and certification requirements.

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GOVERNMENT PROCUREMENT

Guatemala is not a party to the WTO Government Procurement Agreement. Currently, Guatemala's Government Procurement Law requires most government purchases over \$113,000 to be submitted for public competitive bidding. The government occasionally declares certain projects a matter of national emergency, thereby avoiding the competitive bidding process. Foreign suppliers must submit their bids through locally registered representatives, a process that can place foreign bidders at a competitive disadvantage. Additionally, U.S. companies have long alleged that significant corruption exists in public procurement and is a barrier to entry. In March 2004, the new Berger Administration made mandatory the use of Guatecompras, an Internet-based electronic system to publicize Guatemala's procurement needs, which is improving transparency in the government procurement process. However, many government offices, including a large number of municipalities, do not use Guatecompras yet.

The CAFTA-DR requires the use of fair and transparent procurement procedures, including advance notice of purchases and timely and effective bid review procedures, for procurement covered by the Agreement. Under the CAFTA-DR, U.S. suppliers will be permitted to bid on procurements of most Guatemalan government entities, including key ministries and state-owned enterprises on the same basis as Guatemalan suppliers. The anti-corruption provisions in the Agreement require each government to ensure that bribery in matters affecting trade and investment, including in government procurement, is treated as a criminal offense, or is subject to comparable penalties, under its law.

INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

Implementation of CAFTA-DR obligations with respect to IPR should strengthen and improve Guatemala's IPR protection regime. Implementation of these obligations should also provide stronger deterrence against piracy and counterfeiting by criminalizing end user piracy and requiring Guatemala to authorize the seizure, forfeiture, and destruction of counterfeit and pirated goods and the equipment used to produce them. The CAFTA-DR text also mandates both statutory and actual damages for copyright and trademark infringement to help ensure that monetary damages can be awarded even when it is difficult to assign a monetary value to the violation.

Patents

Guatemala's 2000 Industrial Property Law made improvements to the protection afforded to patent holders, increasing the term of protection for a patent to 20 years from the date of filing the patent application. It also increased the number of products and services that are considered patentable, including living organisms, commercial plans and chemical compounds or compositions. This law provides patent protection for pharmaceutical and agricultural products for the first time, and establishes a mailbox system to process and protect cases filed since 1995. To comply with CAFTA-DR, the Guatemalan Congress must ratify the Patent Cooperation Treaty and the Budapest Treaty on the International Recognition of the Deposit of Microorganisms for the Purposes of Patent Procedure.

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Copyrights

Piracy of copyrighted material, including videos, optical discs (CD-R & DVD-R formats), and software, remains widespread, and weak enforcement of existing legislation remains a concern. Some progress has been achieved in concluding valid licensing agreements with copyright holders and in reducing the incidence of pay television piracy, though rural operators still remain outside the legitimate system. Guatemala has ratified the WIPO Copyright Treaty (WCT) and the WIPO Performances and Phonograms Treaty (WPPT). Implementation of CAFTA-DR enforcement provisions should help reduce copyright piracy.

Trademarks

Exclusive rights for trademarks are granted on a first-to-file basis, thus permitting third parties to register and gain exclusive use of well-known or famous trademarks. An administrative dispute resolution system has been established in the event that a well-known or famous trademark is granted to a third party. In practice, however in practice companies have had to go through the courts, which can take several years. The local Internet domain name registrar does not accept applications for well-known and famous names from applicants who are not the trademark holders as frequently as it once did. Additionally, when receiving an Internet domain name registration, the domain name owner is required to submit the registration to the WIPO online dispute resolution system in the event of a challenge by a third party. Implementation of CAFTA-DR enforcement provisions should help reduce trademark infringement.

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Currently, international telephone traffic must be routed through the facilities of an enterprise licensed by the Guatemalan Superintendence of Telecommunications. U.S. companies have raised allegations of anti-competitive behavior, including unilateral changes of interconnection rates, by the country's dominant fixed line telephone service provider, Telgua, which is a subsidiary of Telmex of Mexico. Guatemala's courts have ruled against Telgua in those cases where a verdict was reached, but the anticompetitive practices continue. The CAFTA-DR will require that Guatemala further open its telecommunications market to competition on a non-discriminatory basis, as well as strengthen the authority of the independent regulatory body to address potential anticompetitive practices by the incumbent operators. International fixed line interconnection rates have decreased since the signing of the FTA.

Foreign banks may open branches or subsidiaries in Guatemala subject to the conditions of the Monetary Board, including capital and lending requirements based exclusively on the balance sheet of the local entity. Branches and subsidiaries must be inscribed in the Mercantile Registry, as is the case with any business.

Some professional services may only be supplied by professionals with locally recognized academic credentials. Public notaries must be Guatemalan nationals. Under the CAFTA-DR, as with banks, U.S. insurance companies would have full rights to establish subsidiaries and joint ventures upon entry into force of the agreement, with branching rights phased in. U.S. insurance suppliers would also be able to provide cross-border insurance in areas such as marine, aviation

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and transportation, goods in international transit, reinsurance as well as services auxiliary to insurance such as claims settlement, actuarial, risk assessment and consulting. Foreign enterprises may provide licensed professional services in Guatemala through a contract or other relationship with an enterprise established in Guatemala.

INVESTMENT BARRIERS

Guatemala's 1998 investment law generally provides for national treatment of foreign investment. However, specific restrictions remain in several sectors of the economy, including auditing, insurance, and forestry, although these restrictions are not always enforced. Complex and confusing laws, regulations, red tape, and corruption constitute practical barriers to investment.

The CAFTA-DR will establish a more secure and predictable legal framework for U.S. investors operating in Guatemala. All forms of investment will be protected, including enterprises, debt, concessions, contracts and intellectual property. U.S. investors will enjoy, in almost all circumstances, the right to establish, acquire, and operate investments in Guatemala on an equal footing with local investors. Among the rights afforded to U.S. investors are due process protections and the right to receive a fair market value for property in the event of an expropriation. Investor rights will be backed by an effective, impartial procedure for dispute settlement that is fully transparent. Submissions to dispute panels and panel hearings will be open to the public, and interested parties will have the opportunity to submit their views.

OTHER BARRIERS

Allegations of official corruption under the previous administration and a poor security environment may have weakened investors' confidence and affected investment and trade decisions related to Guatemala. The anti-corruption provisions in the CAFTA-DR require each government to ensure that bribery in matters affecting trade and investment is treated as a criminal offense, or is subject to comparable penalties, under its law.

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HONDURAS

TRADE SUMMARY

The U.S. goods trade deficit with Honduras was \$506 million in 2005, a decrease of \$55 million from \$562 million in 2004. U.S. goods exports in 2005 were \$3.2 billion, up 5.4 percent from the previous year. Corresponding U.S. imports from Honduras were \$3.8 billion, up 3.0 percent. Honduras is currently the 37th largest export market for U.S. goods.

The stock of U.S. foreign direct investment (FDI) in Honduras in 2004 was \$339 million, up from \$262 million in 2003. U.S. FDI in Honduras is concentrated largely in the manufacturing sector.

IMPORT POLICIES

Free Trade Agreement

The United States concluded free trade agreement negotiations with El Salvador, Guatemala, Honduras, and Nicaragua in December 2003 and with Costa Rica in January 2004. In May 2004, the six countries signed the United States–Central America Free Trade Agreement. During 2004, the United States and the Central American countries integrated the Dominican Republic into the free trade agreement. On August 5, 2004, the seven countries signed the Dominican Republic – Central America – United States Free Trade Agreement (CAFTA-DR).

All of the signatory countries except Costa Rica have ratified the agreement. CAFTA-DR will enter into force between the United States and other signatories on a rolling basis as the United States determines that countries have taken sufficient steps to implement their commitments under the Agreement.

CAFTA-DR will remove barriers to trade and investment in the region and will further regional economic integration. CAFTA-DR will also require the Central American countries and the Dominican Republic to undertake needed reforms to provide market liberalization, transparency and certainty in areas including: customs administration; protection of intellectual property rights; services, investment, and financial services; government procurement; and sanitary and phytosanitary (SPS) barriers, and to liberalize other non-tariff barriers.

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Tariffs

Honduras' tariffs on most goods from outside the Central American Common Market (CACM) are currently within the zero percent to 15 percent range. Once the CAFTA-DR goes into effect, about 80 percent of U.S. industrial and commercial goods will enter the region duty-free, with the remaining tariffs phased out over ten years. Nearly all textile and apparel goods that meet the Agreement's rules of origin will be duty free and quota-free immediately, promoting new opportunities for U.S. and regional fiber, yarn, fabric, and apparel manufacturing. The Agreement's tariff treatment for textile and apparel goods may be made retroactive to January 1, 2004.

Honduras maintains a combination price band and absorption agreement for corn, grain, sorghum, and corn meal. Under the price band mechanism, import duties can vary from 5 percent to 45 percent, depending on the import price. The duty for these products drops to 1 percent if the end-users agree to first purchase a predetermined amount of corn and sorghum from domestic farmers; otherwise, the higher tariffs of the price band mechanism remain in effect. The tariff reduction only takes place during the non-harvest season (March through August), and only end-users who have previously signed the absorption agreement may apply for this preferential treatment. A similar absorption agreement exists for rough rice, with duties of 1 percent for signers of the agreement and 45 percent for everyone else. The United States has strongly opposed the Honduran policies on these grains as limiting access for U.S. agricultural products.

Under the CAFTA-DR, Honduras will eliminate its tariffs on nearly all agricultural products within 15 years (18 years for rice and chicken leg quarters and 20 years for dairy products). For the most sensitive products, tariff-rate quotas (TRQ) will permit some immediate duty-free access for specified quantities during the tariff phase-out period, which will expand over time. Honduras will liberalize trade in white corn through expansion of a TRQ. Accordingly, when implemented, the CAFTA-DR will lead to the elimination of market access barriers, including the price band and absorption agreement system, for all products other than white corn.

Non-Tariff Measures

The Agreement also requires transparency and efficiency in administering customs procedures, including the CAFTA-DR rules of origin. Honduras committed to ensure greater procedural certainty and fairness in the administration of these procedures and all Parties agreed to share information to combat illegal transshipment of goods.

Honduras implemented the WTO Customs Valuation Agreement in February 2000.

STANDARDS, TESTING, LABELING, AND CERTIFICATION

Food imports into Honduras could grow significantly with a more transparent and efficient process of granting sanitary permits. The Honduran government requires that sanitary permits be obtained from the Ministry of Health for all imported foodstuffs, and that all processed food products be labeled in Spanish and registered with the Division of Food Control (DFC) of the

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Ministry of Health. The Ministry of Health agreed to expedite this surveillance process by focusing most closely on products considered to be at high risk for sanitary concerns (such as raw meat) and simplifying the procedures for low-risk products. Concerns remain, however, that regulations are not being strictly enforced for Honduran businesses. The Honduran government has also cited SPS concerns in periodically denying applications for the importation of pork, poultry, and dairy products.

Since 2002, Honduras has imposed a ban on poultry products from a number of U.S. states due to concerns over low-pathogenic avian influenza (LPAI). The ban was revised and renewed in March 2004, in spite of World Organization for Animal Health (OIE) guidelines that the presence of LPAI does not justify trade restrictions and despite information provided to Honduran officials by the U.S. Department of Agriculture (USDA) indicating the dates on which testing was completed in the affected states. USDA estimates that if Honduran restrictions on U.S. raw poultry and poultry parts were lifted, U.S. producers could export an additional \$10 million of poultry products to Honduras annually. In response to Mexico's October 2005 decision to lift its ban on poultry from nine U.S. states where LPIA was previously detected, the Honduran Ministry of Agriculture agreed to lift Honduras' ban as well. However, no date has been announced for lifting the ban.

When the United States and Central America launched the free trade agreement negotiations, they initiated an active working group dialogue on SPS barriers to agricultural trade that met in conjunction with the negotiations to facilitate market access. The objective was to leverage the impetus of active trade negotiations to make changes to the Central American countries' SPS regimes. Through the work of this group, Honduras committed to resolve specific measures affecting U.S. exports to Honduras. In particular, under CAFTA-DR, Honduras will recognize the equivalence of the U.S. food safety and inspection system for meat, poultry, and dairy, thereby eliminating the need for plant-by-plant inspections.

GOVERNMENT PROCUREMENT

Honduras is not a party to the WTO Government Procurement Agreement. Under the Government Contracting Law, which entered into force in October 2001, all public works contracts over one million lempiras (approximately \$53,850 as of December 2004) must be offered through public competitive bidding. Public contracts between 500,000 and one million lempiras (\$26,925 and \$53,850) can be offered through a private bid, and contracts less than 500,000 lempiras (\$26,925) are exempt from the bidding process. Currently, to participate in public tenders, foreign firms are required to act through a local agent that is at least 51 percent Honduran-owned.

While foreign firms are granted national treatment for public bids, some still complain of mismanagement and lack of transparency in the bid processes. One way that the Government of Honduras has tried to improve transparency and fairness in government procurement is by contracting with the United Nations Development Program (UNDP) to manage procurement for a number of ministries and state-owned entities. However, in some cases, however, U.S. companies have expressed concerns about the way UNDP has managed major procurements for the government, including complaints that bid requirements were written so narrowly that they

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avored a particular company from the outset and that UNDP management of invitation-only, limited-bid process, was not transparent.

The CAFTA-DR requires the use of fair and transparent procurement procedures, including advance notice of purchases and timely and effective bid review procedures, for procurement covered by the Agreement. Under the CAFTA-DR, U.S. suppliers will be permitted to bid on procurements of most Honduran government entities, including key ministries and state-owned enterprises. The anti-corruption provisions in the Agreement require each government to ensure that bribery in matters affecting trade and investment, including in government procurement, is treated as a criminal offense, or is subject to comparable penalties, under its law.

EXPORT SUBSIDIES

Honduras does not have export subsidies or export-promotion schemes, other than the tax exemptions given to firms in free trade zones. Under the CAFTA-DR, Honduras may not adopt new duty waivers or expand existing duty waivers conditioned on the fulfillment of a performance requirement (e.g., the exportation of a given level or percentage of goods). Honduras may maintain existing duty waiver measures provided such measures are consistent with its WTO obligations.

INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

Honduras largely took action to implement the Trade-Related Aspects of Intellectual Property Rights (TRIPs) Agreement by the January 1, 2000 deadline. In December 1999, the Honduran Congress passed two laws to reform previous legislation concerning copyrights, patents, and trademarks. The Honduran Congress, however, has yet to pass laws governing the protection of integrated circuit designs and plant varieties. In the CAFTA-DR, Honduras agreed to ratify or accede to the 1991 Act of the International Convention for the Protection of New Varieties of Plants by January 1, 2006.

Implementation of CAFTA-DR obligations would strengthen Honduras' IPR protection regime. Implementation of those obligations would also provide stronger deterrence to piracy and counterfeiting by criminalizing end-user piracy and requiring Honduras to authorize the seizure, forfeiture, and destruction of counterfeit and pirated goods and the equipment used to produce them. The CAFTA-DR text also mandates both statutory and actual damages for copyright and trademark infringement, to help ensure that monetary damages can be awarded even when it is difficult to assign a monetary value to the violation. Finally, under current laws, prosecutors can only confiscate pirated goods when the affected company files a complaint. After CAFTA-DR is implemented, prosecutors will be able to confiscate pirated goods and file intellectual property cases "*ex-officio*" or on their own initiative.

Copyrights

Honduras's copyright law, updated in 1999, added more than twenty different criminal offenses related to copyright infringement and established fines and suspension of services that can be levied against offenders. However, the piracy of books, sound and video recordings, compact

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discs, and computer software is still widespread in Honduras, due to limited enforcement capacity. A spot survey by an industry-sponsored IPR advocacy group found that nearly 75 percent of all compact discs for sale in Honduran markets were pirated. U.S. software companies are also pushing for ministries and state-owned entities to ensure that they use only authorized licensed software. A major U.S. software company has estimated that it loses \$5 million annually due to software piracy in Honduras. The piracy of cable television signals has also been a problem in Honduras. During 2004, two different U.S. companies claimed that their competitors were broadcasting pirated cable television signals from the United States, and that the Honduran authorities were not vigorously investigating and prosecuting these activities. The CAFTA-DR enforcement provisions are designed to help reduce copyright piracy.

SERVICES BARRIERS

Currently, special government authorization must be obtained to invest in the tourism, hotel, and banking services sectors. Foreigners may neither hold a seat on nor provide direct brokerage services in Honduras' stock exchange. Honduran professional associations heavily regulate the licensing of foreigners to practice law, medicine, engineering, accounting, and other professions.

Under the CAFTA-DR, Honduras will allow substantial market access in services across their entire services regime, subject to very few exceptions. In addition, U.S. financial service suppliers will have full rights to establish subsidiaries, joint ventures or branches for banks and insurance companies. Also, Honduras will allow U.S.-based firms to offer cross-border services in areas such as financial information and data processing, and financial advisory services. In addition, Honduran mutual funds will be able to use foreign-based portfolio managers. The right to provide professional services will be granted on a reciprocal basis.

INVESTMENT BARRIERS

Currently, the Government of Honduras must approve any foreign investment in sectors including telecommunications, basic health, air transport, insurance and financial services, private education, and most sectors related to natural resources and farming. Foreigners are barred from small-scale commercial and industrial activities with an investment less than 150,000 lempiras (about \$8,078). Foreign ownership of land within 40 km of the coastlines and national boundaries is constitutionally prohibited, although tourism investment laws allow for certain exceptions. Inadequate land title procedures, including overlapping claims and a weak judiciary, have led to numerous investment disputes involving U.S.-citizen landowners.

Until December 2005, the government-owned telephone company Hondutel maintained monopoly rights over all fixed-line telephony services. However, in 2003 the government began to allow foreign investors to participate in fixed-line telephone services as "sub-operators" in partnership with Hondutel. At present, approximately 40 firms have entered into "sub-operator" contracts with Hondutel, of which five firms are already providing services to the public. By law, Hondutel's monopoly expired in December 2005, but as of March 2006, the Government of Honduras had not yet passed a new telecommunications law that will allow new market entrants to operate independently or to invest as strategic partners in Hondutel. At present there are no plans for full privatization of the parastatal firm. Both foreign and domestic firms already enjoy

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full rights to invest in cellular telephone services. The Ministry of Natural Resources and Environment at times delays the issuance of environmental permits for U.S. and domestic investors, despite continued pressure from the United States Government to decide on these permits in a transparent and timely manner. In July 2004, the Minister of Natural Resources and the Environment issued a decree calling for a new national policy on mining and ordered the government agency responsible for granting mining permits and concessions, DEFOMIN, to stop granting any new mining concessions. This review is ongoing and has blocked plans of some U.S. investors, including the expansion plans of a U.S. company operating in Honduras, which has cancelled an \$8 million investment in the mining sector due to this delay. The U.S. government is aware of other investment delays in the mining, housing, and renewable energy sectors, due to ongoing reviews and non-issuance of their environmental permits. Environmental permits often take more than a year for issuance, after the submission of a complete application.

In 2001, a Bilateral Investment Treaty (BIT) between the United States and Honduras entered into force. The treaty provides, among other things, for equal protection under the law for U.S. investors, with limited exceptions, and permits expropriation only in accordance with international legal standards and accompanied by adequate compensation. U.S. investors in Honduras also have the right to submit an investment dispute to binding international arbitration. Upon entry into force of the CAFTA-DR, the BIT will be suspended. For a period of 10 years, however, current U.S. investors may choose either dispute settlement under the BIT or the FTA. Under the CAFTA-DR, U.S. investors will enjoy, in almost all circumstances, the right to establish, acquire, and operate investments in Honduras on an equal footing with local investors.

In the investment chapter of the CAFTA-DR, Honduras will commit to provide a higher level of protection for U.S. investors than under the existing BIT. Among the rights afforded to U.S. investors are due process protections and the right to receive a fair market value for property in the event of an expropriation. Investor rights will be backed by an effective, impartial procedure for dispute settlement that is fully transparent. Submissions to dispute panels and panel hearings will be open to the public, and interested parties will have the opportunity to submit their views. The CAFTA-DR requires that all forms of investment be protected, including enterprises, debt, concessions, contracts, and intellectual property.

OTHER BARRIERS

Historically, U.S. firms and private citizens have found corruption to be a problem which has seriously complicated doing business in Honduras. Corruption has appeared to be most prevalent in the areas of government procurement, the buying and selling of real estate (particularly land title transfers), performance requirements, and the regulatory system. Honduras' judicial system is subject to influence, and the resolution of investment and business disputes involving foreigners is largely non-transparent. Currently, with considerable U.S. help, the Honduran government is reforming the judicial system and fighting corruption; however, progress has been very slow and serious problems remain. In April 2004, Honduras was chosen as eligible to apply for Millennium Challenge Account (MCA) assistance. In June 2005, the Government of Honduras and the Millennium Challenge Corporation signed a program compact for \$215 million. MCA countries are deemed to have shown a commitment to ruling justly (including by tackling corruption), investing in their people, and encouraging economic freedom.

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The anti-corruption provisions in the CAFTA-DR require each government to ensure that bribery in matters affecting trade and investment is treated as a criminal offense, or is subject to comparable penalties, under its law.

Anti-Competitive Practices

U.S. industry has expressed concern that investors who set up business in Honduras have at times found themselves subject to forms of competition that, in the United States, would be considered anticompetitive. For example, in 2003, a U.S.-Japanese joint venture established a cement company in Honduras, challenging the duopoly enjoyed by the two Honduran companies in the market. The new joint venture investment accused the two established companies of predatory pricing that brought local cement prices below the cost of production. After the U.S.-Japanese venture dropped out of the market, prices leapt up to well above their previous level, until they were subsequently regulated by GOH action. Steel prices are also fixed in Honduras, and on a regional basis there are reports of price collusion by the major steel producers. In fall of this year, the Competition Law was passed which regulates against predatory pricing and other monopolistic practices in Honduras, but it will take some time for this law (and the GOH institutions that support it) to come fully into effect.

HONG KONG

TRADE SUMMARY

The U.S. goods trade surplus with Hong Kong was \$7.4 billion in 2005, an increase of \$916 million from \$6.5 billion in 2004. U.S. goods exports in 2005 were \$16.3 billion, up 3.1 percent from the previous year. Corresponding U.S. imports from Hong Kong were \$8.9 billion, down 4.5 percent. Hong Kong is currently the 13th largest export market for U.S. goods.

U.S. exports of private commercial services (i.e., excluding military and government) to Hong Kong were \$3.6 billion in 2004 (latest data available), and U.S. imports were \$4.6 billion. Sales of services in Hong Kong by majority U.S.-owned affiliates were \$8.1 billion in 2003 (latest data available), while sales of services in the United States by majority Hong Kong-owned firms were \$1.2 billion.

The stock of U.S. foreign direct investment (FDI) in Hong Kong in 2004 was \$43.7 billion, up from \$37.6 billion in 2003. U.S. FDI in Hong Kong is concentrated largely in the finance, wholesale, manufacturing, and banking sectors.

IMPORT POLICIES

The Hong Kong government pursues a market-oriented approach to commerce. Hong Kong is a duty-free port, with few barriers to trade in goods and services and few restrictions on foreign capital flows and investment. Hong Kong, however, does maintain excise duties on certain goods, including alcoholic beverages. Duties on alcoholic beverages range from 40 percent to 100 percent *ad valorem* and have been identified as a significant concern for U.S. exporters and producers. The Financial Secretary, however, reiterated in his 2005 budget speech that Hong Kong has no plans to change these duties.

Hong Kong banned imports of U.S. beef in December 2003 following announcement of a case of Bovine Spongiform Encephalopathy (BSE) in the United States. After two years of intensive efforts on the part of the U.S. government and industry, the Hong Kong government announced the lifting of the ban, with certain restrictions, in December 2005. It is estimated that the two-year ban cost U.S. exporters approximately \$160 million.

INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

The Hong Kong government continues to maintain a robust IPR protection regime. Hong Kong has strong laws in place, a dedicated and effective enforcement capacity, and a judicial system that supports enforcement efforts by sentencing those convicted of IPR violations to prison. There are, however, vulnerabilities with regard to some forms of infringement. The U.S. government continues to monitor the situation to ensure that Hong Kong's IPR protection efforts are sustained and that problem areas are addressed.

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The Hong Kong government has sustained public education efforts to encourage respect for intellectual property rights and has re-launched its “no fakes” campaign with local retailers who pledge not to sell counterfeit or pirated goods. Hong Kong authorities also continue to conduct aggressive raids at the retail level and to act against vendors who advertise illegal products over the Internet. In the first eight months of 2005, there were 663 piracy-related arrests. During the same period, the judiciary handed down 918 copyright and trademark convictions, the majority of which led to prison sentences of six to twelve months. Hong Kong Customs’ intelligence operations and raids on underground production facilities have closed most large-scale pirate manufacturing operations, prompting many producers of pirated optical media to switch to computers or compact disc burners to produce illicit copies and forcing retailers to rely increasingly on smuggled goods. In July 2004, Hong Kong Customs used the Organized and Serious Crimes Ordinance (OSCO) to freeze the assets of a pirating syndicate worth \$2.7 million. This was the first time OSCO has been applied to an IPR case.

Despite the crackdown on large-scale illicit manufacturing, there is still concern about Hong Kong’s licensed optical media production lines, which give the territory an overcapacity that must be carefully monitored. The volume of openly marketed pirated optical media found in retail shopping arcades has decreased significantly, but sales of infringing products remain a problem. U.S. officials have encouraged the Hong Kong government to sustain the pace of its ongoing enforcement activities aimed at local producers and vendors of infringing products.

Hong Kong's IPR enforcement efforts have helped reduce losses by U.S. companies, but end-use piracy, the rapid growth of peer-to-peer downloading from the Internet, and the illicit importation and transshipment of pirated and counterfeit goods, including optical media and name brand handbags and apparel from mainland China and elsewhere in the region, are continuing problems. The software industry estimates that Hong Kong’s software piracy rate was 52 percent in 2004, placing Hong Kong well above the software piracy rates in other advanced economies and resulting in industry estimated losses of approximately \$116 million to rights owners.

The Hong Kong government has taken some steps toward addressing each of these problems. In October 2005, in the first successful case of its kind in the world, Hong Kong convicted a man for using BitTorrent file sharing technology to distribute illegally on the Internet three Hollywood movies. He was sentenced to three months imprisonment. The Hong Kong government issued a press release at the time of the conviction quoting the Secretary for Commerce, Industry, and Trade as stating that the posting of copyrighted materials in Hong Kong using BitTorrent dropped 80 percent in the wake of the man's arrest ten months before. Hong Kong Customs routinely seize IPR infringing products from mainland China. Hong Kong officials have also established a joint task force with copyright industry representatives to track down online pirates using peer-to-peer networks for unauthorized file sharing. However, end-use piracy, Internet piracy, and the cross-boundary flow of infringing products still create significant losses

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for American companies, and U.S. officials continue to urge Hong Kong authorities to intensify efforts against these problems.

In November 2005, Hong Kong Customs and four local Internet service providers (ISPs), along with trade associations and IPR owners of a number of brand names, launched a new program called “E-Auctioning with Integrity,” to prevent and stop piracy activities at auction sites. Under the program, ISPs step up their monitoring of goods auctioned on their sites and remove IPR-violating items when the IPR owners alert the ISPs of the suspected counterfeit goods being auctioned. The information on the auction sites is passed on to Hong Kong Customs for investigation.

U.S. pharmaceutical companies are concerned that the Hong Kong Department of Health continues to issue marketing authorizations for patent-infringing pharmaceutical products. The local pharmaceutical industry association (which represents a number of U.S. and other international firms) submitted a proposal to the Hong Kong government in 2004 that would give patent holders an opportunity to commence legal action against infringing generics before their marketing authorization applications are processed by the Department of Health. The Department of Health, however, claims it cannot adopt this proposal without amending its pharmaceutical registration law. In addition, the industry has concerns about sales of counterfeit pharmaceuticals, which threaten consumer safety and brand reputation, and it seeks more vigorous enforcement and tougher penalties to deter this kind of illicit trade. The U.S. government continues to urge the Hong Kong government to address both the marketing approval/patent protection linkage issue and the counterfeiting issue as they pertain to pharmaceutical products.

Amendments to the Copyright Ordinance that provide tougher measures against illicit copy shops took effect on September 1, 2004. The Hong Kong government also plans to introduce new end-user piracy-related Copyright Ordinance amendments in the Legislative Council for consideration and enactment before the end of July 2006. In November 2005, the Hong Kong government put forth a preliminary proposal to introduce a new business end-user criminal offense for significant infringements involving the commercial copying and distribution of four types of printed works: newspapers, magazines, periodicals, and books. The proposal also specified numerical “safe harbour” thresholds for offenses under which criminal liability will not be assessed. The proposed thresholds are 1,000 copies of newspapers, magazines, and periodicals within any 14-day period, and a total retail value of under HK\$8,000 (about US\$1,025) within a 180-day period for books. At present, with the Copyright Ordinance amendments still pending, Hong Kong law provides end-user criminal liability for only four categories of works: computer software, movies, television dramas, and sound recordings.

SERVICES BARRIERS

As a result of changes to legislation and regulations in recent years, there are no significant trade barriers to note with regard to telecommunications or electronic commerce.

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Hong Kong completed its liberalization of the fixed-line telecommunications network services market on January 1, 2003. There are no limits on the number of licenses issued and no time limit for submitting license applications. In July 2004, the Hong Kong government announced that it would withdraw its interconnection policy for local fixed-line telecommunications services by June 30, 2008. Interconnection charges will then be subject to commercial negotiation between the operators concerned.

U.S. banks licensed in Hong Kong are able to provide renminbi (RMB) services, which first became available in November 2004. In November 2005, banks in Hong Kong were permitted modest increases in the scope of RMB business they can offer to clients, including providing services related to deposit taking, exchange, remittances, and credit cards. Making loans in Hong Kong in RMB, however, is still not permitted for any bank.

The October 2002 U.S.-Hong Kong Civil Aviation Agreement significantly expanded opportunities for U.S. carriers. The agreement allows cooperative marketing arrangements between U.S., Hong Kong and third-country carriers (codesharing) and also increases the ability of U.S. carriers to operate cargo and passenger services between Hong Kong and third countries. However, restrictions on frequencies and routes for these services remain. During 2005, the U.S. government continued its dialogue with the Hong Kong government in an effort to alter these limitations.

Foreign law firms that practice foreign law in Hong Kong are barred from practicing Hong Kong law and from employing or joining into partnership with Hong Kong solicitors. Foreign law firms that wish to provide both foreign and Hong Kong legal services may do so only by establishing a Hong Kong legal practice in which all partners are Hong Kong-qualified solicitors and the number of registered foreign lawyers employed does not exceed the number of Hong Kong solicitors. Such firms may be associated with, or even be branches of, overseas law firms if they meet certain criteria (e.g., at least one partner of the Hong Kong firm must also be a partner in the overseas firm).

OTHER BARRIERS

Pharmaceuticals

U.S. industry has expressed concerns about lengthy approval procedures for new pharmaceuticals, which shorten the effective patent life of new products by six months. In addition, U.S. industry is concerned about the lack of transparency in the Hong Kong Hospital Authority's approval process for new drugs. These cumbersome procedures also inhibit the patent owners' ability to market their products on a timely basis.

INDIA

TRADE SUMMARY

The U.S. goods trade deficit with India was \$10.8 billion in 2005, an increase of \$1.4 billion from \$9.5 billion in 2004. U.S. goods exports in 2005 were \$8.0 billion, up 30.3 percent from the previous year. Corresponding U.S. imports from India were \$18.8 billion, up 20.8 percent. India is currently the 22nd largest export market for U.S. goods.

U.S. exports of private commercial services (i.e., excluding military and government) to India were \$4.6 billion in 2004 (latest data available), and U.S. imports were \$2.8 billion. Sales of services in India by majority U.S.-owned affiliates were \$1.2 billion in 2003 (latest data available), while sales of services in the United States by majority India-owned firms were \$892 million.

The stock of U.S. foreign direct investment (FDI) in India in 2004 was \$6.2 billion, up from \$4.8 billion in 2003. U.S. FDI in India is concentrated largely in the manufacturing, mining, and banking sectors.

IMPORT POLICIES

India's tariffs remain high, especially in the agricultural sector. U.S. producers encounter tariff and non-tariff barriers that impede their exports, despite the government of India's (GOI) economic reform program initiated in 1991. While U.S. exports continued to grow in 2005, substantial expansion in U.S.-India trade will depend on continued and significant additional Indian liberalization.

The GOI has made substantial progress in restructuring tariffs applied to non-agricultural goods. In February 2005, the GOI reduced the peak applied duty on most non-agricultural products from 20 percent to 15 percent. Despite tariff cuts on these goods, the U.S. textile industry continues to have concerns about non-transparent applications of tariffs and taxes. The government applies high tariffs to petrochemicals, automobiles, motorcycles, and finished steel products.

According to WTO records, India's simple average applied tariff rate was 29 percent in 2004. India also reduced applied duties in 2005 on certain selected imports, including: metals, refractories and their inputs, catalysts, specific agriculture items including cloves, oleo pine resin, flowers, cloves, specified plantation machinery, Information Technology Agreement bound items, petroleum products, chemicals and petrochemicals, and capital goods. Reductions to India's generally much higher tariffs on agricultural products, processed foods, beverages, and nutritional supplements continue to be negligible.

FOREIGN TRADE BARRIERS

The GOI assesses a one percent customs handling fee on all imports in addition to the applied customs duty. The GOI continues to impose a two percent education fund assessment on all sales, both imported and domestic. The education “cess” is a surcharge applied to nearly all direct and indirect taxes. The GOI includes tariffs in calculating the value upon which to assess additional charges.

The United States has actively sought market-opening opportunities in India, both bilaterally and multilaterally in the Doha Development Round. U.S. Trade Representative Rob Portman and his Indian counterpart, Minister of Commerce and Industry Shri Kamal Nath, held the first U.S.-India Trade Policy Forum meeting in November 2005. U.S. Government officials regularly visit India to meet with Indian diplomatic and trade officials, as well as U.S. and Indian private sector representatives, to identify ways to promote greater trade between the United States and India, including a March 2006 meeting to receive recommendations from the U.S.-India CEO Forum. As part of the United States-India Economic Dialogue, the United States-India Trade Policy Forum is meeting regularly through its focus groups to discuss the full range of bilateral trade and investment issues.

In the World Trade Organization (WTO), India has bound tariffs on 73.8 percent of its tariff lines. The majority of these bindings exceed India’s applied rates of duty. In agriculture, India’s WTO bound tariffs range from 100 percent to 300 percent, also higher than the applied rates in many product areas.

The Indian government publishes tariffs and additional tax rates applied to imports, but there is no single official publication that includes all information on tariffs, fees, and tax rates on imports. The system lacks transparency. Importers must consult separate tariff and excise tax schedules, as well as any applicable additional public notifications and notices, to determine current tariff and tax rates. The rate at which the customs duty is imposed on the goods depends on the classification of the goods determined under the Customs Tariff. The Customs Tariff is generally aligned with the Harmonized System of Nomenclature (HSN). The rate at which the excise duty is imposed on the goods also depends on the classification of the goods under the Excise Tariff, which is primarily based on the HSN. Each Indian state also levies taxes on interstate commerce, which creates additional confusion.

Import Licensing

Importers of vehicles of any type, face restrictive and trade-distorting import practices. For example, the GOI requires special licenses for importing motorcycles. These licenses are virtually impossible to obtain. Import licenses for motorcycles are granted only to foreign nationals: (1) permanently residing in India; (2) working in India for foreign firms that hold greater than 30 percent equity; or (3) working at embassies located in India. Certain domestic importers are eligible to import vehicles without a license, but only if these imports are offset by exports attributable to the same importer.

FOREIGN TRADE BARRIERS

India also maintains a negative import list. The negative list is currently divided into three categories: (1) banned or prohibited items (e.g., tallow, fat, and oils of animal origin); (2) restricted items which require a non-automatic import license (e.g., livestock products, certain chemicals); and (3) "canalized" items (e.g., petroleum products, some pharmaceuticals, and bulk grains) importable only by government trading monopolies subject to cabinet approval regarding timing and quantity.

India has liberalized many restrictions on the importation of capital goods. The government allows imports of all second-hand capital goods by the end-users without requiring an import license, provided the goods have a residual life of five years. Refurbished computer spare parts can only be imported if an Indian Chartered Engineer certifies that the equipment retains at least 80 percent of its residual life.

Fertilizer Subsidy Regime

The Indian government subsidizes di-ammonium phosphate (DAP) fertilizer. Under the current system, which the current government says it will revise by April 1, 2006, the GOI sets a maximum retail price that can be charged to farmers for DAP. This price is not adequate to cover the cost of producing or importing DAP. The excess costs for domestic producers and importers were subsidized, at different levels that favored domestic DAP over imports. From July 2004 through June 2005, base rate subsidies were equalized but final subsidy amounts continue to disadvantage imports. The disadvantage has limited regular commercial import transactions.

In addition to this disadvantage, the current system fixes the subsidy on a retrospective basis and in a non-transparent manner, which in turn acts as a further deterrent for importers. The United States continues to press India to end its costly, trade-distorting treatment of DAP.

Customs Procedures

The GOI appears to apply discretionary customs valuation criteria to import transactions. U.S. exporters have reported that India's customs valuation methodologies do not reflect actual transaction values and effectively increase tariff rates. The United States is working through the WTO Committee on Customs Valuation to obtain further information from India on its valuation methods, and will continue to examine the customs valuation procedures for consistency with India's obligations under the WTO Customs Valuation Agreement.

Indian Customs requires extensive documentation, which inhibits the free flow of trade and leads to frequent processing delays. In large part these delays are a consequence of India's complex tariff structure and multiple exemptions, which may vary according to product, user, or specific Indian export promotion program.

India continues to maintain a reference price system for soybean oil to address alleged under-invoicing. The reference price is the basis upon which India assesses its 45 percent customs duty. When the GOI reference price for soybean oil rises above the transaction price, the effective rate of duty may also increase above India's 45 percent WTO-bound tariff. The GOI reportedly reviews reference prices every 15 days and adjusts them accordingly. Although the reviews are done periodically, India has not formally defined this procedure, making it non-transparent and unpredictable. Exports of U.S. crude soybean oil to India were negligible in 2003 and 2004 after shipments valued at \$25 million were exported in 2002. The U.S. Government continually raises this issue with India, but has not received a response from the Indian government that clarifies its policy and the reference price scheme's relationship to India's WTO commitments.

Certain customs procedures impede importation of automotive products. Motor vehicles may be imported through only three specific ports and only from the country of manufacture. Declared transaction values of automotive products may be rejected, insofar as legitimate reductions in the wholesale price of such products are ignored.

STANDARDS, TESTING, LABELING AND CERTIFICATION

The GOI has identified 109 specific commodities (including food preservatives and additives, milk powder, infant milk foods, certain types of cement, household and similar electrical appliances, gas cylinders, and multi-purpose dry cell batteries) that the Bureau of Indian Standards (BIS) must certify before the products are allowed to enter the country. A system now exists by which foreign companies can receive automatic certification for products made outside India, provided BIS has first inspected and licensed the production facility (at the manufacturers expense). Licensing fees include the cost of the initial inspector's visit and tests, an annual fee of approximately \$2,000 and a marking fee that ranges from 0.2 percent to 1 percent of the value of certified goods imported into or produced in India.

In 2004, Indian Customs began to require registration or an exemption certificate for imported boric acid. The Ministry of Agriculture's Central Insecticides Board and Registration Committee has not published criteria and procedures for obtaining this documentation. Imports of boric acid are, therefore, effectively blocked. Indian government rulemaking has been *ad hoc* and confusing. India may be the only country that requires registration of boric acid intended for non-insecticide use. U.S. industry is required to register, although it asserts that 90 percent of all boric acid imports into India are for non-insecticide uses and should qualify for an exemption. India's boric acid producers are not, according to U.S. industry, subject to the same constraints. The U.S. Government has raised this issue with the GOI on numerous occasions in 2005, but India has taken no action to address the concerns.

The U.S. Government is increasingly concerned over India's failure to notify certain technical regulations to the WTO. India's procedures for establishing vehicle emissions standards are vague and non-transparent. The emissions standards seem to favor small displacement four-stroke motorcycles that are primarily manufactured by Indian producers. Even the latest low-emission technology used by U.S. manufacturers fails to meet India's requirements.

India is also in the process of developing new technical regulations, which will affect medical device trade. While the U.S. fully supports India's legitimate efforts to protect human health and safety, such measures should be based on international standards as much as possible, be developed transparently, and not have the effect of creating unnecessary trade barriers or in any way precluding patient access from life-saving technologies. In September 2005, as part of the U.S.-India Commercial Dialogue, officials of the U.S. and Indian Governments initiated a Standards Dialogue Working Group to seek transparency and understanding of how standards impact upon our bilateral commerce. Three sessions of the dialogue were held in 2005, and additional meetings are planned in 2006.

Sanitary and Phytosanitary (SPS) Measures

The U.S. Government has risen with India concerns regarding India's failure to notify certain SPS measures to the WTO. Bilateral technical level discussions are ongoing and have resulted in short-term agreements to allow continued entry for important U.S. export commodities, such as almonds. The U.S. government continues to impress upon India the need to base its SPS measures on science, including those affecting almonds, apples, bovine semen, dairy products, pulses, poultry, pet food, and forest products. The United States will continue to seek a long-term solution regarding almonds and pulses, and other outstanding SPS issues.

GOI implementation of the "Plant Quarantine (Regulation of Import into India) Order, 2003" and its amendments, prior to notifying them to the WTO SPS Committee, jeopardized Indian imports of U.S. almonds, pulses, fresh fruits and vegetables, among others. Furthermore, new requirements affecting Solid Wood Packaging Material (SWPM), as initially drafted, threatened to adversely impact U.S. exports of nonagricultural products.

Bilateral discussions led the Indian Ministry of Agriculture to: (a) amend its quarantine requirements for wood packaging materials to make them compatible with international standards; and (b) allow U.S. apples and pears to retain market entry also in accordance with international standards. The market access problems were thereby resolved.

The Indian government has implemented several sanitary restrictions that do not appear to coincide with the Office of International Epizootics (OIE) and CODEX recommendations. The OIE and CODEX are the global standard setting bodies for animal health issues and food products, respectively.

Such restrictions have affected Indian imports of poultry and poultry products, pet food, bovine semen, and dairy products. Until February 2004, the Indian pet food market had been a rapidly growing and promising market for U.S. exports. U.S. Government officials resolved this issue in a July 2005 technical meeting in New Delhi, although implementation problems persist.

In the absence of a policy framework for assessing the safety of biotechnology commodities and foods, the GOI decision-making process is slow, non-transparent and arbitrary. Meanwhile, Indian researchers themselves are engaged in the domestic development of agricultural products derived from biotechnology such as mustard seed, potatoes, tomatoes, cabbage, cauliflower, chilies, groundnuts, and rice. They, too, have expressed frustrations regarding the approval process. The GOI reports that it is currently reviewing its policy for evaluating the safety of foods made using biotechnology.

GOVERNMENT PROCUREMENT

India is not a signatory to the WTO Agreement on Government Procurement. Indian government procurement practices and procedures are non-transparent. Foreign firms rarely win Indian government contracts due to the preference afforded to state-owned enterprises in the award of government contracts and the prevalence of such enterprises. The Purchase Preference Policy (PPP) in government enterprises and government departments gives preference to any government enterprise that makes an offer that is within 10 percent of the lowest bid. The GOI renewed this policy for three years, until March 31, 2008, with some modifications.

EXPORT SUBSIDIES

The tax exemption for profits from export earnings was phased out over a five-year period that ended on March 31, 2005. Tax holidays continue for Export Oriented Units and exporters in Special Economic Zones.

INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

India expanded patent coverage effective January 1, 2005. Large-scale copyright piracy, especially in the software, optical media, and publishing industries, continues to be a major problem. The United States retained India on the "Priority Watch List" as part of the 2005 Special 301 review.

Patents

On December 27, 2004, the GOI issued a Patent Amendment Ordinance just ahead of India's January 1, 2005 WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) deadline to enact product patent protection for pharmaceuticals and agricultural chemicals. On March 23, 2005, the Indian Parliament completed its action to make permanent the change to India's patent law. The regulations implementing the law as changed by the Ordinance came into effect January 1, 2005.

FOREIGN TRADE BARRIERS

The new law extends product patent protection to pharmaceuticals and agricultural chemicals. While a positive step, these changes do not address several important weaknesses in India's patent law. For example, the new law does not clarify some ambiguities regarding the scope of patentable inventions. There is also a large backlog in pending patent applications, resulting in long waiting periods for patent approval. The GOI is currently reviewing legislation and implementing regulations to address these deficiencies. The new law also contains ambiguities concerning compulsory licenses and weakened mailbox patents.

Indian law does not provide for adequate protection against unfair commercial use of test or other data that companies submit in order to obtain government marketing approval for their pharmaceutical or agricultural chemical products. The GOI is currently reviewing a report that will make a recommendation on adopting data protection legislation for submission to Parliament in 2006. Without specific protection against unfair commercial use of clinical test data, companies in India are able to copy certain pharmaceutical products and seek immediate government approval for marketing based on the original developer's data. Recognizing the role that TRIPS-consistent protection plays in fostering innovation and investment, a small but growing domestic Indian constituency, comprised of Indian pharmaceutical companies, technology firms, and educational and research institutions, favors changes to improve protection of data.

Copyrights

India's copyright laws need updating and their enforcement is weak. The GOI is not a party to either the 1996 WIPO Copyright Treaty (WCT) or the WIPO Performances and Phonograms Treaty (WPPT).

Piracy of copyrighted materials (particularly software, films, popular fiction works and certain textbooks) remains a problem for both U.S. and Indian producers. Pirated semiconductors are sold in violation of copyright and semiconductor mask laws. India has not adopted an optical disc law to deal with optical media piracy, although inter-ministerial consultations to examine whether optical disk legislation is necessary are now underway. Classification of copyright and trademark infringements as "cognizable offenses" has expanded police search and seizure authority. The law provides for minimum criminal penalties, including mandatory minimum jail terms. If implemented, U.S. industry believes these penalties could effectively deter piracy.

The establishment of a Copyright Enforcement Advisory Council with responsibility for policy development and coordination, as well as the initiation of a program for training police officers and prosecutors concerned with enforcement of copyright laws, has not been vigorously pursued. Due to backlogs in the court system and documentary and other procedural requirements, few cases recently have been prosecuted. U.S. and Indian industry report that piracy levels in all sectors remain high.

Cable television piracy continues to be a significant problem, with estimates of tens of thousands of illegal systems in operation in India. Copyrighted U.S. product is transmitted over this medium without authorization, often using pirated videocassettes, video compact discs (VCDs), or DVDs as source materials. This has had a significant detrimental effect on all motion picture market segments in India – theatrical, home video and television. For instance, pirated videos are available in major cities before their local theatrical release. The proliferation of unregulated cable TV operators has led to pervasive cable piracy.

Noting pockets of positive movement, the United States continues to press for adequate and effective copyright protection.

Trademarks

The Government of India has pledged to upgrade its trademark regime. Upgrades include national treatment for the use of trademarks owned by foreign proprietors, statutory protection of service marks, and clarification of the conditions for the cancellation of a mark due to non-use. Although enforcement is improving, protection of foreign marks in India remains difficult.

The required registration of a trademark license (described by U.S. industry as highly bureaucratic and time-consuming) can be refused on such grounds as "not in the public interest," "will not promote domestic industry," or for "balance of payments reasons." The Foreign Exchange Management Act of 1999 restricts the use of trademarks by foreign firms unless they invest in India or supply technology.

The United States continues to press for adequate and effective protection of trademarks and looks forward to India fulfilling its pledge to upgrade its trademark regime.

Enforcement

India's criminal justice system does not effectively support the protection of intellectual property. India's criminal IPR enforcement regime, including border protection against counterfeit and pirated goods, remains weak. There have been few reported convictions for copyright infringements resulting from raids, including raids against recidivists. Adjudication of cases is extremely slow. Police action against pirates of motion pictures has improved since 2004. Obstruction of raids, leaks of confidential information, delays in criminal case preparation, and the lack of adequately trained officials have further hampered the criminal enforcement process.

Amendments to the Code of Civil Procedure are being considered that would require civil cases to be completed within one year. These amendments may provide more expeditious disposition of the civil cases brought by U.S. industry in Indian courts.

SERVICES BARRIERS

Indian government entities run many major services industries either partially or entirely. Nevertheless, private firms play a large role in advertising, accounting, car rental, and a wide range of consulting services. There is a growing public awareness of India's potential as a major services exporter and increasing demand for a more open services market. While India has submitted an initial offer to provide further services liberalization in the context of the WTO Doha Development Agenda, the offer does not remove existing restrictions in such key sectors as professional services, telecommunications, and financial services. The United States will continue to press India bilaterally and at the WTO to open its services markets.

Insurance

The Insurance Regulatory and Development Authority (IRDA) law opened India's insurance market to private participation with a limit on foreign equity of 26 percent of paid-up capital. In July 2004, the GOI announced its intention to amend the IRDA law to increase that cap to 49 percent. Intense domestic political debate has delayed action.

Banking

Foreign banks may operate in India through only one of three channels: branches, a wholly-owned subsidiary, or up to 74 percent ownership in a private Indian bank. Most Indian banks are government-owned, and entry of foreign banks remains highly regulated. State-owned banks control 80 percent of the banking system. The Reserve Bank of India has granted operating approval to 25 new foreign banks or bank branches since issuing new guidelines in 1993. As of September 2004, 35 foreign banks with 217 branches were operating in India. Five U.S. banks now have a total of 16 branches in India. They operate under restrictive conditions including tight limitations on their ability to add sub-branches. Foreign direct investment (FDI), foreign institutional investment (FII) or portfolio investment and investments by non-resident Indians is being liberalized to 74 percent from 49 percent. At all times, at least 26 percent of the paid up capital of the private sector banks will have to be held by resident Indians. FDI in state-owned banks remains capped at 20 percent. Foreign investor voting rights are capped at 10 percent in private banks and one percent in state-owned banks.

Audiovisual and Communications Services

The Indian government has removed most barriers to the import of motion pictures, although U.S. companies have experienced difficulty in importing film/video publicity materials and are unable to license movie-related merchandize due to royalty remittance restrictions.

FOREIGN TRADE BARRIERS

In March 2004, in the face of considerable distributor and consumer resistance, as well as confusion surrounding pricing issues and other rules, the GOI suspended implementation of the Conditional Access System (CAS) for cable television pending review by a regulatory authority.

The CAS would require television subscribers to install set-top-box decoders to view premium channels. By providing tighter regulation of the cable industry as a whole, CAS was expected to help reduce the problem of pirated broadcasts.

The government of India permits foreign direct investment (FDI) of up to 49 percent in Indian cable networks and companies that uplink from India. Total foreign investment in “direct-to-home” (DTH) broadcasting has been restricted to 49 percent, with an FDI ceiling of 20 percent on investments by broadcasting companies and cable companies. At present, news channels are permitted to have up to 26 percent foreign equity investment. They must also ensure that a dominant Indian partner holds at least 51 percent equity. Operational control of the editorial content must be in Indian hands. The Indian government has also announced restrictive minimum capitalization requirements. In addition, all pay television content providers are required to make their content available to all cable and satellite television system operators; and content providers must give 30-day public notification before cutting off their signals to non-paying system operators.

On November 11, 2005, the Ministry of Information and Broadcasting announced its "Policy Guidelines for Downlinking of Television Channels" – ostensibly to guard against harmful content – that include major new restrictions on foreign pay-TV channels doing business in India. These channels are received through cable TV systems that reach 62 million Indian households mainly in urban areas, and also through direct-to-home satellite services now coming online. These regulations, if left unchanged, will deter future investment by non-Indian broadcasters by imposing new, onerous bureaucratic processes, fees, and litigation expenses; extracting new taxation; threatening revenues from and protection of purchased rights for broadcasting programs; and restricting India-directed content, news, and advertising.

Accounting

Only graduates of an Indian university can qualify as professional accountants in India. Foreign accounting firms can practice in India, if their home country provides reciprocity to Indian firms. Internationally recognized firm names may not be used, unless they are comprised of the names of proprietors or partners, or a name already in use in India. This limitation applies to all but the two U.S. accounting firms that were established prior to the imposition of this rule. The Institute of Chartered Accountants of India (ICAI) continues to ban the use of logos of accounting firms. Only firms established as a partnership may provide financial auditing services. Foreign accountants may not be equity partners in an Indian accounting firm.

Construction, Architecture and Engineering

Many construction projects are offered only on a non-convertible rupee payment basis. Only government projects financed by international development agencies permit payments in foreign currency. Foreign construction firms are not awarded government contracts unless local firms are unable to perform the work. Foreign firms may only participate through joint ventures with Indian firms.

Legal Services

The Indian Bar Council has imposed restrictions on the activities of foreign law firms in recent years that have sharply curtailed U.S. participation in the Indian legal services market. In 2005, the Bar Council of India denied permission to Britain and Australia to allow their law firms to set up practices in India. An American law firm had also approached the Bar Council of India seeking permission to open its branch office in India to render legal services, but its request was similarly denied.

India requires that anyone wishing to practice law must enroll as a member of the Bar Council and if that person happens to be a foreign national then he must belong to a country that allows Indian nationals reciprocal rights to practice in their country. FDI is not permitted in this sector, and international law firms are also not authorized to open offices in India. Foreign services providers may be engaged as employees or consultants in local law firms, but they cannot sign legal documents, represent clients, or be appointed as partners.

Telecommunications

India has taken positive steps towards liberalizing, and introducing private investment and competition in, its telecommunications services market. Concerns remain regarding India's weak multilateral commitments in basic telecommunications and the apparent bias of telecommunications policy towards government-owned services providers, in particular, with respect to access to and use of submarine cable systems.

The national telecommunications policy allows private participation in the provision of all types of telecommunications services. Private operators can provide services within regional "circles" that roughly correspond to the borders of India's states. In November 2005, foreign equity limits were raised from 49 percent to 74 percent.

Competitive carriers are concerned about the neutrality and fairness of government policy. The GOI retains a significant ownership stake and interest in the financial health of the dominant telecommunications firms, all of which formerly enjoyed monopoly status in their areas of operation. The government holds a 26 percent interest in the international carrier, VSNL; a 56 percent interest in MTNL, which primarily serves the Delhi and Mumbai metropolitan areas; and a 100 percent interest in BSNL, which provides domestic services throughout the rest of India. The government has indicated it will privatize MTNL and BSNL in the future, but has not yet established a timetable.

U.S. telecommunications companies have complained about the restrictive policies adopted by incumbent Indian international service provider VSNL on international submarine cable access and landing stations in India, and have requested that the Indian government intervene to ensure that VSNL makes available submarine cable capacity to other suppliers and provides access to and use of cable landing stations on a reasonable and non-discriminatory basis. In mid-2004, VSNL reached agreement with then-U.S.-based Flag Telecom, allowing the latter to sell international bandwidth through a VSNL landing station. However, overall capacity constraints and artificially high prices persist in the market.

The Indian government has put in place new requirements on how international networks are managed in India, which U.S. operators believe seriously impede their ability to do business. In the face of widespread complaints, the Indian government agreed to delay implementation of these rules until July 2006. Whether concerns of U.S. carriers can be addressed in the interim remains unclear. The U.S. Government will continue to work with India to explore how it might regulate the provision of national and international long distance services in a way that will allow U.S. companies to benefit from India's loosening of foreign direct investment limits.

In February 2003, India's telecommunications regulator, TRAI, announced that it would impose a more than 50 percent reduction in its current access deficit charge (ADC) and move towards a revenue-share-based model for long distance calls in place of the existing system where charges are levied on a per minute basis. Concerns remain, however, that the new ADC model will not apply to international calls (i.e., charges will still be levied on a per minute basis) and that U.S. operators may not benefit fully from the rate reduction unless Indian firms pass their savings on to the foreign carriers with which they partner. The U.S. Government will monitor this issue.

In November 2005, TRAI took action to lower the cost of International Private Leased Circuits (IPLCs), and in December, issued a set of recommendations on "Measures to Promote Competition in International Private Leased Circuits (IPLC) in India." If adopted, these recommendations would potentially resolve many of the U.S. telecommunications companies' problems in this market.

In addition, on November 10, 2005, the GOI removed several market barriers in India's long distance telecommunications sector, including the following actions:

-- Legalized Internet telephony effective November 10, 2005 – now all types of access service providers can provide Internet telephony, Internet services, and Broadband services.

--- Reduced the entry fee for new Domestic Long Distance (DLD) licenses from \$22.22 million to \$55,555. Likewise, the annual license fee for DLD licenses will be reduced from 15 percent to 6 percent of adjusted gross revenue (AGR) effective January 1, 2006.

--- Reduced the entry fee for International Long Distance (ILD) from \$5.55 million to \$55,555.

--- Reduced the annual license fee for ILD licenses from 15 percent to 6 percent of AGR effective January 1, 2006

FOREIGN TRADE BARRIERS

--- Removed the mandatory roll-out obligations for existing and future DLD and ILD licenses and existing licenses. The one remaining requirement is to have at least one switch in India.

--- Reduced the net worth requirement for DLD & ILD licenses from \$12.35 million to \$55,555.

--- Removed the mandatory roll out obligation for ILD service licensees.

Distribution Services

The retail sector in India is closed to foreign investment, except for single-brand retail stores, which were opened to up to 51 percent foreign direct investment in January 2006.

U.S. direct selling firms have been misclassified as retail instead of wholesale companies and have also been mischaracterized as illegal pyramid schemes. Current Indian law does not sufficiently differentiate between legitimate direct selling operations and pyramid schemes.

INVESTMENT BARRIERS

Equity Restrictions

Most sectors of the Indian economy are now at least partially open to foreign investment, with certain exceptions. The Indian government continues to prohibit or severely restrict FDI in certain politically sensitive sectors, such as agriculture, retail trading, railways, and real estate. At the same time, the GOI has liberalized other aspects of foreign investment and eliminated various government approvals. Automatic FDI approval in many industries, including bulk manufacturing activities, is now allowed. Some sectors still require government approval.

The Indian government's stringent and non-transparent regulations and procedures governing local shareholding cause concern. Current price control regulations have undermined incentives to increase equity holdings in India. Some companies report forced renegotiation of contracts in the power sector to accommodate government changes at the state and central levels. Press Note 18, promulgated in 1998 by the Ministry of Industry, poses major impediments to investment in India by requiring prior approval of the Indian party to a joint venture before the foreign partner can pursue other investment opportunities in India. This provision had been widely abused, holding foreign partners hostage, even for failed joint ventures. In January 2005, the GOI partially lifted Press Note 18 by eliminating its application to all new joint ventures and relaxing the hold local firms have on the future business plans of foreign partners for existing joint ventures. Investment Disputes After years of negotiation, the Government of India persuaded state-owned financial institutions and the State of Maharashtra to reach a settlement with U.S. investors, the Overseas Private Investment Corporation, and other foreign lenders on the investment dispute surrounding the Enron-sponsored Dabhol power project in July 2005. A comprehensive commercial settlement was thereby achieved and litigation between the claimants has ceased. There has been significant progress in resolving several payment disputes that American power sector investors have with the State of Tamil Nadu. The GOI, which has limited jurisdiction over commercial disputes involving matters under state jurisdiction, has been helpful in convincing Tamil Nadu to settle these commercial disputes.

FOREIGN TRADE BARRIERS

The United States continues to urge the GOI that to create an attractive and reliable investment climate, India and its political subdivisions need to provide a secure legal and regulatory framework for the private sector, as well as institutionalized dispute resolution mechanisms to expedite resolution of commercial issues.

ANTICOMPETITIVE PRACTICES

India suffers from a slow bureaucracy and regulatory bodies that reportedly apply monopoly and fair trade regulations selectively. With little or no fear of government action and with a clogged court system where cases linger for years, Indian firms face few if any disincentives to engage in anticompetitive business practices.

OTHER BARRIERS

India has an unpublished policy that favors countertrade (a form of trade in which imports and exports are linked in individual transactions). The Indian Minerals and Metals Trading Corporation is the major countertrade body, although the State Trading Corporation also handles a small amount of countertrade. Private companies are encouraged to use countertrade. Global tenders usually include a clause stating that, all other factors being equal, preference will be given to companies willing to agree to countertrade. The exact nature of offsetting exports is unspecified, as is the export destination. The Indian government does try, nonetheless, to eliminate the use of re-exports in countertrade.

India's medicines policy concerns U.S. pharmaceutical companies. While the scope of the rigid government-controlled pricing system has been reduced, final steps to eliminate it have stalled. Some politicians and GOI officials continue to call for expanding price controls as the preferred means to confront inflationary trends. The GOI is currently reviewing proposed legislation that would significantly expand price controls over medicines.

Indian states fail to apply consistently certain national laws and regulations. This creates uncertainty for U.S. companies exporting to, and investing in, India. U.S. companies affected by such inconsistency include: cable television content providers of programming subject to conditional access system rules and distilled spirits producers who face non-uniform state-level taxes despite the national government's directive to harmonize such taxes. In addition, less than universal adoption of a state-level VAT by all Indian states and conflicting regulations continue to hamper the free flow of goods within India.

India's implementation of its antidumping regime has raised concerns in key areas such as transparency and due process. India continued to apply aggressively its antidumping law over the past year. According to WTO statistics, India initiated 13 (third highest among all WTO members) antidumping cases in 2005. In fact, from the second half of 2004 through the first half of 2005, which is the most recent 12-month period for which WTO statistics are available, India imposed 30 final antidumping measures, more than any other WTO Member, and ranked second in the number of initiations.

FOREIGN TRADE BARRIERS

Of the newly initiated investigations, two of which involved U.S. exports, chemical products were the leading target of investigation. The United States will continue to seek clarification and address concerns both bilaterally and multilaterally. In September 2004, the United States participated in a technical exchange with Indian antidumping administrators to obtain a better understanding of India's trade remedies laws and their compliance with India's WTO obligations.

INDONESIA

TRADE SUMMARY

The U.S. goods trade deficit with Indonesia was \$9.0 billion in 2005, an increase of \$832 million from \$8.1 billion in 2004. U.S. goods exports in 2005 were \$3.0 billion, up 14.0 percent from the previous year. Corresponding U.S. imports from Indonesia were \$12.0 billion, up 11.2 percent. Indonesia is currently the 39th largest export market for U.S. goods.

U.S. exports of private commercial services (i.e., excluding military and government) to Indonesia were \$1.1 billion in 2004 (latest data available), and U.S. imports were \$323 million. Sales of services in Indonesia by majority U.S.-owned affiliates were \$1.1 billion in 2003 (latest data available), while sales of services in the United States by majority Indonesia-owned firms were \$28 million.

The stock of U.S. foreign direct investment (FDI) in Indonesia in 2004 was not available, \$10.5 billion in 2001. U.S. FDI in Indonesia is concentrated largely in contracted largely in the mining sector.

OVERVIEW

Since taking office on October 20, 2004, President Susilo Bambang Yudhoyono, Indonesia's first directly-elected leader, has pursued plans to improve Indonesia's business climate and regional competitiveness; attract greater foreign and domestic investment, especially in infrastructure and export sectors; and generate high-quality job growth needed for sustained economic development. In support of this effort, President Yudhoyono has called for Indonesia to reassert itself within bilateral, regional and multilateral trade forums and negotiations with the aim of expanding international markets for Indonesian products and supporting global efforts to liberalize trade while protecting Indonesia's economic interests. A Presidential Decree revitalized the National Team for Increasing Exports and Investment (PEPI), established in 2003, with President Yudhoyono as its Chairman. An October 18, 2005, Presidential Decree established an interagency Indonesian National Trade Negotiation Team, with the Coordinating Minister for the Economy and the Minister of Trade as its chair and deputy chair, respectively. Both teams have overarching goals to improve coordination of Government of Indonesia (GOI) strategies and positions in trade dialogues and negotiations, and to facilitate the development of strategic sectors.

Minister of Trade Mari Pangestu announced in the early days of the Yudhoyono Administration a comprehensive trade policy review aimed at dismantling protectionist measures of previous administrations, rationalizing and harmonizing tariffs, and gradually removing bans and quotas and lowering tariffs. As part of this review, Indonesia's Team Tariff, an interagency body responsible for reviewing tariff and non-tariff measures, announced in December 2004 the completion of the first phase of a comprehensive Tariff Harmonization Program.

FOREIGN TRADE BARRIERS

President Yudhoyono's focus on improving Indonesia's business climate and competitiveness address some of U.S. industry's continuing concerns over the wide range of business problems it encounters in Indonesia, including the lack of contract enforceability, discriminatory taxation, the absence of a transparent and predictable regulatory environment, arbitrary and inconsistent interpretation and enforcement of laws, irregularities in government procurement tenders, and ineffective enforcement of intellectual property rights. These business problems cause great uncertainty, which combined with widespread corruption, an ineffective judicial system, non-existent credit reporting, and underdeveloped capital markets, hinders commercial dealings in Indonesia. The Yudhoyono Administration has focused its reform agenda first on revising Indonesia's investment, tax, customs and labor laws; undertaking an effective anti-corruption campaign; and laying the foundation for judicial and civil service reform. President Yudhoyono's anti-corruption campaign has netted several high-ranking government officials and is widely viewed as the first credible effort of its kind in Indonesia. Two other priorities for Indonesia in 2005 were recovery from a massive earthquake and tsunami that struck the nation on December 26, 2004, and the successful negotiation of a peace agreement with rebels in the Aceh region.

Investment gradually replaced consumption as a driver of growth in the first half of 2005, a sign that the business climate was beginning to improve. In August 2005, however, record world fuel prices raised concerns about the cost of Indonesia's domestic fuel subsidy program and doubts about underlying fiscal budget assumptions. Subsequent declining foreign exchange reserves and a depreciating currency caused the government to tighten monetary policy and dramatically reduce the fuel subsidy, which increased fuel prices. In the short term, these measures could dampen economic growth and create political difficulties. In the long-term, the reduction and eventual abolition of fuel subsidies should allow for greater public sector investment in basic social services and infrastructure.

The Indonesian government generally has adhered to its long-term trade liberalization program, and the Yudhoyono Administration has actively pursued greater access to global markets through bilateral, regional and multilateral agreements. For example, Indonesia and Japan held three rounds of Economic Partnership Agreement talks in 2005, and Indonesia is in FTA talks with Australia and China. Indonesia fully implemented the final stage of its commitments under the ASEAN Free Trade Agreement (AFTA) on schedule on January 1, 2002, and has been active in ASEAN's efforts to pursue free trade agreements with China, Japan, South Korea, India, Australia and New Zealand.

The U.S. and Indonesia reenergized Trade and Investment Framework Agreement (TIFA) talks in 2005, holding three productive meetings to discuss outstanding trade concerns and to explore areas for future cooperation. Intellectual Property Rights (IPR) protection and enforcement remains a serious concern in Indonesia, where widespread optical disc piracy and counterfeiting of consumer goods, including automotive parts and pharmaceuticals, cost U.S. firms and the GOI hundreds of millions of dollars in lost revenues and pose serious health and safety concerns for Indonesians.

FOREIGN TRADE BARRIERS

IMPORT POLICIES

Tariffs

In the late 1980s, the GOI began long-term trade reform to wean the economy away from its dependence on oil and gas and to increase Indonesia's industrial competitiveness. In the early 1990s, it began a series of annual deregulation packages designed to gradually lower applied tariff rates, convert non-tariff barriers into tariffs, and remove restrictions on foreign investment. The January 11, 2001, tariff reduction package cut five percentage points on 1,279 tariff lines. The majority, 769 lines, had tariff rates reduced to 10 percent or below. Effective January 1, 2002, Indonesia, along with the other five original ASEAN members, implemented the final phase of the ASEAN Free Trade Agreement (AFTA). Indonesia has reduced tariffs for all products included in its original commitment (7,206 tariff lines) to five percent or less for products of at least 65 percent ASEAN origin.

By January 2003, about 70 percent of Indonesia's tariff lines were assessed import duties ranging between zero percent and five percent. Indonesia's unweighted applied tariff average is 6.9 percent, compared to 20 percent in 1994. Indonesia's average WTO bound rate is 37.1 percent. The government released a new tariff reduction package in January 2004. The new tariff book categorizes tariffs into International Non-ASEAN Tariffs and ASEAN Tariffs. Most Non-ASEAN tariffs fall into 0 percent, 5 percent, and 10 percent tiers, except for sensitive items such as automotive goods and alcohol. ASEAN tariffs fall into three tiers, 0 percent, 2.5 percent, and 5 percent, for all goods covered by the ASEAN Free Trade Agreement (AFTA).

In December 2004, Team Tariff announced the results of the first phase of its Tariff Harmonization Program. The new rates went into effect on January 1, 2005. This first phase covered 1,964 tariff lines with actual changes to 239 lines: 96 tariff increases and 143 tariff reductions. Of particular note are tariff increases for agricultural (rice, fish, chicken quarters, mangos, carrots, mandarin oranges and flowers) and ceramic products and tariff decreases for some mining related products. Indonesia's Parliament has urged the Ministry of Finance and Team Tariff to complete the second phase of the Tariff Harmonization Program, covering the remaining 9,200 tariff lines as soon as possible.

Most Indonesian tariffs are bound at 40 percent. Products for which tariff bindings exceed 40 percent, or which remain unbound include automobiles, iron, steel, and some chemical products. In the agricultural sector, 1,341 tariff lines have bindings at or above 40 percent, including the most sensitive and heavily protected sectors. In the current WTO Doha negotiations, Indonesia, as leader of the G-33, has been advocating special products exemptions from tariff reductions for rice, sugar, soybeans, and corn.

Since late 1999, rice imports have been subject to a specific tariff of 430 rupiah per kilogram (5.1 cents per kilogram or approximately 30 percent on an *ad valorem* basis). In 2004, the Indonesian government instituted bans on imports of rice, sugar and salt, and in 2005, the GOI increased import duties on corn and soybeans from zero percent to 5 percent and 10 percent, respectively.

FOREIGN TRADE BARRIERS

Local agriculture interests continue to lobby the government to increase tariff rates above the levels bound in the WTO on sensitive agricultural products, such as sugar, soybeans and corn. However, the Minister of Trade has announced plans for a comprehensive trade policy review to, among other things, identify and rectify onerous bureaucratic and ill-conceived trade policies.

Non-Tariff Barriers

During the Soeharto era, the National Logistics Agency (Bulog), previously had a monopoly on importing and distributing major bulk food commodities, such as wheat, rice, sugar, and soybeans, but now has the status of a state-owned enterprise with responsibility for maintaining stocks for distribution to military and low-income families, and for managing the country's rice stabilization program. Bulog has floated the idea of again becoming a state trading enterprise with monopoly import rights for some products, but the Indonesian government has not taken action on this proposal. Bulog is no longer entitled to draw on Bank Indonesia credit lines, a privilege it long enjoyed under the Soeharto regime, and must use commercial credit and pay import duties. In conjunction with the minimization of Bulog's authority and role, some designated private companies are now permitted to import rice, wheat, wheat flour, soybeans, garlic, and sugar.

The Indonesian government continues to maintain a ban on imports of chicken parts originally imposed in September 2000 by the Directorate General of Livestock Services in the Ministry of Agriculture (MOA). The U.S. Government has raised concerns about this issue, but the MOA continues to insist on the necessity to assure consumers that imports are halal (produced in accordance with Islamic practices). U.S. imports comply with Indonesia's established requirements for halal certification, and several ministries have unsuccessfully sought to repeal the ban. U.S. industry estimates the value of lost trade from this ban at roughly \$10 million per year.

Indonesia's government also imposes *de facto* quantitative restrictions on imports of meat and poultry products by requiring an Importer Letter of Recommendation ("Surat Rekomendasi Importir"). In approving requests for such letters, the government can arbitrarily alter the quantity allowed to enter, raising concerns that these Letters of Recommendation are being used to limit imports. U.S. industry estimates the annual trade impact of this restriction to be between \$10 million and \$25 million.

Due to the June 2005 finding in the United States of a case of Bovine Spongiform Encephalopathy (BSE) or "mad cow disease", Indonesia's MOA banned imports of U.S. meat and other ruminant products on July 1, 2005. The MOA has yet to specify what information they will need to reinstate this trade, nor has any timeline been given for when they would be ready to reconsider U.S. beef imports. U.S. beef exports had been growing rapidly and approached a record \$15 million in 2005 prior to imposition of the import ban. This action also stopped U.S. exports of the ruminant meat and bone meal, which had been valued at \$50 million annually.

Indonesia's government has imposed a rice import ban since February 2004, which was only eased somewhat in November 2005, when the Ministry of Trade issued import permits to Bulog allowing for imports of about 70,000 tons of rice. However, this decision was met with sharp criticism from other Ministries, producer groups, and Members of Parliament. Observers expect the GOI to extend the ban on rice imports through at least for the first six months of 2006. Historically, the United States has not exported significant quantities of rice to Indonesia commercially; most shipments have occurred through the P.L. 480 Title I concessional loan program.

In June 2004, the Ministry of Trade banned the importation of salt during the harvest season from July through the end of each year. Under the regulations, salt importing companies must be registered and source 50 percent of their raw materials locally. A September 2004 Ministry of Trade decree allows five companies to import sugar. It also states that the Ministry of Trade decides which companies can import sugar and how much.

The U.S. government has received reports that Indonesia's Customs Service uses a schedule of arbitrary "check prices" rather than actual transaction prices on importation documents to assess duties on food product imports. Indonesian Customs officials defend this practice by arguing it combats under-invoicing. They claim that 80 percent of all Customs applications, electronic or paper, are accepted without extraordinary review. Importers are notified, however, when an application appears to be suspicious and, if the matter is still not solved, Customs makes an assessment based on an average of the price of the same or a similar product imported during the previous 90 days. Indonesian Customs, however, does not publicize this methodology or a current list of such reference prices. As a result, although most food product import tariffs remain at five percent, the effective level of duties can be much higher. For example, industry estimates that application of arbitrary check prices adds up to \$2,000 per shipment of U.S. table grapes to Indonesia, leading to an estimated annual loss of around \$3.5 million per year in potential trade for this one product alone. The U.S. government also has received many complaints from importers about costly delays and requests for unofficial payments from a variety of actors when importing goods through Indonesian ports.

The GOI is in the process of amending the Customs Law of 1995 to provide stricter penalties on smuggling, under-invoicing and trading in prohibited goods. The proposed new law would also establish a code of ethics for customs officers and a set of penalties and incentives to punish corrupt behavior and reward good performance. The GOI hopes to enact the new law in 2006. Enforcement will be key to its ultimate effectiveness.

Other quantitative import limits apply to wines and distilled spirits. In addition to the regular import duty of 170 percent, a 10 percent VAT and 35 percent luxury tax, Indonesia's government restricts imports of alcoholic beverages to three registered importers, including one state-owned enterprise.

FOREIGN TRADE BARRIERS

In June 2005, the Ministry of Agriculture announced plans to implement a new certification and testing program for imported fruits. The U.S. Government has reviewed this proposed plan and provided comments to the GOI. The United States exports about \$30 Million to \$40 million of fruit annually to Indonesia. The regulation in its proposed form could jeopardize this trade.

Import Licensing

Indonesia's government continues to reduce the number of products subject to import restrictions and special licensing requirements. Currently, 141 tariff lines are subject to import licensing restrictions, down from 1,112 tariff lines in 1990. Alcoholic beverages, lubricants, explosives, and certain dangerous chemical compounds, among other items, are subject to these requirements.

In March 2002, the Minister of Industry and Trade issued a decree on Special Importer Identification Code Numbers (NPIK). This decree requires importers of certain product categories to apply for a special importer identity card, without which products can be detained at port. These goods include: corn, rice, soybeans, sugar, textile and related products, shoes, electronics and toys.

On October 23, 2002, the Minister of Industry and Trade issued a decree concerning Textile Import Arrangements. Only companies that have production facilities using imported fabrics as inputs for finished products, such as garments or furniture, may obtain import licenses. The United States has raised concerns that the import licensing requirements restrict and distort trade and has recommended that the decree be rescinded. Indonesia's government insists the regulations are designed to help curb smuggling. The increasing gap between GOI import statistics for 4-digit (HS) fabric items and partner country export figures for those same items, however, contradicts this assertion.

STANDARDS, TESTING, LABELING AND CERTIFICATION

In July 2000, the Indonesian government began to implement the Consumer Protection Law of 1998 by requiring registration of imported food products. Importers must apply for a registration number from the Agency for Drug and Food Control (BPOM). This has proven to be an overly complex, time consuming, and costly procedure.

All imported food products must be tested by BPOM. Some U.S. producers have expressed concerns that the extremely detailed information on product ingredients and processing they must provide may infringe upon proprietary business information. This has led some U.S. exporters to discontinue sales. It is worth noting, however, that Indonesia's government has not fully implemented these regulations, and enforcement is weak and inconsistent. If fully implemented the annual level of trade adversely affected by this requirement is estimated by U.S. industry at between \$10 million and \$25 million.

Beginning January 2001, Indonesia's regulations required labels identifying food containing "genetically engineered" ingredients and "irradiated" ingredients. However, the government has not implemented these new requirements because it has yet to establish minimum threshold-presence levels. U.S. industry estimates that the new regulation could affect sales of approximately \$411 million annually in soybeans and soybean meal from the United States. The U.S. government is closely monitoring these situations.

GOVERNMENT PROCUREMENT

Indonesia is not a party to the WTO Government Procurement Agreement (GPA). In November 2004, the GOI issued a Presidential Decree on government procurement aimed at simplifying procedures and increasing efficiency and transparency in the procurement process. However, the new rules grant some special preferences to encourage domestic sourcing and call for the maximization of local content in government projects, regardless of their source of funding. According to the decree, foreign companies are eligible to bid for government contracts as part of a joint partnership or as a subcontractor to a domestic firm, and permissible foreign participation increased from \$1 million to \$5 million. Nevertheless, regional decentralization may introduce additional barriers as local and provincial governments adopt their own procurement rules.

Bilateral or multilateral donors finance many large government contracts and often impose special procurement requirements. For large, government-funded projects, international competitive bidding practices must be followed. The Indonesian government seeks concessional financing for most procurement projects. Since late 1999, the Indonesian government has conducted audits of the state-owned electricity company (PLN), the state oil and gas company (Pertamina), and the State Logistics Agency (Bulog), which identified serious irregularities in procurement. However, no legal action has been taken with respect to these irregularities.

Foreign firms bidding on high value government-sponsored projects have been asked to purchase and export the equivalent value in selected Indonesian products. Government departments, institutes, and corporations are expected to utilize domestic goods and services to the maximum extent feasible, with the exception of foreign aid-financed procurement of goods and services. State-owned enterprises that publicly offer shares through the stock exchange are exempted from government procurement regulations. The new oil and gas upstream authority, BP Migas, regulates the import of all materials used by the oil and gas sector.

FOREIGN TRADE BARRIERS

EXPORT SUBSIDIES

In 2004, the Indonesian government ended several credit programs that offered subsidized loans to agriculture and small and medium sized businesses to support exports.

INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

Copyrights

A new copyright law came into force in July 2003, one year after it passed Parliament. The law contains a number of important provisions long sought by U.S. and Indonesian copyright holders, including provision for the issuance of an implementing regulation on optical disks (OD), criminal penalties for end-user piracy, and the ability of rights holders to seek civil injunctions against pirates. The OD regulation entered into force in October 2004. The outgoing Minister of Industry and Trade issued two ministerial decrees necessary to implement the OD regulation. These new regulations included a six-month transition grace period and became effective in April 2005. However, little has been done to properly implement the OD regulations and, despite assistance provided to the competent authorities by international organizations and trade associations, many unregistered factories with OD production capability continue to operate in Jakarta and other key cities.

The Copyright Law establishes rights to license, produce, rent or broadcast audiovisual, cinematographic, and computer software. It also provides protections for neighboring rights in sound recordings and for the producers of phonograms. It stipulates a 50-year term of protection for many copyrighted works.

The government's enforcement of copyrights is uneven. Piracy of optical media in Indonesia remains widespread, undermining the sale and rental of legitimate products. The GOI regularly consults with copyright holders and associations. Periodic raids result in the seizure of sizable caches of pirated optical disk products. However, none of these cases has resulted in meaningful penalties or permanent impoundment, or destruction of equipment used to manufacture pirated products. In recent years, movies on high-quality pirated digital video disks (DVDs) have become increasingly available alongside video compact disks (VCDs). According to U.S. industry estimates, total losses from copyright piracy in Indonesia during 2005 were roughly \$191.6 million.

Patents

Indonesia enacted its Patent Law on August 1, 2001. The law consolidated three previous laws covering patents, and established an independent commission to rule on patent disputes and appeals. The law transferred jurisdiction over IPR civil cases to the Commercial Court from the District Court, and raised the maximum fine for patent violations to Rp 500 million (\$60,000). The term of protection remains 20 years with a possible two-year extension. A patent is subject to cancellation only in the event the patent holder fails to pay annual fees within specified periods. Unauthorized use of a product or process invention that is the subject of a pending application constitutes patent infringement.

FOREIGN TRADE BARRIERS

Despite these measures, Indonesia continues to suffer from a lack of effective enforcement of patent rights. The patent law does not address some of the weaknesses that concern foreign rights holders. Chief among these is the requirement that an inventor must physically produce a product or utilize a process in Indonesia in order to obtain a patent for the product or process. The standard for excluding inventions contrary to the public interest from patentability appears broader than the standards enumerated in the TRIPS Agreement.

Trademarks

Indonesia enacted its trademark law on August 1, 2001. The law raised the maximum fine for criminal trademark violations to Rp 1 billion (\$120,000), and slightly reduced the maximum possible prison term. The government justified this move by claiming that financial penalties were a greater deterrent to IPR violators than imprisonment. Foreign rights holders, arguing that most IPR cases never result in the maximum sentence, had pushed for minimum sentencing guidelines rather than higher fines.

The trademark law provides for the determination of trademark rights by priority of registration, rather than by priority of commercial use. The law also provides for the protection of well-known marks, but offers no administrative procedures or legal grounds under which legitimate owners of well-known marks can cancel pre-existing registrations. Indonesia's trademark officials' requirement that all trademark modifications be registered raises concerns under the TRIPS Agreement and the Paris Convention. Currently, the only avenue for challenging existing trademark registrations in Indonesia is through the courts, an often-burdensome undertaking that must be initiated within five years from the date of the disputed registration. Faster processing (within 180 days) of trademark cases by the Commercial Courts has provided relief to some trademark holders. However, industry representatives had hoped courts additionally would impose injunctions, especially in cases where a lower court eventually invalidates a false trademark registration.

SERVICES BARRIERS

Despite relaxation of some restrictions, trade barriers to services continue to exist in many sectors.

Legal Services

A few local law firms currently dominate the legal market, and foreign law firms cannot operate directly in Indonesia. A foreign law firm seeking to enter the market must establish a relationship with a local firm. In order to practice, all lawyers must hold Indonesian citizenship and a degree from an Indonesian legal facility or other recognized institution. Foreign lawyers can only work in Indonesia as "legal consultants" and must first obtain the approval of the Ministry of Justice and Human Rights.

FOREIGN TRADE BARRIERS

Distribution

In 1998-99, Indonesia liberalized portions of the distribution services sector under the terms of its agreements with the IMF. The Indonesian government eliminated restrictive marketing arrangements for cement, paper, plywood, cloves and other spices. Indonesia has opened the wholesale and retail trade sectors to foreign investment. Indonesia allows up to 100 percent foreign equity in the distribution and retail sectors, with the condition that the investor enter into a “partnership agreement” with a small-scale Indonesian enterprise. This partnership agreement need not involve an equity stake in the project.

In the energy sector, Indonesia passed an Oil and Gas Law, in November 2001, to deregulate the downstream oil and gas sectors, which includes refining, distribution, storage and retail activities. Under the law, the state oil and gas company Pertamina was converted into a limited liability company (Regulation No. 31/2003) and ended its public service obligation (PSO) two years after passage of the law. The law also stipulates the formation of a new Oil and Gas Downstream Business Regulating Board (Badan Pengatur Kegiatan Usaha Hilir Migas, or BPH Migas) that effectively took control of Pertamina’s former regulatory function over the downstream industry. Although the day-to-day activities of the board must still be defined through implementing regulations, BPH Migas is an independent government institution that reports directly to the President. Its primary functions include regulating the supply and distribution of oil fuel, allocating sufficient fuel oil to meet national fuel oil reserves, stipulating conditions on fuel oil transportation and storage, setting tariffs for natural gas pipeline use, setting the price of natural gas for households and small consumers, and regulating the transmission and distribution of natural gas. The downstream sector is further regulated with President Regulation No. 46/2004 on Oil and Gas Downstream Activities, issued October 14, 2004, which outlines the general procedures, activities and licenses for downstream activities.

The GOI has postponed removal of Pertamina’s PSO until December 31, 2006. In October 2005, Shell was the first private investor to open a non-Pertamina retail fuel station in Indonesia. About 25 local and international investors, including Malaysia’s national oil and gas company Petronas, are reported to have obtained initial licenses for downstream operation.

Financial Services

While Indonesia allows 100 percent foreign ownership of Indonesian banks, the banking sector is still subject to many restrictions. The minimum paid-in capital requirement for multifinance companies was previously regulated by Minister Decree number 488/2000, which included capital requirements of Rp 5 billion for domestic companies and Rp 10 billion for companies with a foreign joint venture partner. However, in 2002, Indonesia issued Minister Decree number 172/2002, which changed the minimum paid-in capital requirement to Rp 10 billion for both domestic and joint venture companies.

Accounting Services

Foreign firms cannot practice under international firms' names, although terms such as "in association with" are permissible. Foreign accounting firms must operate through technical assistance arrangements with local firms. Foreign agents and auditors may act only as consultants and cannot sign audit reports. Licensed accountants must hold Indonesian citizenship.

Audio-Visual

There is a ban on all foreign investment in media businesses, including cinema construction or operation, video distribution and broadcast services. Foreign investment is prohibited in broadcast and media sectors, including the film industry (film making, film technical service providers and movie house operations). The decrees also prohibit foreign investment in the provision of radio and television broadcasting services, radio and television broadcasting subscription services and media print information services.

Construction, Architecture and Engineering

Foreign consultants working under government contract are subject to government billing rates. Foreign construction firms are only permitted to be subcontractors or advisors to local firms in areas where the government believes that a local firm is unable to do the work. In addition, for government-financed projects, foreign companies must form joint ventures with local firms.

Telecommunications Services

In all but basic services delivery, the GOI has recently made progress in making the telecommunications playing field more transparent and competitive. Today, there is very little that would impede a foreign investor from coming into the Indonesian value-added telecommunications market. However, the requirement that a foreign satellite operator must have an Indonesian partner perpetuates inefficiency, raises costs to Indonesian consumers, and constitutes a serious trade barrier.

Indonesia formed a telecommunications regulatory body in July 2004 to improve transparency in regulation development and dispute resolution. To date, this body has been largely inactive and the Ministry of Communication and Information has been more effective in pushing through sector reforms.

The provisions of Indonesia's Telecommunications Law 36, which came into force in 2000, have guided reforms to end monopolies and open basic telecommunications services to majority foreign ownership. Telecommunications Law 36 lays out goals that exceed many of the modest commitments Indonesia agreed to under the WTO Basic Telecommunications Agreement (maximum foreign investment limit of 35 percent for telecommunications services companies) and the WTO Pro-Competition Annex in 1997 (transparent regulatory procedures, nondiscriminatory licensing, and competitive safeguards for companies operating in Indonesian markets).

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In 2002, subsequent implementing regulations for Telecommunications Law 36 established conditions for a new policy of duopoly and accelerated reforms. The government ended the exclusive rights of PT Telkom for domestic long distance service and local fixed-line service in August 2003 and of PT Indosat and Satelindo for international calling service in 2003. Instead, PT Telkom and PT Indosat were established as Indonesia's only full service providers, a move that ensured PT Telkom's survival in the face of increasing competition from Voice-Internet Protocol (VIP) services. Since 2002, however, PT Telkom has focused most investment in the value-added cellular market and added very few new lines to remote areas. Although homes and businesses in Indonesia that are wired enjoy world class telecommunications services, only 5 percent of homes have even basic connectivity.

Telecommunications Law 36 removed previous requirements that prospective foreign investors partner or enter into a revenue-sharing arrangement with a state-owned enterprise. In January 2002, to attract investors, the government committed to raise telephone tariffs each year for three years to achieve market levels. Popular resistance, however, prevented the second round of price increases in 2003. Indonesia has undertaken partial privatization of its telecommunications companies. In July 2002, government ownership of PT Telkom was reduced to 51 percent, after a public offering of 3.1 percent. In December the same year, the government reduced its ownership of PT Indosat to 15 percent, after it sold 41.9 percent to Singapore Technologies Telemedia.

Despite the liberalization that Indonesia has implemented, the government has yet to submit a revised telecommunications offer in the Doha Development negotiations in the WTO.

INVESTMENT BARRIERS

The Yudhoyono Administration has made improving Indonesia's investment climate a priority and has focused its reform agenda first on revising investment, tax, customs and labor laws; undertaking an effective anti-corruption campaign; and laying the foundation for judicial and civil service reform.

A World Bank study found that it takes on average 151 days to establish a business in Indonesia. Foreign direct investment (FDI) declined sharply after the 1997-98 financial crisis, but realized foreign investments topped \$1 billion in 2004, a sign that investor confidence is on the mend. Government approvals for investment proposals reached \$10.3 billion in 2004, compared to \$14.6 billion in 2003 and \$9.8 billion in 2002. Investment proposals from Asia, North American and Europe – traditionally large investors – declined from 2002. Most of this proposed investment is never realized.

On January 1, 2001, Indonesia began to implement a large-scale decentralization of authority and budget control from the central government to the provincial and district-level governments. Differences of opinion between the central and local governments about who has authority on certain issues has added to the level of uncertainty facing foreign investors. In many areas, despite being contrary to Indonesian law, local governments have instituted trade distorting, revenue-raising measures ("retribusi").

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In an effort to help alleviate this problem, under proposed revisions to the law, local governments would be granted the authority to tax based upon a “positive” list indicating affirmative local authority, rather than a “negative” list indicating areas where the central government retains authority.

Decentralization has complicated government efforts to improve Indonesia’s investment climate and reduce burdensome bureaucratic procedures and other requirements on foreign investors. Indonesian law provides for both 100 percent FDI projects and joint ventures with a minimum Indonesian equity of five percent. Currently, Indonesia’s Investment Coordinating Board (BKPM) and other relevant agencies in certain sectors must approve proposed foreign investments, but under the new Investment Law proposed by the Yudhoyono Administration and being debated in Parliament,, Indonesia would move from an investment approval to an investment registration system and BKPM’s new mission would be investment promotion.

Indonesia blocks or restricts foreign investment in some sectors in addition to those service sectors mentioned above. These restricted sectors are included in the “negative list.” The most recent version, issued in August 2000, is based on Presidential Decree 96, which opened some sectors, particularly certain medical services, to foreign investment. Yet other sectors remain closed to foreign investment, such as casino and gaming facilities, air traffic and marine vessel certification and classification systems, and radio frequencies. However, various infrastructures, airline, medical services, marine and fisheries, industrial, and other trade sectors are open to investment subject to joint venture or other conditions. One aim of the proposed new investment law is to provide greater clarity on which sectors are closed and which sectors are open to foreign investment.

ELECTRONIC COMMERCE

Despite the proliferation of Internet service providers in recent years, several factors hinder the growth of electronic commerce in Indonesia. These include the lack of a clear policy in support of an open telecommunications infrastructure, monopoly provision of fixed landline service by PT Telkom, a low level of computer ownership by both businesses and individuals, lack of funding and weak IPR protection. U.S. industry has identified the lack of a legal framework for ensuring security of online transactions as a particularly significant impediment. Indonesia’s government completed drafting of cyber crime and electronic transactions legislation in September 2005 and the measures are currently being debated in the legislature.

OTHER BARRIERS

Transparency

Corruption has been endemic, and remains an enormous problem for foreign companies. According to a January 2005 World Bank study, the costs associated with crime, corruption, regulation, unreliable infrastructure and poor contract enforcement can amount to 20 percent of a firm’s sales in Indonesia. A University of Indonesia August 2005 survey found that bribes account for an average of 1.8 percent of a firm’s production costs. Companies continue to be concerned about demands for irregular fees to obtain required permits or licenses, and

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government awards of contracts and concessions based on personal relationships. Legal uncertainty is also a frequent complaint, and courts at several levels are perceived as inefficient and corrupt. Tax and customs administration in Indonesia, while improving, are still viewed by the business community as widely corrupt and arbitrary.

President Yudhoyono has stated repeatedly that eliminating corruption is one of his Administration's top priorities. The President has established and empowered several institutions to fight corruption. The Anti-Corruption Commission, established in 2003, had close to 200 investigators and other personnel in 2005. The media has joined the effort to expose graft, and investigators are more aggressively pursuing cases. Several corruption probes have led to investigations, indictments and/or convictions of election commission members, a number of governors, Supreme Court justices, the president of the largest bank in Indonesia, and senior police officials. In 2005, President Yudhoyono appointed new officials as Attorney General and Chief of Police and expressed public support for key officials in visible anti-corruption positions. The Supreme Audit Board (BPK) and the Financial Intelligence Unit (PPATK) are building capacity to fight corruption with help from the U.S. Government and other donors. While the Administration's efforts are beginning to produce results, major challenges remain as it is a complex task to make improvements among relevant key personnel. This includes government officials at all levels, auditors, police, prosecutors, judges, and the military. Civil service reform, including better salaries and codes of conduct for all public officials, is a significant policy and budget challenge.

Automotive Policies

The maximum tariff on automobiles is 80 percent. Tariffs on passenger car kits imported for assembly are 25 percent, 35 percent, 40 percent, or 50 percent depending on engine size. Tariffs on non-passenger car kits are a uniform 25 percent. Tariffs on auto components and parts imported for local assembly of passenger cars and minivans are a uniform rate of 15 percent. Imports of motor vehicles are no longer restricted to registered importers or sole agents of foreign automakers, but are open to any licensed general importer. U.S. motorcycle manufacturers are concerned about the high tariff of 60 percent (25 percent on knockdown kits), the luxury tax of 75 percent, as well as the prohibition on motorcycle traffic on tollways as barriers to the Indonesian market.

The luxury sales tax on 4,000cc sedans and 4x4 Jeeps or vans is 75 percent. The luxury tax on automobiles with engine capacity between 1,500cc and 3,000cc ranges from 20 percent to 40 percent, depending on the size of the engine. The December 2000 decision to restructure the way luxury sales taxes are imposed on motor vehicles had a significant negative impact on the automotive market, since 65 percent of the market share belongs to automobiles with engine sizes between 1,500cc and 3,000cc.

ISRAEL

TRADE SUMMARY

The U.S. goods trade deficit with Israel was \$7.1 billion in 2005, an increase of \$1.8 billion from \$5.4 billion in 2004. U.S. goods exports in 2005 were \$9.7 billion, up 6.1 percent from the previous year. Corresponding U.S. imports from Israel were \$16.9 billion, up 16.0 percent. Israel is currently the 19th largest export market for U.S. goods.

U.S. exports of private commercial services (i.e., excluding military and government) to Israel were \$2.6 billion in 2004 (latest data available), and U.S. imports were \$2.2 billion. Sales of services in Israel by majority U.S.-owned affiliates were not available in 2003 (\$604 million in 2002), while sales of services in the United States by majority Israel-owned firms were \$234 million in 2003 (latest data available).

The stock of U.S. foreign direct investment (FDI) in Israel in 2004 was \$6.8 billion, down from \$7.0 billion in 2003. U.S. FDI in Israel is concentrated largely in the manufacturing sector.

The United States-Israel Free Trade Area Agreement

Under the United States-Israel Free Trade Area Agreement (FTA), signed in 1985, the United States and Israel agreed to phased tariff reductions culminating in the complete elimination of duties on all products by 1995. Most tariffs between the United States and Israel have been eliminated as agreed, although tariff and non-tariff barriers continue to affect a certain portion of U.S. agricultural exports.

To temporarily and partially address the differing views between the two countries over how the U.S.-Israel FTA applies to trade in agricultural products, in 1996 the United States and Israel signed an Agreement on Trade in Agricultural Products, establishing a program of gradual and steady market access liberalization for food and agricultural products effective through December 31, 2001. Negotiation and implementation of a new agricultural agreement was successfully completed in 2004. The new agreement is effective through December 31, 2008, and provides improved access for select U.S. agricultural products. The agreement provides U.S. food and agricultural products access to the Israeli market under one of three different categories: unlimited duty-free access; duty-free tariff-rate quotas (TRQs); or preferential tariffs, which are set at least 10 percent below Israel's most-favored nation (MFN) rates. The agreement also provides for annual increases in TRQs.

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IMPORT POLICIES

Tariffs

Under the 1985 FTA, the United States and Israel agreed to eliminate duties on all products by January 1, 1995, the end of the implementation period. Israel removed duties on U.S. non-agricultural products according to the FTA schedule, but substantial tariffs remain on some U.S. agricultural products.

Agriculture

Market Access: Approximately 90 percent of U.S. agricultural exports (by value) enter Israel duty- and quota-free as a result of Israel's implementation of commitments under the WTO, the FTA, and the 2004 Agricultural Agreement. However, remaining U.S. agricultural exports, consisting largely of consumer-oriented goods, face restrictions such as a complicated tariff-rate quota system and high tariffs. In addition, the ability of U.S. exporters to utilize available quota volumes can be hampered by problems with the administration and transparency of Israel's TRQs. TRQ-related problems include a lack of data on quota fill rates and license allocation issues such as small non-commercially viable quota quantities and administrative difficulties in obtaining licenses for within quota imports. Under the 2004 Agricultural Agreement, the Israeli government committed to taking steps to improve the administration of TRQs, including engaging in regular bilateral consultations.

Restrictions remain on other U.S. agricultural exports, including high value goods that are important to the Israeli agricultural sector such as dairy products, fresh fruits, fresh vegetables, almonds, wine, and some processed foods. According to industry estimates, elimination of levies on processed foods could result in increased sales by U.S. companies, with appropriate market development efforts, in the range of \$25 million to \$50 million. Removal of quotas and levies on dried fruits could result in increases in sales by U.S. exporters of up to \$10 million. U.S. growers of apples, pears, cherries and stone fruits estimate that elimination of Israeli trade barriers would lead to an increase of \$5 million to \$25 million in export sales of these products. It is estimated that free trade in agriculture could result in U.S. almond exports growing by as much as \$10 million.

Meat Imports and Kosher Certification: Israel prohibits the importation of any meat or meat product that is not certified as kosher by Israel's chief rabbinate, a policy that presents significant challenges for U.S. meat exporters. There is strong demand in Israel for quality kosher beef. However, the process for granting kosher certificates is expensive and complex. In 2002, the U.S. meat industry and the two governments attempted to develop steps to facilitate U.S. compliance with Israel's kosher requirements. Unfortunately, these efforts were unsuccessful. Industry estimates that kosher certification for U.S. meat could result in an annual increase in U.S. meat exports of \$15 million in the medium term and more than \$25 million in the long-term. In addition, work on an agreement on veterinary certificates of health for live animal imports was suspended after the announcement of the discovery of a single U.S. case of Bovine Spongiform Encephalopathy (BSE) involving an imported animal. The Israeli government has

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engaged in regular consultations with the U.S. Department of Agriculture to alleviate any remaining concerns, but the ban remains in effect.

Israel permits the domestic production and marketing of non-kosher meat, but bans its importation. The ban on the import of non-kosher meat raises questions in terms of the 1985 FTA requirement that any religious-based restrictions be applied in accordance with the principle of national treatment. U.S. firms estimate that elimination of the prohibition on non-kosher imports could result in increased sales of up to \$10 million.

Wine Imports: The 2004 Agricultural Agreement for the first time grants U.S. wine exporters an annual tariff-rate quota of 200,000 liters of wine. In addition, U.S. exports in excess of the quota limit are charged with a tariff lower than Israel's MFN rate. However, other impediments to U.S. wine exports remain. Wine importers note that the Government of Israel (GOI) does not require Israeli wine producers to follow the detailed labeling requirements of the official Israel Standard for Wine, while these rules are strictly enforced on imported wines.

Rabbinical regulations for kosher certification also pose challenges for U.S. and other foreign wine exporters. For example, rabbinical regulations do not permit use of the same company name on kosher and non-kosher wines. To keep their kosher certification, importers of kosher wines are not permitted to import non-kosher wines. Kosher wines cannot be stored in the same warehouse as non-kosher wines.

Sales of U.S. wines to Israel are about \$700,000 per year. The industry estimates that the elimination of trade barriers could result in increased exports worth up to \$10 million per year.

Agricultural Labeling Requirements: Imported food products face rigid labeling requirements. For many products, the labeling required by Israel is far more detailed than that required in the United States. The cost of additional labeling has acted as a deterrent for many U.S. companies that have considered marketing their products in Israel. The loss of sales of American products is difficult to estimate due to the variety of products affected by these regulations.

The Israeli government has adopted licensing requirements for products based on their classification as sensitive or non-sensitive. Importers of those products that are classified as sensitive due to their potential impact on public health, such as those containing bleached wheat flour and non-FDA regulated food supplements, have increasingly experienced difficulties and increased costs in obtaining these licenses.

Customs Procedures

Some U.S. exporters have reported difficulties in claiming preferences under the FTA. Israeli concerns about the U.S. methods for issuing certificates of origin have sometimes delayed entry of, or delayed preferential tariff treatment for, U.S. goods entering Israel.

Purchase Taxes

The GOI reduced the value added tax (VAT) rate from 17 percent to 16.5 percent in the fall of 2005. It also announced its intention to lower the VAT to 16 percent by the end of 2006. The import tax on new automobiles will be lowered from the current rate of 95 percent to 72 percent by 2010.

Textiles

Israel restricts imports of used clothing and bans the importation of seconds fabrics. There has been an increased enforcement effort by the Israeli Customs Authority regarding its inspection of textile products entering Israel for which FTA preferential treatment is claimed.

STANDARDS, TESTING, LABELING AND CERTIFICATION

Technical standards pose a prominent non-tariff barrier limiting U.S. exporters' access to the Israeli market. Since 1999, Israeli law has mandated that the Standards Institution of Israel (SII) adopt multiple international technical standards whenever possible. However, the SII has not implemented this requirement. In addition, SII's formal process for adopting or developing technical standards appears to be a significant market access obstacle to U.S. exporters, despite concerted U.S. Government efforts to address issues of access and transparency. Moreover, each government ministry may adopt additional mandatory regulations that can prevent the importation of U.S.-made products and services to Israel. This procedure has created difficulties for U.S. exporters who contend that transparency and due process are frequently lacking, most notably for food imports. In addition, U.S. industry has said that requirements for technical standards are often not uniformly enforced. In some instances, domestic products appear to have an advantage over imports because enforcement of standards on domestic producers has been inconsistent, while standards requirements are more strictly enforced with respect to imported goods. U.S. companies that have been doing business in Israel for many years are increasingly confronted with new, often EU-based, standards that arbitrarily discriminate against U.S. products. In addition, the SII will not recognize U.S. testing or accreditation of electrical components and products unless the product undergoes additional and often costly tests in Israel.

The U.S. Embassy has established a four party committee to address standards issues that prevent American companies from exporting to Israel. The Committee includes representatives of the U.S. Embassy, the Israel-American Chamber of Commerce, the Commissioner of Standards, and the SII. American companies that face export problems may submit their cases for review. This system has been somewhat effective in obtaining individual waivers for companies. However, SII has not always provided the waivers that it said would be forthcoming. In one case, an American company that was promised such a waiver is still waiting for the official waiver eight months after it was expected. In addition, the SII has not implemented a "timeline" that the four party committee established in order to assure timely responses. The United States is pressing for a more systematic solution to prevent the loss of market access for American companies.

GOVERNMENT PROCUREMENT

Israel is a signatory to the WTO Agreement on Government Procurement (GPA), which covers most Israeli government entities and government-owned corporations. Most of the country's open international public tenders are published in the local press. However, government-owned corporations make extensive use of selective tendering procedures. In addition, the lack of transparency in the public procurement process discourages U.S. companies from participating in major projects and disadvantages those that choose to compete. Enforcement of the public procurement laws and regulations is not consistent. Poor design and unfair management of public tenders discourages U.S. bidders.

Israel also has offset requirements that it implements through international cooperation (IC) agreements. Under IC agreements, foreign companies offset their earnings from sales to the Government of Israel by agreeing to invest in local industry, co-develop or co-produce, subcontract to local companies, or purchase from Israeli industry. The IC offset percentage for industries covered by Israel's WTO GPA obligations through the end of 2005 was 30 percent of the value of the contract; for industries excluded from GPA coverage, including most military procurements, the offset is 35 percent. In late 2005, Israel agreed to reduce the level of its offsets to 28 percent on January 1, 2006, and to offer compensatory adjustments in the form of expanded coverage of services and to reduce its threshold for construction services from 8.5 million SDRs to 5 million SDRs, which is the threshold that most other GPA Parties apply. Israel also agreed to negotiate a schedule for the reduction of its offsets in the market access negotiations that will be conducted in 2006 under the GPA.

U.S. suppliers have found the size and nature of their IC proposals to be a decisive factor in close tender competitions, despite a court decision that prohibits the use of offset proposals in determining the award of a bid. Small and medium-sized U.S. exporters are often reluctant to commit to make purchases in Israel in order to comply with the IC requirements and refrain from participation in GOI tenders.

In addition, the inclusion of unlimited liability clauses in many government tenders discourages American firms from competing. When faced with the possibility of millions of dollars in legal costs for unforeseeable problems resulting from a government contract, most American firms are forced to insure against the risk, which raises their overall bid price, and reduces their competitiveness.

For civilian local currency procurement by the Ministry of Defense (MOD), a United States-Israeli Memorandum of Understanding (MOU), extended in 1997, gives U.S. competitors equal status with domestic suppliers. This MOU applies to procurements that are not connected with U.S. military assistance programs. Despite this MOU, U.S. suppliers have expressed concern about the lack of transparency and apparent lack of justification for excluding U.S. suppliers from many MOD tendering opportunities. The MOU, which has had a favorable effect on the Israeli defense industries by opening up the U.S. market to their products, has not resulted in an open market for U.S. suppliers competing on MOD's local currency procurements. Efforts by U.S. manufacturers or their agents to win military tenders to supply food continue to fail.

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INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

Israel is a member of the WTO and the World Intellectual Property Organization (WIPO). It is a signatory to the Berne Convention for the Protection of Literary and Artistic Works, the Universal Copyright Convention, the Paris Convention for the Protection of Industrial Property, and the Patent Cooperation Treaty. Israel was obligated to implement the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) by January 1, 2000. The United States continues to encourage Israel to accede to the WIPO Copyright Treaty and the WIPO Performance and Phonograms Treaty (commonly known as the WIPO Internet Treaties), particularly in view of the importance of Israel's high-technology software and telecommunication industries.

In April 2005, Israel adopted limited data exclusivity legislation that provided some new protection from unfair commercial use of the confidential test data of pharmaceutical firms. However, these data exclusivity provisions provide data protection periods that fall far short of the periods provided in OECD-level economies, as well as other countries in the Middle East. Furthermore, even during these truncated periods of protection, generic companies are permitted to rely on the undisclosed test data of U.S. companies to get approvals for the export of the generic product. Research and development, as well as clinical trial expenditures made by international pharmaceutical companies, have fallen in recent years as these companies have moved these activities to countries with more favorable data protection regimes.

In December 2005, the Israeli government passed legislation that curtailed existing pharmaceutical patent term adjustments granted to compensate for delays in obtaining regulatory approval of a drug. This legislation further weakened the protection for intellectual property of research-based pharmaceutical companies in Israel. The new legislation references a group of 31 countries (Australia, the United States, Iceland, Japan, Norway, Switzerland and the 25 countries of the EU) in determining the length of patent term extension. In addition, the legislation creates numerous bureaucratic obstacles for patent holders who wish to apply for a patent term extension. The legislation also applies retroactively to all pending applications for patent term extensions and already granted patent term extensions.

As a result of the deficiencies of the data exclusivity legislation and the prospect of passage of the patent term extension legislation, Israel was placed in April 2005 on the Special 301 "Priority Watch List". The U.S. Government continues to urge the Israeli government and the Knesset to take steps that will provide a reasonable period of non-reliance on confidential data and periods of patent term extension similar to that granted in OECD countries.

Israel has increased its budgetary, educational, police, and judicial resources devoted to the enforcement of the country's copyright and trademark laws. In addition, Israel passed amendments to its copyright laws that should make it easier for law enforcement officials, prosecutors, and judges to pursue, prosecute, and punish copyright crimes. In 2005, U.S. industry estimated the loss due to inadequate intellectual property protection for motion pictures, records and music, business software, entertainment software and books to be \$154 million.

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In 2005, the Government of Israel introduced in the Knesset new draft legislation to update and consolidate the country's copyright laws. This legislation may result in the exclusion of end-user piracy from criminal liability, a step that may lead to weaker protection for business software. In addition, a separate law concerning writable media threatens to legalize the downloading of protected content from the Internet, and to compensate rights holders through a tax on the media itself. In October 2004, the Government of Israel assured the United States that it would continue to provide U.S. music rights-holders' with national treatment protection. However, the language of the 2005 copyright legislation indicates that foreign right holders will not be compensated for the public performance of phonographic recordings. The United States is closely tracking these developments and working to assure that Israel fulfills its commitment to accord national treatment to U.S. music rights-holders consistent with a 1953 U.S.-Israel bilateral treaty and Israel's assurances of October 2004.

SERVICES BARRIERS

Audiovisual and Communications Services

Israel has made progress in liberalizing its telecommunications sector. Foreign companies are now able to participate in joint ventures providing cellular and international telephone service, direct home broadcasting satellite services, cable television, and Internet service. Israel officially opened domestic telephone service to domestic and foreign competition in 2000. Also, the Israeli government recently approved the use of wireless technologies, such as Bluetooth devices and WiFi (802.11) devices. In October 2005, the Israeli government sold its controlling interest in the Bezeq Group, the state-owned telecommunications company, to a group of private investors.

In 2001, Bezeq received a license to provide high speed Internet service with the condition that it permits other Internet service providers to have access to its infrastructure. The Knesset amended the telecommunications law to permit cable television providers (including firms with U.S. ownership) to provide high-speed Internet and other telecommunications services.

The international telephone market in Israel expanded in 2004, with two of the Internet companies -- Netvision and Internet Gold Lines -- receiving licenses to provide international telephone service.

In December 2004, the Ministry of Communication (MOC) announced a plan to crack down on the use of Voice-over Internet protocol (VoIP) services. The move was a response to the successful marketing of VoIP "talk cards" by unlicensed individual providers to foreign workers seeking less expensive phone calls to their home countries. However, the MOC has yet to formally announce their plans for preventing the circumvention of the licensing regime without interfering with the use of VoIP by legitimate Internet service providers.

Only selected private Israeli television channels are allowed to advertise. These channels received broadcast licenses and the advertising privilege in exchange for certain investment commitments. Israeli law largely prohibits other channels, both public and private, from advertising. The government funds the country's public channels, whereas the remaining private channels generate revenues via subscription fees. In 2002, the Israeli government developed

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regulations that allow foreign channels aired through the country's cable and satellite networks to broadcast a limited amount of advertising aimed at a domestic Israeli audience. Currently, the regulations allow foreign channels to use up to 25 percent of their total advertising time to target the Israeli market. The regulations allow a foreign channel to apply for more than 25 percent advertising time if the channel can prove that it has a sizable viewing audience outside of Israel. The U.S. Government is concerned that these restrictions on advertising will inhibit the economic viability of U.S. firms participating in the Israeli broadcasting sector.

INVESTMENT BARRIERS

The Israeli government actively solicits foreign private investment, including joint ventures, especially in industries involving exports, tourism, telecommunications, and high technology. Foreign firms are accorded national treatment in terms of taxation and labor relations, and are eligible for incentives for designated "approved" investments in priority development zones. There are generally no foreign ownership restrictions, but the foreign entity must be registered in Israel. Investments in regulated sectors, including electronic commerce, banking, insurance, and defense industries, require prior government approval in Israel. Profits, dividends, and rents generally can be repatriated from Israel without difficulty through a licensed bank.

Numerous U.S. companies have subsidiaries in Israel. Israel is a member of the International Centre for Settlement of Investment Disputes (ICSID) and a party to the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards.

The Bachar capital market reforms, which were adopted by the Knesset in July 2005, seek to increase competition and prevent conflicts of interest in the highly concentrated banking sector. The government must determine allowable charges for asset sales before the Bachar reforms can be implemented. Once implemented, the reforms should increase access and opportunities to the banking sector for U.S. and other foreign firms.

A key element of the Bachar reforms includes gradually removing from the banks' ownership and management of the Provident funds, which are private retirement funds and mutual funds. In return, banks will be able to enter the insurance market and sell life insurance.

ELECTRONIC COMMERCE

U.S. industry has not reported any barriers to electronic commerce in Israel. Israel still lacks a clear body of regulations and tax laws covering electronic commerce transactions. In August 2000, an Electronic Signature Bill was passed to regulate signatures on electronic media. Loopholes in the laws dictate that a consumer can decline to pay for any merchandise for which they did not physically sign, which serves as a disincentive to the establishment of online businesses. The Ministry of Justice maintains a register of authorizing entities to issue electronic certificates attesting to the signature of the sender of an electronic message. Also under their jurisdiction is the Registrar of Data Bases, which by law must issue licenses to any firm or individual holding a client database. This measure is designed to protect personal information from unwanted third-party intrusion.

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JAPAN

TRADE SUMMARY

The U.S. goods trade deficit with Japan was \$82.7 billion in 2005, an increase of \$7.1 billion from \$75.6 billion in 2004. U.S. goods exports in 2005 were \$55.4 billion, up 2.2 percent from the previous year. Corresponding U.S. imports from Japan were \$138.1 billion, up 6.4 percent. Japan is currently the 3rd largest export market for U.S. goods.

U.S. exports of private commercial services (i.e., excluding military and government) to Japan were \$35.2 billion in 2004 (latest data available), and U.S. imports were \$19.6 billion. Sales of services in Japan by majority U.S.-owned affiliates were \$43.7 billion in 2003 (latest data available), while sales of services in the United States by majority Japan-owned firms were \$22.7 billion.

The stock of U.S. foreign direct investment (FDI) in Japan in 2004 was \$80.2 billion, up from \$68.1 billion in 2003. U.S. FDI in Japan is concentrated largely in the finance, and manufacturing sectors.

REGULATORY REFORM OVERVIEW

While Japan has made significant progress on regulatory and structural reform over the years, more needs to be done to ensure Japan's economy remains on a growth trajectory and to expand opportunities for U.S. companies doing business in the Japanese marketplace. The United States therefore welcomes Prime Minister Koizumi's unwavering commitment to a meaningful economic reform agenda. Onerous regulations, however, continue to hamper commerce in Japan. The United States puts a high priority on efforts to achieve meaningful regulatory and structural reform.

The U.S.-Japan Regulatory Reform and Competition Policy Initiative

The Regulatory Reform and Competition Policy Initiative (Regulatory Reform Initiative) is one of the chief vehicles the United States uses to engage Japan on economic reform. The Initiative is one of six components of the U.S.-Japan Economic Partnership for Growth (Partnership), which President Bush and Prime Minister Koizumi launched in 2001. This Initiative addresses key sectors, including telecommunications, information technologies, energy, medical devices and pharmaceuticals, financial services, and agriculture. It also addresses crosscutting sectoral issues, including competition policy, transparency, privatization, legal system reform, revision of Japan's commercial law, and distribution. Through the Regulatory Reform Initiative, the United States continues to advocate the reform of laws, regulations, administrative guidance and other measures, formal and informal, that impede access to the Japanese market for U.S. goods and services.

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The Fourth Report to the Leaders under the Regulatory Reform Initiative details progress achieved over the past year. Building on this progress, the United States kicked off the fifth year of the Initiative by submitting to Japan in December 2005 its recommendations to be discussed between the two governments in the coming months. The first such round of discussions occurred in Japan in late 2005 and early 2006 at the working group level. After convening another round of working group meetings and a high-level meeting in the spring of 2006, the two governments intend to conclude a Fifth Report to the Leaders in the summer of 2006.

SECTORAL REGULATORY REFORM

Telecommunications

Under the Regulatory Reform Initiative, the United States continues to seek regulatory changes to promote competition, innovation, and choice in Japan's telecommunications sector. The competitive and regulatory environment in this sector has evolved over the past several years, resulting in the rollout of numerous innovative technologies and competitively priced advanced services. Through its December 2005 Regulatory Reform submission and in bilateral consultations, the United States has asked Japan to take measures to address specific market access impediments related to a wide range of policies in this sector. In addition, the United States continues to request that Japan develop a plan to move regulatory functions outside the purview of a ministerial agency, where it is subject to direct political control, to a more independent organization. It is also important for Japan to establish and exercise meaningful sanction authority by the regulator (e.g., imposition of fines, payments of damages, and license restrictions) to punish anticompetitive behavior.

Interconnection and Pricing: Japanese laws and regulations do not prevent NTT regional carriers from imposing high and onerous conditions on their competitors for interconnection. This is one of the most significant indications that Japan needs to improve its competitive safeguards with respect to dominant carriers. In 2005, the Ministry of Internal Affairs and Communications (MIC) implemented a more rational rate structure for wireline interconnection rates by phasing out certain fixed costs that MIC has permitted regional operators to charge competitors, a revision long sought by the United States. However, MIC's five-year transition period constitutes a disappointing delay in this much-needed rate reduction. MIC is expected to continue studying how to revise or replace the rate regime, and the United States will continue discussions with MIC to ensure that any changes will improve the competitive environment.

Dominant Carrier Regulation: NTT has worked to maintain its market dominance through a number of measures, such as denying interconnecting carriers access to emergency services and proposing higher interconnection charges for carriers competing with alternative technologies (e.g., DSL services). Despite being one of the most profitable companies in Asia, NTT is citing declining revenues as justification for an announced reorganization plan that, among other things, would consolidate wireline and wireless operations. Competitors have voiced concern that the plan would rollback the "breakup" of NTT companies in 1999 that was intended to foster competition within the NTT group.

Universal Service Program: Japan's universal service fund mechanism, which has been inactive since it was established in 2003, was revised in 2005. Doubts remain as to whether the revised fund can be considered "competitively neutral" as it is expected to benefit only the NTT regional carriers in specific high-cost areas. The United States continues to monitor whether MIC is taking sufficient steps to ensure that NTT East and NTT West will not take advantage of their dominant position to inhibit competition. This will become increasingly important as MIC reviews its competition policy in upcoming years to facilitate both wireline/wireless and broadcast/telecommunications convergence.

Mobile Termination: New entrants to Japan's telecommunications market have also expressed concern about the high access rates charged by NTT DoCoMo, the dominant wireless service provider. While DoCoMo reduced rates significantly in 2003, its rate reduction in 2005 was only 3.4 percent. Following reforms to the Telecommunications Business Law in 2001, DoCoMo was recognized as a dominant carrier in 2002, but MIC has not required DoCoMo to explain how its rates are calculated.

New Mobile Wireless Licenses: For the past twelve years, MIC limited the mobile wireless market to three main operators, including NTT DoCoMo with a market share of over 50 percent. In 2005, MIC took a significant step forward by making substantial blocks of spectrum available primarily for new wireless entrants, thereby creating opportunities not only for telecommunications companies wanting to expand into the wireless business in Japan, but also equipment suppliers to those companies. MIC pre-approved licenses for three new market entrants in October 2005, which have already attracted substantial U.S. investment to deploy new facilities. However, much work remains to be done to create a level playing field for the new market entrants, including "roaming" on incumbent networks at reasonable rates, sufficient access to towers and tower sites, and analyzing incumbents' unused spectrum to eliminate "warehousing."

Information Technologies (IT)

Since 2001, e-Japan Strategies and Programs have promoted the use of IT and e-commerce in Japan by removing regulatory barriers and increasingly emphasizing private-sector input and leadership in the development and implementation of IT and e-commerce policies. After focusing on IT infrastructure build-out earlier this decade, Japan's strategies have shifted to highlighting IT and e-commerce use. Notably, the IT Policy Package 2005 promoted the use of IT and e-commerce in areas closely related to the welfare of individual citizens and prioritized areas such as information security and e-government.

As Japan responds to the challenges that lie ahead in this pivotal sector, the U.S. Government is urging Japan to establish a regulatory framework that ensures competition, promotes innovation, protects users, allows private sector-led regulation where appropriate, and protects intellectual property rights in the digital age. The U.S. Government's recommendations in its December 2005 Regulatory Reform submission support Japan's goals by focusing on: protecting intellectual property; removing regulatory and non-regulatory barriers to e-commerce; promoting e-commerce via private-sector self-regulatory mechanisms and technologically neutral, market-driven solutions; and expanding IT procurement opportunities.

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Legal and Other Regulatory Barriers: While Japan has made great strides in promoting e-commerce and increasing the use of online processes in the private and public sectors, legal and other regulatory barriers remain that prevent Japan from fully realizing its IT potential. In its December 2005 Regulatory Reform submission, the United States urged Japan to: (1) implement its new IT Strategy in a manner that promotes private-sector leadership and self-regulation in IT and e-commerce by ensuring that any Cabinet orders, ministerial ordinances, guidelines, or other measures prepared to implement the Strategy or its policy goals also are open to public comments, a minimum period of 30 days is provided for comments, and comments received are seriously considered and reflected as appropriate in the final measures and actions that are implemented; (2) seek out a diverse range of views in any IT- and e-commerce-related government-organized study groups; (3) reaffirm the importance of private-sector leadership in IT-related standards setting; (4) ensure adherence to technology neutrality as Japan pursues implementation of proposals and policies laid out in the IT Strategic Headquarters' September 2004 "Basic Concept on IT International Policy Centered on Asia" and related sections of the IT Policy Package 2005; and (5) ensure that Japan's IT and e-commerce policies and regulations are compatible with international practice.

Personal Data Regulation (Privacy): Japan's Law on the Protection of Personal Information (Privacy Law) went into effect in April 2005. Ministries and agencies have subsequently formulated implementation guidelines to ensure the Law's effectiveness. In March 2005, Ministries from the Government of Japan participated in a seminar for U.S. and Japanese enterprises on the Privacy Law, educating over 300 participants on how to comply with the Law. In its regulatory reform recommendations this year, the United States urges Japan to ensure that: the Privacy Law is implemented in a transparent and coordinated manner; guidelines are clearly defined as mandatory or voluntary; a system is established to publish information about violations and corrective actions; and guidelines are enforced consistently and fairly. The United States commends the Ministry of Economy, Trade and Industry (METI) for conducting annual reviews of its implementation guidelines, and recommends that all Ministries conduct similar annual reviews. To further support Japan's efforts to ensure the effective implementation of the Privacy Law, the U.S. Government has recommended collaborating to ensure a successful third privacy roundtable, where the Ministries could further explain the implementation of their guidelines, as well as address industry's concerns regarding compliance and enforcement.

Online Nuisance, Deceptive Practices, and Fraud: Japan has recognized the growth and impact of malicious activity and fraud propagated on the Internet, and their corresponding threat to online behavior. The United States commends the Japanese government for amending the Law on Regulation of Transmission of Specified Electronic Mail (Anti-Spam Law) to include direct penalties, for actively analyzing issues such as spam and phishing, and for the Information Security Policy Council's (ISPC) calls to address new online threats. The United States urges Japan to: work closely with the private sector in combating spam, phishing, and other online fraud; vigorously enforce the amended Anti-Spam Law; implement any online fraud-related laws, regulations, and guidelines in a manner that strives not to unduly promote, mandate, or favor specific technologies; and work closely with the Government of the United States to share information and collaborate to best address rising issues of online fraud.

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This includes cooperating with the United States to ensure a successful anti-phishing, spam, and online fraud conference with relevant stakeholders in April 2006 to raise awareness, highlight best practices, and promote public-private partnerships to counter online hazards.

Strengthening Intellectual Property Rights (IPR) Protection: The U.S. Government's 2005 Regulatory Reform Initiative submission includes a number of recommendations to Japan intended to strengthen IPR, such as: (1) extending the term of copyright for sound recording and all other subject matter protected under Japan's Copyright Law; (2) adopting a statutory damages system that would act as a deterrent against infringing activities; and (3) actively working with the United States to develop ways to promote greater protection of intellectual property rights worldwide, especially in Asia. (See also "Intellectual Property Rights Protection" in this chapter.)

Digital IPR: Japan's liability rules for Internet Service Providers (ISPs) went into effect in May 2002, along with implementing guidelines drafted by a private sectorled working group. The United States remains concerned the liability rules are unclear, do not provide the appropriate balance among the interests of telecommunication carriers, ISPs, rights holders, and website owners, and fail to provide adequate protection for rights holders. The United States continues to urge Japan to monitor compliance with the implementing guidelines for ISP liability rules and their effectiveness for ensuring that infringing materials are removed from websites quickly and adequate remedies are provided for any injuries suffered. In regard to temporary copies, the scope of protection for such copies remains vague in Japan, which could erode the ability to protect copyrighted materials. The United States will continue to monitor developments in this area.

Network Security: The United States continues to welcome Japan's efforts to improve and ensure the security and reliability of government information systems. Japan's new National Information Security Center (NISC) affirmed the importance of private sector input in the development of new information security standards for central government entities by holding a public comment period on a draft of these standards in fall 2005 and subsequently making publicly available a summary of the main issues raised in the comments received, as well as an indication of NISC's response or actions taken. In its December 2005 Regulatory Reform submission, the United States recommended that NISC solicit input from the public on all government computer security requirements it issues, whenever possible; promote consistent implementation of minimum information security requirements by all Ministries; and ensure that procurement of IT products or services to meet Japan's government information security requirements is fair and transparent for all domestic and foreign vendors. The United States also suggested that if Japan decides to provide guidance to local governments regarding their information security standards, that Japan encourage them to use those security requirements issued by NISC for the central government to promote consistency.

Japan has also taken significant steps regarding information security in the private sector. In the Regulatory Reform Initiative Fourth Report to the Leaders, the Government of Japan recognized that voluntary best practices can be more easily revised and, therefore, it would work in conjunction with the private sector to develop and disseminate voluntary best practices for information security in the private sector during FY2005 and beyond.

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Information Systems Procurement: The U.S. Government supports Japan's information systems procurement reforms. To ensure that these reforms are producing the intended results, the United States urges the Japanese government to continue to monitor and evaluate the implementation and effectiveness of measures listed in the memorandum of agreement adopted by the Ministries in 2002 (and revised most recently in 2004) and create additional measures to strengthen the reforms. The U.S. Government welcomes Japan's efforts to disclose more complete information about procurement awards on the Internet, review rules for participation in bidding and adopt changes that increase flexibility and promote competition, and renovate government "legacy" computer systems to reduce costs and increase performance. In its December 2005 Regulatory Reform submission, the United States also encouraged Japan to enhance efforts to set clear limits on liability in procurement contracts, promote wider dissemination of the benefits of new intellectual property (IP) created through government-sponsored projects, protect rights to IP incorporated into procurement deliverables, and increase IP training for procurement officers.

Energy

Important progress continues in Japan's efforts to liberalize its electricity and natural gas markets. The United States has worked with Japan through bilateral consultations, including by sharing its own experiences, to help Japan foster improved energy efficiency, lower energy costs, and boost competition through the enhancement of new market opportunities. As of the end of 2005, approximately 63 percent of Japan's electricity market and approximately 50 percent of its natural gas market have been opened to competition. As reform and liberalization proceeds, it remains important that Japan pay careful attention to the actual market-based impacts of these reforms and that further reforms or adjustments are implemented whenever necessary to ensure that Japan's energy markets are truly competitive, efficient, and open to new market participants. The United States has also emphasized the importance of transparency, urging Japan to ensure that its regulatory processes are sufficiently open to engender the confidence of market participants and consumers alike.

Electricity: The further liberalization of Japan's electricity market in 2005 was complemented with the operational launch in the same year of two potentially important institutions: a nationwide wholesale power exchange, and a neutral transmission system organization (NSO) to set transmission and distribution rules. Japan has continued to carry through on implementing key elements of legislative reforms passed in 2003, including the abolition of the transmission rate "pancaking system" along with the introduction of a new framework for network users to pay uniform transmission rates. The United States will monitor these new developments, including the growth and vigor of participation in the new wholesale power exchange. The United States will also continue to monitor the broader evolution of Japan's reforms in this sector, including as Japan prepares to consider from 2007 further liberalization in Japan's electricity market down to smaller users (including the household level).

Natural Gas: Japan will expand the scope of competition by taking its next step in 2007 to liberalize the natural gas market to customers with an annual demand of 100,000 cubic meters. At this time, however, Japan has not yet committed to expanding retail choice down to the household level. In addition to further liberalization, Japan has taken other steps to help enhance

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the transparency and fairness of third party access to gas pipelines, including improvements in the information disclosure that companies provide to make the process for approving rates more transparent. The United States has urged Japan to take a variety of additional measures to ensure truly meaningful third-party access to Japan's natural gas infrastructure is achieved to enable smooth market entry, including measures that enhance the certainty of third-party access to liquefied natural gas (LNG) terminals.

Medical Devices and Pharmaceuticals

The United States and Japan address regulatory and reimbursement pricing issues in the medical device and pharmaceutical sectors through the Working Group on Medical Devices and Pharmaceuticals. The Working Group meets under the Regulatory Reform Initiative and the 1986 Market-Oriented, Sector-Selective (MOSS) Medical Equipment and Pharmaceutical Agreement. In these bilateral consultations, the United States focuses on ensuring that Japan's regulatory system provides faster approvals and that its reimbursement system appropriately values innovation.

The U.S. Government's top regulatory priority in the medical device and pharmaceutical sectors is faster product approvals. In this regard, the United States has welcomed the establishment in 2004 of Japan's new regulatory agency, the Pharmaceuticals and Medical Devices Agency (PMDA), which is intended to speed approvals in part by the effective use of expanded resources provided through an increase in user fees paid by product applicants. The U.S. Government therefore has urged PMDA to implement measures outlined in the November 2005 Fourth Report to the Leaders, such as meeting targets for faster product approvals. Japan has established a target of concluding by 2009 its work on approvals for 90 percent of new medical device applications and 80 percent of new drug applications within one year by 2009, and set similarly specific shorter-term targets for gradual improvements in the intervening years. The United States continues to urge Japan to attain those targets.

Since the establishment of PMDA, however, the U.S. medical device and pharmaceutical industries have reported that companies have faced significant delays in product reviews and approvals due in part to a shortage of qualified PDMA staff. The U.S. Government urges Japan to implement plans contained in the 2005 Report to the Leaders to ensure PMDA increases its resources and expertise, including recruiting qualified PDMA staff, to facilitate product reviews and safety. In its December 2005 Regulatory Reform Initiative recommendation, the United States urged Japan to take steps to enhance PMDA's ability to perform reviews.

Regarding drugs, the United States urged Japan to use performance metrics agreed upon by PMDA and the U.S. drug industry to facilitate faster drug reviews and discussions with industry on improving the review system. The United States also urged Japan to take steps to facilitate consultations with industry on drug clinical trials. Regarding medical devices, the United States recommended that Japan improve reviews of products that have undergone "partial changes" by clarifying approval procedures. The U.S. Government also is concerned about Japan's unreasonable requirements for clinical trial data provided in support of medical device applications. The United States urged Japan to require only relevant clinical trial data for medical devices.

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The U.S. Government also is concerned about the effect of revisions to Japan's Pharmaceutical Affairs Law (PAL) that took effect on April 1, 2005. One effect of the PAL revision is an increase in PMDA's responsibilities for inspections of medical device and drug factories. In the 2005 Report to the Leaders, Japan noted that overseas inspections will generally not delay the review process for approvals of new devices and drugs. The U.S. Government has urged Japan to take steps to ensure that overseas audits or factory inspections not delay approvals of new products.

As for pricing reform, the U.S. Government's top priority is to ensure that Japan's policies reward the development and introduction of innovative medical devices and pharmaceuticals. Japan has recognized that innovation can foster economic growth and improved healthcare, as noted in its so-called "Visions" policy papers, which contain plans to improve the international competitiveness of its medical device and pharmaceutical industries and markets. The United States has urged Japan to implement the Visions quickly. In 2006, the Japanese Government is expected to discuss and approve changes in its healthcare system to remedy financial problems caused by the aging of its population. The U.S. Government has been encouraging Japan to implement changes that result in both long-run cost savings and improved health. The United States has recommended that Japan fix inefficiencies in its healthcare system such as its excessively long hospital stays, which are triple the average of countries in the Organization for Economic Cooperation and Development. The U.S. Government also is urging Japan to consider the long-term benefits of reimbursement pricing systems that foster the development of innovative drugs and devices. Such policies will promote the speedy introduction of advanced products that not only help save and improve lives but help make Japan's healthcare system more efficient by precluding the need for surgeries and reducing the lengths of hospital stays.

Regarding drug reimbursement, in the 2005 Regulatory Reform Initiative Report to the Leaders, Japan noted it will allow manufacturers to make presentations on their products' effectiveness and usefulness at certain key advisory body meetings, consider all data provided by firms about their drugs when the drugs' reimbursement levels are under consideration, and recognize the differences between biologics and chemical-based drugs. In the 2005 Regulatory Reform Initiative submission, the United States urged Japan to provide industry with meaningful opportunities to express its views on changes to the reimbursement pricing system and implement on a trial basis a pricing method for new drugs that ensures the full scope of their value can be evaluated based upon data from manufacturers.

Regarding medical device reimbursement, in the 2005 Report to the Leaders, Japan noted it will recognize the value of diagnostic products when determining reimbursement pricing. In its 2005 Regulatory Reform Initiative submission, the U.S. Government proposed that Japan consult with companies affected by the "Foreign Average Price" rule for medical devices, which caps Japanese prices by linking them to lower prices abroad. That rule fails to consider the higher cost of doing business in Japan. The United States is urging Japan to use a medical device reimbursement mechanism based on market factors in Japan and to consult with companies that would be affected by the reimbursement mechanism.

Separately, Japan's 2002 Blood Law established a principle of "self-sufficiency" and included a Supply and Demand Plan that enables the Japanese government to manage supply and demand in the blood market. The United States has been urging Japan to ensure the Plan does not discriminate against foreign blood plasma products and is consistent with Japan's international trade obligations. The United States is also urging Japan to develop a reimbursement pricing system for blood products that accounts for the unique characteristics of that industry and that is not based on the pharmaceutical model. In addition, the U.S. Government has been encouraging Japan to consult fully with industry on regulatory and reimbursement pricing matters related to blood products and to apply policies and regulations in a fair and transparent manner.

Financial Services

Japan's financial sector has become increasingly integrated into the global financial system in recent years. Foreign financial institutions have made important acquisitions in securities brokerage, insurance, and banking. Consolidation among Japanese financial institutions has continued, while traditional segmentation among various types of financial institutions is steadily being phased out. These changes have expanded opportunities for foreign financial firms in Japan to compete on a clear and level playing field. While supervision and disclosure have improved, Japan must continue to move forward in establishing transparency in regulation and supervision of financial institutions in line with international standards and best practices. In 2005, the Government of Japan took the following steps to liberalize financial services and make regulation more transparent.

Securities and Exchange Law: Under a revised Securities and Exchange Law (SEL), Japan in 2005 began to allow private financial institutions, such as banks and insurance companies, to engage in securities businesses. SEL amendments, which went into force April 1, 2005, include the introduction of a system of fines to combat unfair trading practices and revisions of the law governing paperless stock transactions to permit companies to stop issuing physical stock certificates. Legislation to allow foreign exchange trading on margin took effect in July 2005. The new rule was designed to protect investors by setting forth specific criteria for margin foreign exchange trading.

On June 22, 2005, the Diet approved additional revisions to the SEL. The revised law has three provisions: (1) companies that seek to acquire more than one-third of the outstanding shares in a listed company in after-hours transactions are subject to takeover bid regulations (this revision was triggered by Livedoor's early 2005 purchase of a large amount of shares in Nippon Broadcasting System in after-hours trading); (2) parent firms of companies listed in Japan, if not under a continuous disclosure obligation, must disclose a certain level of parent company information; and (3) non-Japanese firms may disclose their financial statements in English, with an attached summary in Japanese.

Japan Post Distribution of Mutual Funds: Following the December 2004 legislation removing a ban on sales of mutual funds at post offices, Japan Post in 2005 chose three private financial firms to produce mutual funds for sale at 550 of its 24,700 post offices in its first phase of mutual fund sales. One U.S. firm and two Japanese firms were selected. Other foreign financial firms operating mutual funds in Japan plan to compete for Japan Post distribution in the future.

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Banking Law: On October 26, 2005, the Diet approved a bill revising the Banking Law. The approved bill allows non-financial companies to handle such banking services as taking deposits and providing loans as bank agents, with the approval of the Financial Services Agency. Retailers, such as convenience store chain operators, supermarkets, and automobile dealers, are expected to launch banking services as bank agents from April 2006.

Agriculture

Agricultural issues made progress under the Regulatory Reform and Competition Policy Initiative in 2005. The main topic addressed was the need for Japan to be consistent with international plant health standards on official control and pest risk assessment.

The Japanese government routinely required that imported produce be fumigated for insect species that are already present in Japan and not officially controlled. This practice is inconsistent with international practice and with the International Plant Protection Convention (IPPC). The fumigation requirement is particularly detrimental to trade in fresh fruits and vegetables, primarily lettuce and citrus. Fumigation adds unnecessary costs and results in produce deterioration, making products unmarketable. The U.S. lettuce industry estimates that exports would increase by at least \$100 million if this issue could be resolved.

In December 2004, at the first round of the Cross-Sectoral Working Group under the Regulatory Reform Initiative in Tokyo, the United States proposed that Japan harmonize its risk assessment and official control practices with International Plant Protection Convention standards. The United States also stressed the need for improved transparency and market predictability in Japan's phytosanitary enforcement procedures. As a follow-on to the December 2004 meeting, the United States and Japan held a plant health workshop in April 2005 to discuss in detail the application of IPPC standards for risk assessment and official control. The Japanese government acknowledged it would review official control practices and shift some pests from quarantine to non-quarantine status, based on the outcome of risk assessments. As a result, for example, Japan agreed to review the quarantine status of a number of pests, primarily of lettuce, that are present in Japan and not officially controlled. In addition, Japanese scientists visited the United States to consult with U.S. scientists on risk assessment policies and procedures. The United States will continue to urge Japan to adopt international standards, develop a comprehensive list of non-quarantine pests, and reduce excessive, unnecessary, and trade-distorting fumigation.

STRUCTURAL REGULATORY REFORM

Antimonopoly Law and Competition Policy

Under the Regulatory Reform Initiative, the United States continues to propose progressive measures to strengthen competition policy and enforcement of Japan's Antimonopoly Act (AMA) that would bolster competition and improve market access. One of the key problems in addressing anticompetitive practices in the Japanese market has been the historically weak status of the Japan Fair Trade Commission (JFTC) and its lack of sufficient enforcement powers and resources to implement the AMA effectively. Significant improvements should result from April 2005 amendments to the AMA, the first significant revision of the AMA in over 25 years.

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Strengthening the Effectiveness of Antimonopoly Enforcement: Cartel activity, including widespread bid rigging, continues to be a serious problem in Japan. One important reason is administrative and criminal sanctions did not constitute an adequate deterrent against companies and individuals engaging in unlawful anticompetitive practices. Administrative surcharges (fines) were too low to serve as a meaningful deterrent, with a maximum six percent surcharge of the sales in question over a maximum of three years. Although the AMA provides for criminal sanctions against violators, criminal prosecutions have been sporadic, and prison sentences against corporate officials have been routinely suspended. The JFTC has initiated only nine criminal prosecutions of AMA violators since 1990, including two in 2005. Where these cases have resulted in convictions, fines have been imposed. All prison sentences were suspended, however, even for an individual convicted of a repeat offense in a recent case.

A number of other factors limited the effectiveness of the JFTC's enforcement against egregious AMA violations. The JFTC did not have the powers enjoyed by other Japanese criminal investigation authorities, including the power to conduct compulsory searches and seizures. Nor did it have the authority to reduce administrative surcharges or promise not to bring criminal charges against companies that come forward to expose illegal activities through a corporate leniency program for cartel whistleblowers.

The April 2005 amendments to the AMA, however, address many of these problems. Administrative surcharges increased to 10 percent of cartel sales for large manufacturers and service providers that are first-time AMA offenders, and to 15 percent for repeat offenders. The amendments authorize the JFTC to introduce a corporate leniency program that eliminates administrative surcharges for the first company to report its participation in an unlawful cartel and cooperate with the JFTC's investigation and reduces surcharges for up to two more companies applying for leniency. The JFTC introduced such a leniency program in January 2006, and undertook not to file a criminal accusation against the first company (and its officers and employees) that enters the leniency program for a given cartel. In addition, the amendments provided the JFTC with criminal investigation powers; increased penalties for interference with JFTC investigations or for non-compliance with the JFTC cease and desist orders, streamlined hearing procedures, and extended the statute of limitations for AMA violations to three years after the conduct stopped. The United States is recommending that the JFTC take steps to maximize the effectiveness of its leniency program and to heighten compliance with the AMA.

The JFTC's ability to enforce the AMA has also been hindered by insufficient personnel. Some progress has been made, as seen by the increase in the JFTC's staff levels from 474 in 1990 to 706 in 2005. More importantly, the number of JFTC investigative staff has increased from 154 in 1990 to 360 as of March 2006. Nonetheless, the JFTC remains understaffed, particularly in the areas of economic analysis and investigations, to enforce the AMA adequately. The JFTC inaugurated a Competition Policy Research Center in 2003, staffed in part by visiting academic economists. However, the assignment of economists to JFTC investigations still appears to be quite limited.

Increasing the Procedural Fairness of JFTC Enforcement Activities: Segments of Japan's business community have complained that JFTC procedures lack due process. In order to enhance the JFTC's authority and credibility with the business community, the JFTC undertook to introduce a system in January 2006 to allow companies subject to a proposed public warning by the JFTC to submit evidence and make arguments as to why such a warning should not be issued. The JFTC also added two hearing examiners who are qualified attorneys, so that three out of seven hearing examiners are now attorneys or judges. The United States is recommending that the JFTC implement additional measures to improve the reliability and fairness of JFTC investigatory and administrative procedures.

Prevention of Bid Rigging: Japan has undertaken important steps in recent years to strengthen sanctions against bid rigging. In January 2003, the Diet enacted a law against bureaucrat-led bid rigging (so-called *kansei dango*). In July 2005, the Ministry of Land, Infrastructure and Transport (MLIT) clarified that companies engaging in serious bid rigging would be subject to suspension from bidding for up to two years. Nevertheless, concerns persist that debarment sanctions often are applied only in slow seasons and that sanctions against government officials complicit in bid rigging activities are weak or ineffective. The United States is recommending that Japan take further measures to address bid rigging, including implementation of an administrative leniency program that exempts whistleblowers from administrative sanctions such as suspension of designation, an increase in the minimum suspension from bidding for bid-rigging recidivists, and strengthening measures to address conflicts of interests created by the *amakurari* system.

Transparency and Other Government Practices

The United States continues to raise a broad range of issues under “Transparency and Other Government Practices” with the aim of urging Japan to create a more transparent and participatory regulatory system that fosters accountability and ensures fairness and predictability for Japanese consumers as well as domestic and foreign firms. Japan has made some progress in expanding meaningful public participation, but additional measures are needed, and in its December 2005 Regulatory Reform submission, the United States urged Japan to increase transparency in the following areas.

Public Comment Procedures: The effectiveness of Japan's Public Comment Procedures (PCP), in place since 1999, remains uncertain. The September 2005 annual survey of PCP implementation released by the Ministry of Internal Affairs and Communications (MIC) reflects many of the inadequacies of Japan's PCP implementation prior to its recent incorporation into the Administrative Procedure Law. In FY2004, over half of the public comment periods for regulatory revisions requiring Cabinet decisions were shorter than 30 days. While the recent amendment of the Administrative Procedure Law has strengthened the PCP, the United States urges Japan to evaluate and eliminate remaining inadequacies in PCP implementation to make it more effective in promoting a more transparent and fair rulemaking system. Specifically, the United States recommends that Japan compel ministries and agencies to provide minimum 30-day public comment periods and commit to making further revisions to the PCP if recent reforms still provide insufficient opportunities for meaningful public input into the policymaking process.

Special Zones for Structural Reform: The U.S. Government continues to support Japan's efforts to promote regulatory reform through the Special Zones for Structural Reform and lauds Japan's continued expansion of this program since the approval of the first zones in April 2003. The number of zones grew by 224 over the past year, bringing the total to 548 by the end of 2005. To ensure that this initiative continues to promote local and national economic revitalization, as well as opportunities for both domestic and foreign companies to operate in a deregulated environment, the United States urges Japan to continue transparent implementation and expeditious nationwide application of zone measures. In keeping with the focus on expanding market entry opportunities, the United States also recommends that Japan continue to encourage foreign participation in the zones initiative by publishing in English on the Internet a comprehensive list of current zones, progress on zone applications, and updated information.

No Action Letters: The Financial Services Agency (FSA) is studying measures to enhance its No-Action Letter (NAL) system and develop other means of expanding the body of written interpretations of Japanese financial law and regulations as a key element of its Program for Further Financial Reform. The number of NALs published by the FSA is increasing. The FSA has issued 9 No-Action Letters since April 2004, up from six issued in the previous 12 months and four during the first 21 months after the NAL system was introduced in July 2001. Under the Program for Further Financial Reform, the FSA has encouraged more active use of its NAL system by publishing in February 2005 "Detail of the No-Action Letter System" (an English-language version of the bylaws of the NAL system) and distributing in June 2005 a detailed questionnaire to the general public (including regulated firms) on the NAL system and suggestions for improvement of the FSA's implementation of the NAL system and its laws and bylaws.

Public Participation in the Development of Legislation: The United States encourages Japan's ministries and agencies to accelerate the practice of providing greater opportunities for the public to comment on legislation in the early stages of its formation. Specifically, the United States urges Japan to fully utilize and implement the Public Comment Procedures and ensure that the insurance industry (both domestic and foreign) and all interested parties are provided meaningful opportunities to be informed of, comment on, and exchange views with officials on proposed amendments to the Insurance Business Law, the Life Insurance Policyholder Protection Corporation (Life PPC) reform legislation or other existing laws and regulations related to the Life PPC prior to their implementation and/or submission to the Diet.

APEC Transparency Standards: APEC leaders have agreed to a package of transparency standards for the range of trade and investment areas. The United States and Japan have worked closely to create these standards. Accordingly, the United States and Japan should continue to work jointly to achieve full implementation of the APEC Transparency Standards in the domestic legal regimes of countries in the Asia-Pacific region.

Privatization

Prime Minister Koizumi's efforts to restructure and privatize Japan's public corporations continue to make important progress. The U.S. Government recognizes that these reforms, if implemented in a fully market-oriented manner, can have an important impact on the Japanese economy by stimulating competition and leading to a more productive use of resources.

The U.S. Government has a particular interest in the Prime Minister's initiative to reform and privatize Japan Post, which has large banking and insurance businesses in addition to its mail and parcel delivery operations. The U.S. Government has long called on the Japanese government to eliminate the tax, regulatory, and other advantages Japan Post has over U.S. and other private companies. With the passage of related legislation by the Diet in October 2005, Japan has established a framework to make important progress in this direction. As Japan moves forward with its implementation of these reforms, the U.S. Government, through the Regulatory Reform Initiative and in other fora, continues to urge the Japanese government to ensure that all necessary measures are taken to achieve a truly level playing field between Japan Post and the private sector in Japan's banking, insurance, and express delivery markets at the earliest possible date. In this regard, the U.S. Government welcomes inclusion in the legislation of the principle that equivalent conditions of competition will be established. The U.S. Government also continues to call on Japan to ensure that a level playing field is in fact created before the postal financial institutions are permitted to introduce new lending services, underwrite new or altered insurance products, or originate non-principal-guaranteed investment products. The U.S. Government also is urging Japan to ensure that the process by which this reform proceeds is made fully transparent and inclusive, including full and meaningful use of Public Comment Procedures and opportunities for interested parties to express views to related officials and advisory bodies before decisions are made. (*For additional detailed discussion of Japan Post privatization and postal financial institutions, please see "Insurance" under the Services Barriers section.*)

Commercial Law

Japan has been making steady progress on reforming its commercial law. In 2005, it enacted legislation aimed at modernizing its Corporate Code, including provisions that, when they come into effect, will permit the use of modern merger techniques, such as triangular mergers, in cross-border merger and acquisition transactions. Problems, however, still remain that impede foreign investment and corporate restructuring and that hinder good corporate governance practices. Of particular concern are efforts by some parts of the Japanese business community to erect barriers to beneficial foreign investment in Japan.

In its December 2005 Regulatory Reform submission, the United States urged Japan to build on past reforms by further improving its commercial law and corporate governance and rejecting efforts to protect entrenched management and impede foreign investment in Japan. Specifically, the United States is recommending that Japan implement the new triangular merger provisions promptly in a manner that does not impose significant restrictions on the use of foreign company shares in cross-border transactions and that facilitates tax deferral benefits in such transactions in appropriate cases.

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The United States is also recommending that Japan take measures to facilitate efficient tender offer bids as well as to improve corporate governance by adopting mechanisms that encourage and facilitate the active exercise of shareholder rights by both institutional and small investors, while providing legal mechanisms to ensure oversight of management and shareholder decisions.

The United States has also urged Japan to make revisions to its Company Law before it comes into effect in 2006 to remove all legal liability that a new provision has created for legitimate branches of foreign corporations in Japan. Article 821, which was included in the new Company Law that passed Japan's Diet in 2005, has created great uncertainty among foreign corporations, including U.S. corporations that conduct their primary business through their company branches in Japan's market. As written, Article 821 appears to prohibit such branches of foreign corporations from engaging in transactions in Japan on a continuous basis. While supplementary steps were taken in Japan's Diet prior to passage of the new Company Law to assure companies that the Japanese government would not apply Article 821 to legitimate entities, legal uncertainty has remained for these branches, particularly with respect to private litigation that could be brought against their directors and officers.

Legal System Reform

Reform of the Japanese legal system is essential to the establishment of an environment in Japan that is conducive to international business and investment and that supports deregulation and structural reform. After more than 15 years of urging by the United States and the foreign legal community, Japan enacted legislation in 2003 that substantially eliminates restrictions on the freedom of association between foreign and Japanese lawyers, effectively permitting partnership and employment relationships between them.

In its December 2005 Regulatory Reform submission, the United States again welcomed passage of the legislation regarding free association between Japanese and foreign lawyers and urged implementation by both the Ministry of Justice and the relevant bar associations in a manner that upholds the liberalization. The United States also calls on Japan to allow foreign lawyers to form professional corporations and establish branches throughout Japan and to count all of the time foreign lawyers spend practicing law in Japan toward the three-year experience requirement for licensure as a foreign legal consultant.

Distribution and Customs Clearance

The efficiency of Japan's distribution system is hampered by high airport user fees, relatively inefficient and costly customs procedures, low credit card acceptance at traditional merchants and ATMs, burdensome regulations on operators of fleet vehicles, and excessive rules on the activities of private express delivery companies. In addition, at the end of 2005, the Ministry of Land, Infrastructure, and Transportation (MLIT) announced proposals for changes to Japan's city planning laws that would, if enacted, restrict retailers' ability to meet Japanese consumers' needs by opening larger stores offering cheaper and more varied goods.

In its 2005 Regulatory Reform recommendations, the United States continued its focus on seeking improvements in Japan's distribution sector. Reform recommendations included urging Japan to: continue to reduce airport fees and assure transparency in the setting of those fees at Japan's international airports; take additional steps to streamline customs procedures; further increase acceptance of credit and debit cards as payment for goods and services; mandate compliance with international standards for retail banking and ATM security; streamline changing fleet vehicle registrations and registering title transfers; and ensure new regulations or other measures are not implemented that would limit the ability of large-scale retailers to open stores in Japan.

IMPORT POLICIES

Rice Import System

Although Japan has generally met import volume commitments made during the Uruguay Round and subsequent negotiations, Japan's highly regulated and non-transparent distribution system for imported rice assures that high quality U.S. rice does not enjoy meaningful access to Japanese consumers. U.S. rice exports to Japan in January-October of 2005 were valued at just under \$118 million, representing 340,966 metric tons of rice or about 50 percent of Japan's minimum access requirement. In 1999, Japan established a tariff-rate quota (TRQ) that was to assure access to the Japanese market for 682,000 metric tons (milled basis) of imported rice annually. The Japan Food Department (JFD) of the Ministry of Agriculture, Forestry, and Fisheries (MAFF), manages imports within the TRQ through periodic minimum access (MA) tenders for imported rice and through the simultaneous-buy-sell (SBS) system. Under both programs, the activities of the JFD lack transparency. Moreover, less than one-half of one percent of rice imported from the United States reaches Japanese consumers as an identifiable product of the United States. Imports of U.S. rice under the periodic MA tenders, for example, are destined almost exclusively for government stocks or re-exported as food aid. A small share of U.S. rice imported under these tenders is released from JFD stocks and permitted to enter the industrial food-processing sector. Since Japan adopted a tariff system in 1999, no rice has been imported outside of the import quota because it would be subject to a duty of 341 yen per kilogram, which is equivalent to a 400 percent to 1,000 percent *ad valorem* tariff, depending on the variety of rice. Through the MA tenders, the JFD imports roughly 582,000 metric tons of rice. The U.S. rice industry has been disappointed by the JFD's record of buying medium-quality rice for industrial use, food aid, and blending, rather than top-quality rice for table use. The U.S. industry also faces barriers in moving rice imported under the JFD's MA tenders into the market place. The industry believes that medium-grain U.S. rice - the type of rice imported directly by the JFD - can be competitive in the non-table use market. However, lack of information on obtaining U.S. rice held in JFD stocks has made the development of this commercial market difficult.

Under the SBS system, also administered by the JFD, Japan imports the remaining 100,000 metric tons of its total MA commitment. The U.S. rice industry is particularly concerned over the operation of the SBS system, which was designed to allow exporter's access to final consumers in Japan in order to engage in consumer market development. The SBS system, which provides a substantial mark-up to the JFD (equal to the difference between the import price of rice and the wholesale price in Japan), has not allowed U.S. exporters to develop markets in Japan for high-quality short grain U.S. rice used for the table market.

In June 2003, the Japanese Diet passed a law that included a comprehensive rice reform plan designed to cut government spending, curb surplus production, and make Japanese rice farmers more efficient. The reforms are scheduled to be fully implemented by 2008. Many areas of the plan, however, remain vague, and there is concern that parts of it may be undone before it is fully implemented. In the long term, the reforms would reduce the need for extremely high levels of protection for Japanese rice farmers.

Despite these reforms, Japan's position on market access for rice in ongoing WTO agricultural negotiations is to decrease Japan's Minimum Access commitment for rice, allegedly because of Japan's changing demographics and declining rice consumption. This proposal is counter to one of the principal aims of the Doha Development Agenda (DDA), which is to open agricultural markets and expand trade. Expanding market access for U.S. rice hinges on increasing Japan's market access commitment, reducing tariffs, changing the import system to make pricing and bidding more transparent, and revising the SBS system so the market can function freely. Currently, Japan's complex import system for rice makes it impossible to ensure price stability and a stable year-round supply of U.S. rice. Because the majority of U.S. rice imports sit in warehouses, importers of U.S. rice are denied the opportunity to establish direct relationships with Japanese consumers. The United States is seeking greater market access, particularly for direct access to Japanese consumers, for U.S. rice in the Doha Development Agenda.

Wheat Import System

Japan requires that wheat be imported through the Ministry of Agriculture, Forestry and Fisheries' (MAFF's) Food Department, which then releases wheat to Japanese flour millers at prices that are substantially above import prices. These high wheat prices discourage wheat consumption by increasing the cost of wheat-based foods in Japan.

Corn for Industrial Use

To support demand for domestically produced potatoes and sugar, the Japanese government requires Japanese corn starch manufacturers to blend potato starch with corn starch in manufacturing corn sweeteners. The tonnage of corn starch production must be matched by purchases of domestic potato and sweet potato starch in the ratio of one part of potato starch for 12 parts of corn starch. If corn sweetener producers use potato starch at a lower ratio than 1:12, they cannot import corn at the zero tariff rate accorded to the pooled quota. Instead they must pay a tariff on corn equal to 12,000 yen per metric ton or 50 percent of the value of a shipment, whichever is higher.

The blending requirement discourages consumption of imported corn by raising the cost of corn sweeteners and directly displaces over 200,000 metric tons of U.S. corn sales annually. The United States is seeking resolution of this issue in the Doha Development Agenda agriculture negotiations. In December 2004, Japan notified industry and the U.S. Government that it is considering abolishing the blending requirement by 2007 and moving to a tariff or levy regime instead.

Pork Import Regime

Japan is the world's largest importer of pork, importing a record 868,000 tons in Japanese Fiscal Year (JFY) 2004. U.S. pork exports to Japan in JFY 2004 were valued at over \$1 billion. In 2004 and 2005, restrictions on beef and poultry and favorable exchange rates contributed to demand for pork products.

Japan's pork import system includes a gate price and a safeguard negotiated during the Uruguay Round which automatically raises tariffs if imports are 19 percent or more above the average level of imports during the previous three years. The gate price system distorts pork trade by encouraging Japanese importers to buy mixed shipments of different cuts of pork (rather than the cuts the market would otherwise demand) to minimize tariffs by keeping the average CIF price of their shipments at or below the gate price.

In the Doha Development Agenda negotiations, the United States is seeking substantial reductions in pork tariffs, reform of the gate price system and safeguard, and greater transparency in Japan's import regime.

Beef Safeguard

Once Japan fully opens its beef market, there will be a high probability that Japan's beef safeguards will be triggered, hampering the United States' ability to fully regain historical export levels. When Japan first applied its beef safeguard in 2003, the United States pressed the Japanese government at the highest levels to recognize the non-typical market conditions caused by Japan's first case of Bovine Spongiform Encephalopathy (BSE). Similarly, the United States has expressed to Japan its opposition to any re-imposition of the beef safeguards based on the unusual market conditions caused by the ban on U.S. beef in December 2003.

Japan's beef safeguard was negotiated during the Uruguay Round to afford protection to domestic producers in the event of an import surge. The safeguard is triggered when imports increase by more than 17 percent from the previous Japanese Fiscal Year on a cumulative quarterly basis. Once triggered, the safeguard remains in place for the rest of the fiscal year. If triggered, tariffs on chilled beef and frozen beef increase from 38.5 percent to 50 percent.

In 2002 and 2003, the United States pressed at the highest levels of the Japanese government to recognize the non-typical market conditions due to BSE in the application of the beef safeguard.

The United States is intent on negotiating a change in the beef safeguard in the Doha Development Agenda. Based on the current Japanese safeguard methodology and current import levels, if Japan triggers the safeguard, U.S. exports will be subject to a higher import duty, which will negatively impact exports.

Fish Products

Japan is the most important export market for U.S. fish and seafood, accounting for over 40 percent of U.S. exports of such products in 2004. Japan maintains several species-specific import quotas on fish products. U.S. fish products subject to import quotas include pollock, surimi, pollock roe, herring, Pacific cod, mackerel, whiting, squid, and sardines. During the Uruguay Round, Japan agreed to cut tariffs by about one-third on a number of fishery items, but avoided commitments to modify or eliminate import quotas.

The United States and Japan hold annual government-to-government consultations on fish to discuss issues related to Japan's import quota system, including its administration, marine science, ecology and other bilateral and international fishery-related issues. The most recent consultations were held in Seattle in January 2005, following consultations that were held in November 2003. U.S. exporters have been concerned about the quota application process and other administrative procedures. Over the past few years, however, Japan has made substantial improvements in its import quota system for fish products, due in large part to recommendations from the United States and European Union. These changes include greater transparency in disclosing the recipients of quota allocations, changes in the timing of quota allocations, and the breakout of several types of fish (including mackerel, sardines, Pacific cod and others) from the "Fish and Shellfish" category into individual categories with quotas listed by weight rather than value. Although the requests of U.S. exporters for access to the Japanese market have been largely accommodated in recent years, the U.S. Government has urged the Japanese government to disband the import quota system on the grounds that it has outlived its usefulness.

As part of ongoing WTO discussions, a number of countries are working to resolve issues involving fish subsidies under the WTO Rules Committee. Japan provides numerous fishery subsidies, but these and those of other countries have yet to be classified and addressed within the WTO context.

High Tariffs on Beef, Citrus, Dairy, and Processed Food Products

Japan maintains high tariffs on a number of food products that are important trading items for the United States, including red meat, citrus, and a variety of processed foods. Examples of double-digit import tariffs include a 38 percent tariff on beef, a 32 percent tariff on oranges, a 40 percent tariff on processed cheese, and a 30 percent tariff on natural cheese. These high tariffs generally apply to food products where Japan is protecting domestic producers.

High tariffs discourage the use of imported products, and in some cases keep Japanese prices so high that they reduce total consumption of certain products. Tariff reductions are therefore a high priority in the Doha Development Agenda agriculture negotiations.

FOREIGN TRADE BARRIERS

Wood Products, Housing, and Building Materials

Japan is the second largest overseas export market for U.S. wood products, with U.S. exports to Japan for the first 11 months of 2005 at \$653 million, a drop of 9.4 percent from the \$721 million in exports during the first 11 months of 2004. Japan's home building materials market is second in size to only that of the United States. Estimates of the size of the home building and construction materials markets range upward of \$62 billion, not including materials going into the repair and remodeling market. New housing starts in Japan are not expected to strengthen appreciably in the foreseeable future but pent-up demand for wood and various building products from the repair and remodeling sector for the existing and outdated housing stock are expected to remain strong. During the period of January through September 2005, total housing starts stood at 911,435, a 3 percent increase from the same time period of 2004 (885,494). As for North American 2x4 frame housing starts, the January-September 2005 time frame witnessed 68,178 new units, a 3 percent increase from the 66,269 units built in the same time period in 2004.

Japan continues to restrict the import and use of U.S. manufactured wood products through tariff escalation (i.e., progressively higher tariffs on more processed wood products). The elimination of tariffs on wood products has been a long-standing U.S. objective, and the United States will continue to urge Japan to eliminate wood product tariffs. In 2001, the United States and Japan agreed that future discussions on wood/building products issues would be pursued under the government auspices of the Wood Products Subcommittee and its two technical committees, the Building Experts Committee (BEC) and JAS Technical Committee (JTC). The Building Experts Committee and the JAS Technical Committees last met in Chicago in September 2005 to discuss a range of issues related to indoor air quality regulations, fire performance requirements for wood products, and acceptance of overseas product testing and performance data and technical calculation methods. The discussions were generally productive, but many technical issues remain unresolved. Japan gave information on recent changes to the Building Standards Law and agreed to work with the United States and Canada to promote harmonization of fire testing results.

Marine Craft

Japan continues to maintain an inspection system for new boats and marine engines that is unique in the world in its severity and complexity and has the effect of seriously impeding market access for American manufacturers. Japan's regulations – administered by the Ministry of Land, Infrastructure and Transport (MLIT) and the Japan Craft Inspection Organization (JCI) – are vague and subject to arbitrary and inconsistent interpretation. Over-regulation has not improved boating safety in Japan compared to other major boating nations and has helped to keep the recreational boating industry (marinas, boats, engines, accessories, etc.) unusually small when compared to other developed nations.

The U.S. Government has made some inroads in encouraging Japan to deregulate this market. For example, in 2004, MLIT agreed to further deregulate its license system by eliminating the five-ton weight limit on pleasure boat operators' licenses. Japan has also increased its acceptance of plastic fuel tanks and has eased its marine engine requirements. In order to realize the full benefits of these deregulatory measures, other burdensome aspects of the Japanese

inspection system must be addressed. The United States urges Japanese regulatory authorities to study how recreational boating is regulated in similar markets around the world. Other countries, including the United States, have put in place systems to ensure an extremely high level of boater safety without imposing burdensome requirements on manufacturers and importers. In the United States, the National Marine Manufacturers Association (NMMA) operates a certification program following the standards of the independent American Boat and Yacht Council, which exceed U.S. Coast Guard requirements. The CE program used throughout Europe and increasingly throughout the world is another example of an acceptable approach. The U.S. looks forward to refocusing future marine craft meetings to discussion of Japan's overall regulatory approach and the potential benefits of harmonizing Japan's system with accepted international practices.

Leather/Footwear

In 1991, Japan liberalized treatment of footwear imports, setting a footwear quota of 2.4 million pairs per year. By JFY 1998 it had raised this quota to roughly 12 million pairs per year. In the Uruguay Round, Japan agreed to reduce tariffs over an eight-year period on under-quota imports of leather footwear, crust leather, and other categories.

The process by which the Japanese government establishes quotas lacks transparency. U.S. industry reports that there is no consultation with leather shoe importers to determine anticipated import levels. Indeed, Japanese authorities make no effort to limit quota allocations to firms that plan to use them. The U.S. Government will continue to seek elimination of these quotas.

Above-quota imports of footwear still face market access barriers, despite the fact that Japan has met its Uruguay Round agreements to lower the *ad valorem* ceiling rate by 50 percent and the alternative "per pair" or specific-rate ceiling by 10 percent. According to the latest Japanese government customs tariff schedule, the above-quota rates have declined to the higher duty of either 21.6 percent *ad valorem* or 4,300 yen per pair. However, because Japan is entitled to apply the higher of the two rates, which is typically the 4,300 yen per pair specific rate, the effect of the larger *ad valorem* rate reduction is negated.

U.S. industry has expressed concern that the quota on leather footwear imports effectively bars U.S. footwear manufacturers and U.S. brands from the Japanese market, one of the largest consumer markets in the world. According to the industry, the only way U.S. footwear companies can penetrate the Japanese market is through licensing arrangements where footwear is produced in Japan under a licensee. Many U.S. companies, however, have avoided this option because of the potential threat to the reputation of their brands by uncontrollable licensees that may not uphold the brand's quality or effectively market the brand's name.

STANDARDS, TESTING, LABELING AND CERTIFICATION

Japan has many standards that limit trade in farm, forest, and industrial products. Japan has always been particularly conservative on questions involving food safety, human health, and the application of sanitary and phytosanitary standards.

Recently, however, there appears to have been an increase in Japan's use of standards and other administrative requirements to limit agricultural imports in particular, and a greater tendency to deviate from scientific principles in setting new import policies and requirements.

Beef

On December 12, 2005, Japan partially reopened its market to U.S. beef after a nearly two-year ban resulting from the December 2003 discovery of a single imported cow with Bovine Spongiform Encephalopathy in Washington State. Achieving a reopening of the Japanese market to U.S. beef was a top priority of the Administration throughout 2005. Japan's partial market reopening in December 2005 enabled U.S. exporters, under a special export verification program with Japan, to export beef from cattle 20 months of age and younger. Before the ban, U.S. beef and beef product exports to the Japanese market (the largest export market for U.S. beef) totaled roughly \$1.3 billion annually.

Japan effectively closed its market again, however, on January 20, 2006, after suspending import inspection procedures for U.S. beef when one shipment of veal from a single U.S. meat packing company was discovered by Japanese authorities to not meet the terms of the export verification program. In response, the U.S. Department of Agriculture conducted a thorough review of the incident, presented the results of this review to the Japanese government on February 17, and announced additional safeguard measures to prevent further incidents from occurring. Although certain products in this veal shipment were not allowed under the export verification program with Japan, the U.S. Government emphasized that the contents of the shipment were nevertheless completely safe for consumption and as such did not pose a health risk.

The U.S. Government remains engaged with Japan in an intensive, high-level effort to reopen its market which involves numerous meetings between officials and technical experts from both governments. During those exchanges, the United States continues to provide all the necessary data and assurances to the Japanese government and its citizens to demonstrate the safety of U.S. beef. In addition, to further ensure that potentially infected material cannot enter the food chain, the United States continued to implement changes it made in the previous year to slaughter and feed processes.

In addition to pressing Japan to reopen its market, the United States is also urging Japan to take the next step to bring its measures in line with international guidelines of the World Animal Health Organization (OIE) by allowing imports of all ruminant and ruminant products deemed safe. The United States will aggressively work toward achieving this important objective.

SPS in Regulatory Reform

SPS issues were taken up in 2004-2005 for the first time under the Regulatory Reform and Competition Policy Initiative. The main topic addressed was the adoption by Japan of international plant health standards for the conduct of pest risk assessments and official control policy. Through talks conducted under the Regulatory Reform Initiative, Japan made several positive steps to revise its fumigation policy. First, and most importantly, Japan agreed to change its official control policy to become consistent with international standards. Japan also agreed to assess certain pests of lettuce, with the aim of removing fumigation requirements for them. Second, Japan confirmed that it is now conducting a pest risk assessment for Western Flower Thrips, one of the most frequently intercepted pests on lettuce. The United States hopes this process will lead to significant market expansion for U.S. produced lettuce.

Building Size, Designs, and Wood Products

Restrictions on building size, designs, and wood products continue to constrain the use of some foreign building products and systems commonly used in the United States and elsewhere, 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 and formaldehyde emissions. The United States is pleased to see positive developments in fire testing recognition. U.S. organizations now have the option of seeking and obtaining Overseas Recognized Performance Evaluation Body status in order to conduct fires tests and seek Japanese government approval.

The Japanese government has adopted and implemented regulations with respect to indoor air quality and the emission of certain volatile organic compounds, including formaldehyde, which are found in some building materials. Regulations on indoor air quality covering volatile organic compounds appear to be overly restrictive for some products such as wall coverings. The United States also has concerns about guidelines for other chemicals, especially if those guidelines become mandatory as well.

Fresh Apples Quarantine Requirements for Fireblight

For years, Japan imposed burdensome quarantine restrictions on apples, limiting the ability of U.S. growers to access the Japanese market. Of particular concern are Japan's requirements that aim to prevent transmission of fireblight. Japan's quarantine restrictions for fireblight included the prohibition of imports of U.S. apples from any orchard containing fireblight, three inspections of fireblight-free orchards at different times in the growing season, maintenance of a 500-meter fire-blight-free buffer zone surrounding export orchards, and post-harvest treatment of apples with chlorine. These requirements were not scientifically based, significantly raised costs, and reduced the competitiveness of U.S. apples in Japan.

In light of Japan's continued refusal to modify its restrictions on the basis of the scientific evidence, on March 1, 2002, the United States initiated WTO dispute settlement procedures. In its report of July 15, 2003, the dispute settlement panel agreed with the United States that Japan's inspection and buffer-zone requirements were inconsistent with Japan's obligations under the WTO Agreement on the Application of Sanitary and Phytosanitary Measures.

In June 2004, Japan amended its quarantine restrictions arguing that the changes brought Japan into compliance with the WTO panel decision. In the view of the United States, Japan failed to come into compliance with the WTO rulings. In July 2004, therefore, the United States requested that a WTO compliance panel be convened to determine whether Japan's revised measures were consistent with its WTO obligations. The compliance review panel released its final report in June 2005. Japan has stated that it will comply with the panel's findings and remove the quarantine restrictions for fireblight on U.S. apple exports.

Ban on Fresh Potatoes

Japan's Ministry of Agriculture, Forestry and Fisheries (MAFF) prohibits the entry of all fresh potatoes from the United States due to phytosanitary concerns, primarily over Golden Nematode and potato wart, despite efforts by the U.S. potato industry and the USDA to remove the import restriction. United States has long argued that Golden Nematode only exists under quarantine in New York, and that potato wart no longer exists in the United States. In an effort to resolve this issue, the United States successfully gained entry approval specifically for chipping potatoes from January to June, during Japan's off-season. USDA was able to negotiate with Japan a safeguarding procedure that allows potatoes to be shipped to chipping plants in Japan under strict controls to prevent the importation of potential pests. Through these efforts, U.S. chipping potatoes gained market access to Japan in early 2006.

Biotechnology

While Japan has adopted a largely scientific approach in its approval process for agricultural biotechnology products, the United States is concerned with the recent changes in Japan's regulatory system, and seeks assurances that new requirements will be science-based, clearly stated, and will provide sufficient time for compliance as well as a smooth transition in order to reduce risk of trade disruption.

To date, MAFF and the MHLW, which regulate biotechnology products, have approved the importation of 59 biotechnology plant varieties for food, including corn, potatoes, cotton, and soybeans. In July 2003, Japan inaugurated a Food Safety Commission (FSC) with responsibility for performing food-related risk evaluations. MAFF is requiring new mandatory environmental safety reviews for all biotechnology products, including those that have already gained approval, as part of their implementation of the Biosafety Protocol. It is still unclear what will be required for these mandatory environmental reviews.

The United States is also concerned by Japan's efforts to expand mandatory labeling of foods made from the products of biotechnology when no health risks exist, thereby potentially discouraging consumers from purchasing these foods. In 2002, MAFF included potato products, frozen potatoes, dried potato, and potato starch and potato snacks in the mandatory biotechnology-labeling scheme. The United States believes consumers should have information on foods that have been produced through biotechnology, but alternatives to mandatory labeling, such as educational materials, public discussions, and voluntary labeling regimes, can provide more meaningful information to consumers and respond to consumer and market demands. The United States is also concerned by MAFF's possible plans to expand mandatory labeling to feed and seed, which are now being discussed internally in the Ministry.

The United States is urging Japan to continue to participate in discussions on biotechnology advancement and regulation in international fora, such as the WTO, the Codex Alimentarius Commission, the OECD and APEC. Given the continuous development of new biotechnology-produced food products, the United States and Japan share a common interest in working together to promote effective biotechnology approval and regulatory policies.

Restrictive Food Additive List

Japan's overly restrictive list of food additives still limits imports of U.S. food products, especially processed foods. Japanese regulations, which limit the use of specific food additives on a product-by-product basis, are out of step with international practice. Japan refuses, for example, to allow the importation of light mayonnaise, creamy mustard, or figs containing potassium sorbate, a food additive evaluated and accepted by numerous national and international standard-setting organizations, including the Joint FAO/WHO Experts Committee on Food Additives. Japan, however, allows its use in 36 other foods, most of which are traditional Japanese food products not normally produced outside of Japan. In 2002, Japan created a list of 46 food additives for expedited review. Since then, however, the United States and many of Japan's other trading partners have been very disappointed by the lack of progress to approve many of these or any other additives. In addition, Japan classifies post-harvest fungicides as food additives (involving a separate registration process), even though the international community, including Codex, classifies them as pesticides. The United States urged MHLW to begin regulating post-harvest fungicides as pesticides as part of their revised positive list of Maximum Residue Levels (MRLs), but MHLW has indicated it will not consider this request. No post-harvest fungicides have been approved since the 1970s.

Feed Additive Ban

In August 2002, MAFF publicly announced its intent to ban 29 animal feed additives. After gathering additional information, MAFF decided in October 2003 to ban only those additives that could create a resistance problem for humans. Antibiotic animal feed additives have been in use for over 30 years. Many countries, including the United States, are in the process of reviewing regulations regarding the use of these antibiotics. In December 2002, the United States received conflicting reports that Japan had decided to move forward with a ban in advance of a report on the matter from a MAFF scientific committee, and seemingly in the absence of a science-based risk assessment. The Japanese Food Safety Commission set up detailed guidelines for risk assessment in September 2003, and although industry is relatively satisfied with the guidelines, the United States will continue to follow the issue closely to ensure Japan follows through in a manner consistent with its WTO obligations.

Nutritional Supplements

Although Japan has taken steps toward liberalization of its nutritional supplements market, many restrictions remain. The approval process for “Foods with Health Claims” (FHC) remains costly, time-consuming, and burdensome. In addition, health claims are prohibited for supplements that do not qualify for the FHC category, which include over half of this \$10.7 billion market. To address these concerns, the United States has urged Japan in its recommendations under the Regulatory Reform Initiative to increase transparency of its system for regulating supplements, to allow educational and informational statements on labels and in advertising (provided such statements are accurate and verifiable), and to reduce duties for nutritional supplements to the same level as duties for drugs containing the same ingredients.

Cosmetics and Quasi-Drugs

Japan’s regulation of cosmetics and quasi-drugs (a category defined under Japan’s Pharmaceutical Affairs Law) includes unnecessary and burdensome requirements that do not enhance product safety, quality, or efficacy. These requirements and a lack of transparency in the regulatory system serve to impede the ability of U.S. companies and products to compete in the Japanese market. In addition, certain advertising claims for cosmetics and quasi-drugs may not be made in Japan even though these claims are based on verifiable data. Allowing these claims would enable companies to provide consumers with information that would help them make sound choices and would improve consumer access to innovative products. The United States has urged Japan in its recommendations under the Regulatory Reform Initiative to work with industry to identify and eliminate unnecessary requirements, to improve transparency in the regulatory process, and to permit the use of efficacy claims based on verifiable data.

Poultry

Since 2002, Japan has imposed a number of national and statewide bans on U.S. poultry meat due to the detection of low pathogenic strains of avian influenza (AI) in limited areas in the United States. As a result, U.S. poultry meat exports to Japan have decreased substantially since then, from roughly \$81 million in 2001 to \$45 million in 2002, \$29 million in 2003, \$31 million in 2004, and \$30 million in 2005.

Japan's periodic nationwide trade restrictions are unwarranted under international guidelines and have unnecessarily disrupted millions of dollars of U.S. poultry product exports. According to standards set by the international animal health organization, the Office of International Epizootics (OIE), quarantine procedures and some restrictions on imports are appropriate for highly pathogenic strains of AI and not for low pathogenic strains.

The OIE standards also provide for regionalization in the case of highly pathogenic AI (i.e., importing countries should limit bans to zones where highly pathogenic AI has occurred, while allowing imports from other regions in the exporting country, when the exporting country has effective control and surveillance measures in place to quarantine the affected region).

Japan continues to prohibit imports of poultry products from New York and Connecticut due to past findings of AI. USDA will continue to encourage Japan to remove these unnecessary restrictions.

GOVERNMENT PROCUREMENT

Construction, Architecture and Engineering

Although Japan has the second largest public works market in the world (\$180 billion for 2005), U.S. firms annually obtain far less than one percent of projects awarded. Japan's procurement of construction services, above certain thresholds, is subject to the WTO Government Procurement Agreement (GPA). In addition, two public works agreements are in effect: the 1988 U.S.-Japan Major Projects Arrangements (MPA) (updated in 1991) and the 1994 U.S.-Japan Public Works Agreement, which includes the "Action Plan on Reform of the Bidding and Contracting Procedures for Public Works" (Action Plan). The MPA included a list of 42 projects in which international participation is encouraged. Under the Action Plan, Japan must use open and competitive procedures for procurements valued at or above the GPA thresholds.

Problematic practices continue to inhibit the full involvement of U.S. design/consulting and construction firms in Japan's public works sector. A major problem in Japan's market is bid-rigging (*dango*), under which companies consult and prearrange a bid winner. High-profile bid-rigging scandals in 2005 brought to light the prevalence of this practice. Other problematic practices include use of arbitrary qualification and evaluation criteria that exclude U.S. firms, unreasonable restrictions on the formation of joint ventures, unclear or conflicting bid/contract procedures, and the structuring of individual procurements so they fall below thresholds established in international agreements.

FOREIGN TRADE BARRIERS

Public works issues are raised in the Trade Forum under the U.S.-Japan Economic Partnership for Growth. During the December 2005 Expert-Level Meeting on Public Works (Expert-Level Meeting) under the Trade Forum, the United States urged Japan to eliminate the obstacles that prevent U.S. companies' full participation in this sector. The United States also encouraged Japan to strengthen its efforts to eliminate bid-rigging and asked Japan to continue to address the problem of firms submitting bids so low that they raise questions as to whether the work can be reliably performed.

The United States asked Japan not to use qualifying and evaluation criteria that excluded U.S. firms from procurements. The United States encouraged Action Plan entities to be flexible in their interpretation of a company's experience in cases where the qualifying conditions are unique to Japan and to allow qualifying conditions to be satisfied based on similar work experiences. The United States also urged Japan not to use ISO 9000 series registration with the effect of creating a barrier to international trade.

The United States again urged Japan to abolish its three-company joint venture rule (which limits to three the number of members in joint ventures for most construction projects), to increase use of the "mixed-type procurement" (which allows companies to decide whether to bid solo or as a joint venture), and to use design architect and city landscaping procurements to increase joint venture opportunities for firms specializing in architectural design. The United States also expressed concern about the lack of information on new bid/contract procedures that were not included in the Action Plan.

The United States asked for increased monitoring of the introduction of these procedures and asked Japan to ensure the new procedures are consistent with the Action Plan and the GPA. The United States also asked Japan to disseminate information on the streamlining of documentation requirements for design proposals to all Action Plan entities.

The United States welcomed the first Project Management (PM) procurement issued in the history of Japan's public works market. During the Expert-Level Meeting, the United States urged Japan to increase the number of PM and Construction Management (CM) projects commissioned during this fiscal year and structure procurements in such a way that foreign firms with appropriate expertise are able to compete. (CM and PM are advanced project delivery and management systems that maximize the efficiency of a project.)

Under its GPA market access coverage, Japan has an exemption for procurement relating to the operational safety of transportation for certain entities. The United States has raised concerns with the appropriateness of Japan's use of this exemption.

The United States is promoting U.S. firms' participation in new types of public works projects in Japan such as Urban Renewal, Private Finance Initiative (PFI), and Local Area Renewal projects. During the Expert-Level Meeting, the United States asked Japan to provide contact points and early information for these projects. The United States is encouraged by increased communication between U.S. and Japanese construction industry representatives, through which firms can directly share their interests and concerns related to Japan's market.

FOREIGN TRADE BARRIERS

The United States is paying special attention to several major projects covered by the public works agreements of particular interest to U.S. companies. These projects include: Okinawa Institute of Science and Technology; National Institute projects commissioned by the Ministry of Education, Culture, Sports, Science and Technology; Haneda Airport development and expansion; Kansai International Airport; Central Japan International Airport; Kyushu University Relocation Project; International Medical Center Project; Okinawa Zukeran General Hospital Project; Japan Railways' procurements; major public buildings, urban development and redevelopment projects; major PFI projects; and remaining MPA projects.

INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

The United States continues to pursue its intellectual property rights protection agenda with Japan through bilateral consultations and effective coordination in multilateral and regional fora. For its part, Japan continues to make progress in improving the protection of intellectual property rights and, relative to other countries, piracy is not a major problem, though several key issues remain, including the need to improve Japan's legal and administrative intellectual property framework to protect copyrights in the digital age. The United States has identified a number of areas where further action by Japan is needed, including: (1) addressing persistent patent-related problems; (2) improving and expanding protection of copyrighted works, particularly on the Internet; (3) providing effective protection for well-known trademarks; (4) providing protection for geographical indications; (5) affording greater protection of trade secret information; and (6) continuing to improve border enforcement mechanisms.

Patents

The United States has focused particular attention on improving the processing and approval of patent applications and reforming Japan's practice of affording only narrow patent claim interpretation. The United States remains concerned with several aspects of Japan's patent administration, including the relatively slow process of patent litigation in Japanese courts, the lack of an effective means to compel compliance with discovery procedures, and the lack of adequate protection for confidential information produced relative to discovery.

In recent years, Japan has taken a number of steps to address these issues. A revised patent law took effect on January 1, 2000. This law is designed to make it easier for plaintiffs to prove patent infringement in courts. Key provisions include requiring defendants to justify their actions, obligating defendants to cooperate with calculation experts, giving judges discretion over the amount of damages, increasing the penalty in cases where patents were obtained fraudulently, and allowing courts to seek technical advice from the Japan Patent Office (JPO). The United States will continue to monitor closely whether these revisions reduce the cost of access to Japanese courts that has been particularly onerous to foreign patent owners in the past. The United States welcomes these steps to improve the level of patent protection in Japan and will continue working with Japan to strengthen its patent laws in several fora.

FOREIGN TRADE BARRIERS

Copyrights

The increasing use of the Internet and explosive growth of high-speed access in Japan has presented new challenges for protecting intellectual property rights, especially for copyrighted materials. The protection of this material is critical for electronic commerce to flourish and for the continued development of content-related industries such as games, music, film, and software. The United States continues to be concerned that Japan's Internet Service Provider (ISP) liability law does not provide adequate protection for the works of rights holders on the Internet or the appropriate and necessary balance of interests among telecommunications carriers, service providers, rights holders and website owners. The United States urges Japan to use all the opportunities available to improve these shortcomings in the law. (*This issue is also taken up in the "Information Technologies" section under Sectoral Regulatory Reform.*)

The United States is also urging Japan to reduce the piracy rate, especially in light of the growing threat of online piracy. A notable step toward creating an effective deterrent against piracy, providing compensation to rights holders, and improving the efficiency of copyright cases in Japan's courts would be amending Japan's Civil Procedures Act to provide for an award of statutory damages at the election of the rights holders as an alternative to actual damages. In addition, in order to set an example for the private sector, the United States urges Japan to issue a decree forbidding any copyright infringement in its government operations. The United States is also concerned about the personal use exception both as it applies to the Internet and to students and book piracy. Japan should make its law clear that the use of peer-to-peer networks to download and copy copyrighted works without the rights holder's authorization is not permitted under the personal use exception. The personal use exception also appears to allow students to copy entire textbooks for personal use as long as they do not distribute copies.

The United States urges Japan to explicitly incorporate the three-part test from international treaties into the Copyright Law to address both these problems.

The United States is concerned about the provision on anti-circumvention in Japan's Copyright Act, which applies only to devices whose principal function is circumvention and which does not protect access controls against circumvention.

In a positive vein, in recent years Japan put into effect an extension of the term of copyright protection for cinematographic works, animation, and video games to bring the term of protection closer to the growing international trend. The United States continues to urge the Japanese government to extend the term of protection for all the subject matter of copyright and related rights to life plus 70 years, or where the term of protection of a work (including a photographic work), performance or phonogram is to be calculated on a basis other than the life of a natural person, to 95 years.

Trademarks

Trademarks must be registered in Japan to ensure enforcement. Thus, any delays in the registration process make it difficult for foreign parties to enforce their marks. Legislation passed in preparation for Japan's ratification of the Madrid Protocol in March 2000 contains several useful provisions. Effective January 1, 2000, Japan began establishing a system to notify the public of trademark applications received. Effective March 14, 2000, trademark holders are entitled to compensation for damages for the period from application until registration of the trademark.

Regrettably, in spite of the existence of provisions in Japan's Unfair Competition Law designed to afford greater protection to well-known marks, protection of such marks remains weak. Of particular concern is Japan's register of well-known marks, where employees of the Japan Patent Office make *ex officio* determinations whether a mark is well-known or not. One defect of the "list" approach to well-known mark protection is that one can essentially pay one's way onto the list by requesting defensive registrations in many classes. A trademark committee is currently reviewing the scope of protection for well-known marks, and the U.S. Government will continue to monitor its progress.

Geographical Indications (GIs)

Articles 22 to 24 of the TRIPS Agreement set forth the obligations of WTO Members with respect to GIs and their relationships to trademarks. It is unclear whether Japan currently provides interested parties with the legal means to prevent misuse of a GI or whether Japan provides trademark owners with the legal means for resolving conflicts between trademarks and asserted GIs. The United States understands the Japanese government is currently studying the issue of GI protection and fully supports that effort. Outstanding concerns remain, since it is unclear whether Japan maintains an undisclosed list of protected GIs against which applications for trademark registration are reviewed. Reports have indicated that the Japanese government is considering the use of GIs to protect the identity of traditional food products from well-known production areas in Japan, but it is unclear how Japan would implement such protection. Japan has recently announced that it has three new Japanese terms which have been designated as GIs for wines and spirits by the Commissioner of the National Tax Agency through its Labeling Standard Concerning Geographical Indications, "to be protected in the territories of WTO members." The United States is concerned as to why the Japanese Tax Commissioner is designating GIs to be protected outside of Japan, and whether foreign GIs are directly registrable under the Japanese GI system without intervention by a foreign government. The United States looks forward to receiving further information on these concerns.

Trade Secrets

Although Japan amended its Civil Procedures Act to improve the protection of trade secrets in Japanese courts by excluding court records containing trade secrets from public access, the law is inadequate. Because Japan's Constitution prohibits closed trials, the owner of a trade secret seeking redress for misappropriation of that secret in a Japanese court is forced to disclose elements of the trade secret in seeking protection.

FOREIGN TRADE BARRIERS

Because of this, and the fact that court discussions of trade secrets remain open to the public with no attendant confidentiality obligation on either the parties or their attorneys, protection of trade secrets in Japan's courts will continue to be considerably weaker than in the courts of the United States and other developed countries. The Diet passed a bill to partially amend the Unfair Competition Prevention Law in May 2003. The bill contains a provision that states that a person who illegally acquires, uses, and discloses corporate secrets is subject to criminal sanctions. The scope of the amendment, however, is limited. The United States continues to urge Japan to undertake further reform in this area.

Border Enforcement

The United States continues to monitor the Japan Customs and Tariff Bureau's (JCTB) implementation of the policy to allow parallel imports of patented products based on a 1997 Japan Supreme Court ruling. Further, insofar as Japan provides *ex officio* border enforcement of trademarks and copyrights through the JCTB, efforts should be made to enhance such enforcement through aggressive interdiction of infringing articles. In an effort to bolster Japan's border control measures, the United States has urged Japan to improve its application, inspection, and detention procedures to make it easier for foreign rights holders to obtain effective protection against infringed intellectual property rights at the border. Although Japan increased the amount of resources devoted to enforcement during 2004, the United States urges Japan to continue to improve and tighten its border enforcement to ensure effective implementation of its TRIPS obligations.

SERVICES BARRIERS

Insurance

Japan's private insurance market is the second largest in the world, after that of the United States, with direct net premiums of an estimated 36.1 trillion yen (approximately \$335 billion) in JFY 2004. In addition to the offerings of Japanese and foreign private insurers, substantial amounts of insurance are also provided to Japanese consumers by the large life insurance unit (Kampo) of government-owned Japan Post, the National Public Health Insurance System, and a web of insurance cooperatives (*kyosai*).

Two bilateral Insurance Agreements, implemented in 1994 and 1996, are in effect and have contributed significantly to deregulating the Japanese insurance market. Largely as a result of positive changes brought about by these agreements, foreign insurance companies have continued to increase their presence in Japan's private sector insurance market (total market excluding Kampo and *kyosai*). Foreign insurers now hold an estimated 25.1 percent of the private life insurance market (JFY 2004) and a 4.4 percent share of the private non-life insurance market (JFY 2004). In the third sector, foreign firms have approximately 60 percent of the private sector life medical/nursing care insurance market (JFY 2004) and about 11 percent of the private sector non-life medical/personal accident market (JFY 2004).

FOREIGN TRADE BARRIERS

Given the size and importance of Japan's private insurance market as well as the scope of the obstacles that remain, the U.S. Government continues to place a high priority on working with the Japanese government to ensure that its regulatory framework fosters an open, fair, and competitive insurance market. Several important issues and concerns remain to be addressed in order to achieve this.

Postal Insurance: Japan Post's insurance business, or Kampo, is effectively the world's largest insurer and remains by far the largest player in Japan's insurance market. Kampo is bigger than the four largest private sector Japanese life insurers combined and is estimated to account for nearly 40 percent of all life insurance assets in Japan. In FY 2004, there were 73 million Kampo-issued life insurance policies in force compared to 124 million for all private life insurance companies combined.

The U.S. Government has long-standing concerns about tax, regulatory, and other advantages given to Kampo over its private sector competitors as well as over the impact these advantages have had on competition in Japan's insurance market. It remains important that Japan eliminate these advantages and create a level playing field. In this regard, the U.S. Government has taken particular interest in Prime Minister Koizumi's initiative to privatize and reform Japan Post. The reform framework established under legislation passed by Japan's Diet in 2005 includes a number of key measures that, if implemented fully, will represent long-awaited progress in areas of concern to U.S. and other insurers in the market. Importantly, the legislation also included the establishment of equivalent conditions of competition between Japan Post and the private sector as a basic principle of the reforms. In addition to eliminating Japan Post's tax and regulatory advantages and ensuring equal supervisory treatment, the U.S. Government continues to look to Japan to take other steps necessary to achieve a level playing field.

These steps include measures to both ensure and demonstrate that cross-subsidization does not occur among the new Japan Post corporations to be created under the new laws, such as by requiring Japan Post's strict adherence to the arms-length rule under the Insurance Business Law and adequate financial disclosures.

The U.S. Government also continues to call on Japan's government to ensure that a level playing field is actually created between the postal insurance institutions (both the existing Kampo business and, from October 2007, the new postal insurance business) and private insurers before the postal insurance institutions are permitted to underwrite and introduce new or altered insurance products. Approval of any proposed new products by the new postal insurance company, according to the new laws, will shift in October 2007 from Diet approval to a new process whereby decisions are made by the Prime Minister (with the Commissioner of the Financial Services Agency acting as proxy) and Minister of Internal Affairs and Communications, after hearing the opinion of an appointed government advisory body. It is important that this new process be fair and open to all parties. It is also critical that this process include careful analysis of, and full consideration given to, actual competitive conditions in the market, and that private sector views are actively solicited and considered.

As any modification to the postal financial system could have a significant impact on competition in Japan's insurance market, adequate transparency in the process of implementing the reforms passed by the Diet remains key, both prior to the start of the privatization process in October 2007 and after. The U.S. Government has recommended that Japan take a variety of steps to ensure transparency and inclusiveness, including: (1) providing meaningful opportunities for interested parties to exchange views with related government officials as well as members of government-commissioned advisory committees and groups before decisions, including those on products, are made; and (2) fully utilizing Public Comment Procedures with respect to implementing regulations, guidelines, Cabinet and other orders, and other measures.

The U.S. Government will continue to carefully monitor developments as the Japan Post reform process unfolds and express its views through regularly scheduled Working Groups under the U.S.-Japan Regulatory Reform Initiative, bilateral insurance consultations, and at other opportunities. The U.S. Government will also continue to closely monitor the performance of a new Kampo insurance product (including a rider providing for supplemental health coverage) which the U.S. Government and others strongly objected to when introduced in January 2004.

Kyosai. Insurance businesses run by cooperatives, or *kyosai*, have occupied a substantial presence in Japan's insurance market. According to the Japan Cooperative Insurance Association, *kyosai*-issued policies amounted to more than 20 percent of all in-force life policies in the market and 35 percent of all in-force non-life policies in 2002, the last year for which statistics are available.

Some *kyosai* are regulated by their respective agencies of jurisdiction (the Ministry of Agriculture, Forestry and Fisheries, or the Ministry of Health, Labor and Welfare, for example) instead of by the Financial Services Agency (FSA), while others have been allowed to operate without any regulatory supervision at all. These separate regulatory schemes undermine the ability of the Japanese government to provide companies and policyholders a sound, transparent regulatory environment, and afford *kyosai* critical business, regulatory, and tax advantages over their private sector competitors. The U.S. Government has stated its position that all *kyosai* should be subject to the same regulatory standards and oversight as their private sector counterparts to ensure a level playing field and to protect Japanese consumers.

The Japanese government took some important steps in 2005 to bring more oversight scrutiny to unregulated *kyosai*. Under changes to take effect from 2006, a new "small-amount, short-term" *kyosai* provider category will be created. Previously unregulated *kyosai* that meet the criteria for selling small-amount and short-term insurance policies to customers will be supervised by the FSA and held to some of the same regulatory standards as private sector insurers. Previously unregulated *kyosai* that do not meet these criteria will be required to meet the same license requirements as private insurers. Other *kyosai*, however, will continue to be allowed to operate with a minimum of regulatory supervision, including public welfare cooperatives and cooperatives run by workers within private corporations. As the Japanese government implements this new system and reviews its operation as required under the amended law, the U.S. Government urges that additional steps be taken to hold all *kyosai* to the same regulations and FSA supervision as are applied to private companies.

With respect to *kyosai* regulated by ministries and agencies other than the FSA, the U.S. Government remains concerned by their continued expansion in Japan's insurance market. This is particularly the case in light of the differences in regulatory treatment and other requirements that continue to give these *kyosai* inherent advantages over private sector companies. The U.S. Government continues to call on Japan to bring all regulated *kyosai* under the same regulatory obligations and FSA supervision as that applied to the private sector.

Policyholder Protection Corporations: The life and non-life Policyholder Protection Corporations (PPCs) are mandatory policyholder protection systems created in 1998 to provide capital and management support to insolvent insurers. As a result of subsequent industry failures, private sector insurers have been called upon to contribute considerable sums to the PPC since that time. U.S. industry, particularly life insurers, has expressed serious concern over the burden of these contributions. The U.S. Government has stressed the need for a sustainable funding framework that does not unfairly burden private companies.

Japan's Diet passed legislation in 2005 to renew the PPC system starting in April 2006. While some improvements were made on the previous system under the legislation, the PPC system nonetheless continues to rely upon pre-funding by its members, instead of adopting a system of funding to follow an insolvency that results in a draw of funds from the PPC (post-funding). The U.S. Government continues to urge Japan to adopt more fundamental changes in the PPC systems, including the post-funding approach, when the next renewal of the system is enacted. Ensuring adequate transparency is also important as the new system is reviewed and as preparations are made to renew it, including providing opportunities for interested parties to express views to related government officials and government-appointed advisory groups.

Bank Sales. Initial steps taken in 2001 and in 2002 to allow for limited sales of insurance products through banks were augmented with a new step, effective December 2005, to further liberalize this sales channel.

Although these steps are welcome, the range of products now available through banks nonetheless represents a small percentage of the universe of private insurance products that could be made available to Japanese consumers through banks.

A key advisory body to the Japanese government, in its 2004 report, recommended that full liberalization of bank sales of insurance be accomplished within three years at the latest. The U.S. Government continues to urge the Japanese government to completely liberalize the bank sales channel, within a time period no later than the period identified by this advisory body, to allow banks to sell all types of insurance offered by any regulated private insurer.

The United States will continue to work closely with U.S. industry to follow these issues and will urge the Japan to adequately resolve these concerns in an open and transparent manner.

Professional Services

U.S. and other foreign firms and individuals are hampered in providing professional services in Japan by a complex network of legal, regulatory, and commercial practice barriers. U.S. professional services providers are highly competitive. Their services also help facilitate access for U.S. exporters of other services and goods, and contribute valuable expertise to the economies they serve. The availability of such services can be a key factor in U.S. firms' decisions whether to invest, and thus is central to improving the environment for foreign direct investment in Japan.

Accounting and Auditing Services: U.S. providers of accounting and auditing services face regulatory and market access barriers in Japan that impede their ability to serve this important market. Only Certified Public Accountants (CPAs) or Audit Corporations (made up of five or more Japanese CPAs) can offer accounting services. Foreigners must pass a special examination to qualify, an examination last offered in 1975. The United States will continue to urge Japan to remove restrictions on accounting services.

Legal Services: As noted above in the Legal System Reform portion of the Regulatory Reform Initiative section, 2003 and 2004 brought sweeping reform in the area of association between Japanese and foreign lawyers, and the new system of Joint Law Firms (*kyodo jigyo*) was implemented on April 1, 2005.

Medical Services: Restrictive regulation limits foreign access to the medical services market. In the U.S.-Japan Investment Initiative, the United States has advocated allowing commercial entities to provide for-profit medical services and allowing more outsourcing of certain medical services, such as diagnostic and chronic care services (advanced imaging, maintenance dialysis, rehabilitation, etc.) to open this sector to foreign capital-affiliated providers.

Educational Services: Over-regulation also has discouraged foreign universities from operating branch campuses in Japan, presenting obstacles in the form of both administrative requirements and restrictions on pedagogical choices. The U.S.-Japan Investment Initiative has taken up these issues, and the Japanese government has established a new category for Foreign Branch Campuses of accredited institutions of higher education in the United States and elsewhere. Three U.S. universities were granted this status in 2005. The United States expects this designation will provide these campuses a number of important rights (such as student rail passes and the issuance of student visas) similar to those accorded Japanese educational institutions. However, the new status for foreign universities does not yet grant the tax benefits enjoyed by Japanese institutions and their students.

INVESTMENT BARRIERS

Despite being the world's second largest economy, Japan continues to have the lowest inward foreign direct investment (FDI) as a proportion of total output in any major OECD nation. Foreign participation in mergers and acquisitions (M&A) activity, which accounts for some 80 percent of FDI in other OECD countries, also lags in Japan, although it is on an upward trend. This relative lack of foreign investment can act as a restraint on the expansion of imports.

FOREIGN TRADE BARRIERS

Much of the recent increase in FDI flows reflects restructuring in the financial services and telecommunications sectors. The Japanese government has recognized the importance of FDI in revitalizing its economy. Prime Minister Koizumi, for example, vowed in January 2003 to double the stock of FDI in Japan in five years. Japan has since taken several steps to improve the FDI environment, including revision of the Corporate Code in June 2005 to permit the use of triangular stock swaps for international M&A deals, although implementation has been postponed until a year after the rest of the new Corporate Code takes effect in April 2006. U.S. businesses have applauded these steps, but continue to urge that tax rules be clarified and amended to facilitate use of modern merger techniques.

Cross-border M&As are more difficult in Japan than in other countries, partly because of conservative attitudes towards outside investors and partly because of differing management techniques and the relative lack of financial transparency and disclosure. The scarcity of qualified lawyers, auditors, and accountants is another impediment. Although negative media coverage of a recent high-visibility takeover attempt and efforts by some parts of the Japanese business community to erect barriers to beneficial investment still reflect traditional antipathy toward FDI, Japanese attitudes toward inward investment have become more positive, and some progress has been made through the introduction of consolidated taxation and revised bankruptcy procedures that make it easier for corporations and their assets to be acquired or merged in a "rescue" format.

The U.S.-Japan Investment Initiative, co-chaired by the U.S. Department of State and Japan's Ministry of Economy, Trade and Industry (METI), was established in 2001 to focus on needed changes in the basic operating rules of Japanese markets and to encourage policy changes to improve the overall environment for foreign (and domestic) investment. The Investment Initiative has held a series of meetings and seminars. The Working Group of the Initiative met in Tokyo in January, May and December 2005, and Investment Seminars were held in Nagoya and Chiba in May 2005 and in New York and San Jose in December 2005. The Working Group will meet again in spring 2006, and seminars are tentatively planned for October 2006 in Sendai and the Tokyo region. The private sector participates actively in this process and has offered detailed suggestions on how to increase transparency, as well as recommending the introduction of new financial instruments for international transactions.

ANTICOMPETITIVE PRACTICES

There are detailed discussions related to anticompetitive practices and Antimonopoly Act (AMA) enforcement in several other parts of this report, particularly under the Regulatory Reform section.

Law Against Unjustified Premiums and Misleading Representations: The JFTC imposes overly restrictive limits on the use of premium offers (prizes) and other sales promotion techniques, and thereby discourages even legitimate cash lotteries and product giveaways used in such promotions. Foreign newcomers, who depend on innovative sales techniques to market their company names and products, are significantly impaired by the JFTC's restrictions on premiums. In addition, the JFTC allows "fair trade associations" (essentially, private trade associations) to set their own promotion standards through self-imposed "fair competition codes."

FOREIGN TRADE BARRIERS

Trade associations often use the cover of these codes to adopt additional standards that are stricter than required by JFTC regulations under the Premiums Law and have the effect of restraining vigorous competition. As of December 31, 2005, there were still 40 JFTC-authorized premium codes.

ELECTRONIC COMMERCE

The United States made numerous recommendations in its December 2005 Regulatory Reform submission for maximizing the adoption and use of information technology (IT) and electronic commerce, including: removing regulatory and non-regulatory barriers; strengthening the protection of intellectual property rights; implementing the new Privacy Law in a transparent, coordinated and consistent manner; expanding IT procurement opportunities; and ensuring effective network and online security. The United States is urging Japan to ensure that laws governing electronic transactions are technology-neutral and are compatible with international practice. The United States will continue to work with Japan on these and other electronic commerce issues through the IT Working Group under the Regulatory Reform Initiative. (*For more details, see the "Information Technologies" section under Regulatory Reform.*)

OTHER BARRIERS

Aerospace

Japan is the largest foreign market for U.S. aircraft and aerospace products. The commercial aerospace market in Japan is generally open to foreign firms, and many Japanese firms have entered into long-term relationships with American aerospace firms. The U.S. Government continues to monitor Japan's funding for the development of an indigenous small aircraft.

Military procurement by the Japan Defense Agency (JDA) accounts for over half of the domestic production of aircraft and aircraft parts and continues to offer the largest source of demand in the aircraft industry. Although U.S. firms have frequently won contracts to supply defense equipment to Japan (over 90 percent of the annual foreign defense procurement is from the United States), the JDA has a general preference for domestic production or the licensing of U.S. technology for production in Japan to support the domestic defense industry.

Japanese defense projects are carried out according to the Mid-Term Defense Program (JFY2005-2009), which began in April 2004, and has a projected budget of \$224 billion over this five-year period. Major projects include: ground and maritime ballistic missile defense systems, new maritime patrol aircraft, and new transport and tanker aircraft.

Although Japan has considered its main space launch vehicle programs as indigenous for many years, U.S. firms continue to participate actively in those space systems, including Japan's primary space launch vehicle, the H2-A. The U.S. Government has welcomed Japan's plans to develop a supplementary GPS navigation satellite constellation known as the "quasi-zenith" system, with the first launch scheduled for 2008.

FOREIGN TRADE BARRIERS

The United States is working very closely at the technical level with Japanese counterparts to ensure the Japanese system remains compatible with the U.S. system and anticipates that U.S. companies will have the opportunity to supply major components of this system. The United States will continue to promote expanded access by American firms to commercial opportunities in Japan's domestic space programs as appropriate.

Autos and Auto Parts

Further opening of the Japanese auto and auto parts markets remains an important objective of the United States, but access to Japan's automotive market continues to be impeded by a variety of overly restrictive regulations, a lack of transparency in rule making, and lackluster enforcement of antitrust laws. While there has been a trend toward closer integration and important technological advancements in the global automotive industry over the past several years, the effect these changes will have on market access and competition in this sector remains unclear.

The U.S. Government remains disappointed with overall flat sales of North American-made vehicles and parts in Japan. Sales in Japan of motor vehicles produced in the United States increased slightly by 3.1 percent in 2005, following a decline of 8 percent in 2004. U.S. automakers currently sell less than 12 percent as many U.S.-made vehicles in Japan as they did in 1995.

Even as American automakers have invested in Japanese auto manufacturers, foreign access to Japan's automotive distribution network remains troubling to U.S. auto companies. The U.S. automotive trade imbalance with Japan, \$50.2 billion in 2005 (\$35.2 billion deficit in autos and \$15.0 billion deficit in auto parts), is the equivalent of more than 60 percent of the overall U.S. trade deficit with Japan and made up 6.5 percent of the 2005 worldwide U.S. trade deficit.

The United States continues to work with Japan to address crosscutting issues affecting the automotive sector, such as expanding opportunities for foreign investment, increasing transparency in rule making, and promoting corporate restructuring in the Japanese economy under the Economic Partnership for Growth.

Civil Aviation

Although market access for U.S. air carriers in Japan was improved significantly by an agreement reached in 1998, U.S. carriers remain constrained by enduring restrictions on traffic rights, operational flexibility, and pricing and by extremely high airport costs in Japan.

Several rounds of formal and informal talks aimed at further liberalization have taken place between the two sides since the 1998 agreement was signed, but without any success. The two sides met in July 2005, and the result was an informal proposal which would have benefited only one U.S. carrier. The U.S. Government's attempt to expand the scope of that offer in bilateral talks in January 2006 was to no avail. In light of Japan's position, the United States is considering how best to move forward.

Key U.S. concerns include restrictions on operating rights for non-incumbent cargo carriers, limitations on same country carrier code-sharing, change of gauge limitations, and restrictive pricing practice.

Due to its geographic location as the closest landing point in Asia from the United States, several U.S. carriers maintain large hub operations at Narita International Airport. Nonetheless, in comparison to similar international airports in other countries, movements at Narita fall well below potential airport capacity, unnecessarily limiting slot availability. In periods of high demand, U.S. non-incumbent combination carriers have been unable to operate routes made available under the 1998 Memorandum of Understanding (MOU). A second runway opened in April 2002 provides additional slots, but at less than 2500 meters, the runway cannot accommodate most long-haul operations. An extension project to allow use of this runway for long-haul routes is underway, but this project is bundled with other capital upgrades and the overall budget tops 33 billion yen. At this point it is not clear this project will be able to pay for itself, and it is possible an increase in the already high user-fees will be used to finance it. Recently lowered landing fees at Narita were offset in part by raising other fees and introducing new ones. The issue of excessively high landing fees at Kansai and the new Central Japan International Airport (Centrair) airports continues to be raised in the U.S.-Japan Regulatory Reform talks and in bilateral aviation discussions. (*See the "Regulatory Reform Initiative" in the Distribution Section.*)

The international business and tourism sector in Japan is constrained by high landing and users fees at Narita, Kansai and Centrair Airports. Opening the formula used to calculate landing fees at Japan's international airports to public comment and ensuring the landing fee calculation at all airports is transparent both for domestic and international flights would benefit both Japanese consumers and the civil aviation industry.

The United States will continue to press for further liberalization consistent with its global policy to promote competition and market access in civil aviation.

Business Aviation

Japan's regulatory framework impedes the development of business aviation. The regulations for commercial airline safety, maintenance, and repair regulations administered by the Japan Civil Aviation Bureau (JCAB) of the Ministry of Land, Infrastructure, and Transport (MLIT) also apply to business aircraft, thus raising the costs of qualification, operation, and maintenance. Landing business planes is difficult due to limited slots and local rules that hamper flexible scheduling, especially near Tokyo. The result of such regulatory burdens is that Japanese companies, foreign companies in Japan, and foreign companies interested in doing business with Japan currently cannot use business aviation effectively and economically. Further, these burdens are a barrier to foreign direct investment since investors cannot easily land at Japanese airports. U.S. aircraft manufacturers believe that the regulatory burden has limited sales of their planes to Japanese companies that would greatly benefit from their use.

Multiple airports in the Chubu and Kansai regions now welcome business aircraft, providing many of the same services that business aircraft operators receive in the United States and Europe. Since April 2005, regional (non-designated) airports may also accept landings of international charter and business aviation flights with only three days notice, provided that customs, immigration and quarantine (CIQ) is available. But airports in the Tokyo metropolitan area, namely Narita and Haneda, remain extremely difficult to use for business flights. Moreover, severely restricted hours for landings and take-offs and the lack of services significantly limit travel on business aircraft to and within Japan.

Based on the growing needs of business aircraft owners and operators, the United States recommends that JCAB reexamine the application of these civil aviation regulations to business aviation and develop appropriate regulations specific to the business aviation industry. The United States encourages JCAB to consider the regulatory reform requests submitted by U.S. and Japanese industry. In advance of the opening of the additional runway at Haneda planned for 2009, the United States urges Japan to make immediate improvements in the overall regulatory framework.

Electric Utilities

The United States continues to stress that by introducing genuine competition into non-fuel procurement (valued at approximately \$10 billion annually) Japan can effectively reduce the cost of its electric power, which remains among the highest in the industrialized world. U.S. exports should rise significantly if barriers are lifted. U.S. exports currently account for approximately 3.5 percent of Japanese electric utility procurements, or around \$350 million per year. Japan's utilities actively participate in the New Orleans Association (NOA), a U.S. Embassy-sponsored forum that enhances communication between Japanese electric power utilities and U.S. suppliers of non-fuel materials, equipment, and services. The United States continues to urge Japanese utilities to further increase procurement of foreign products and services (which often prove more economical) and to seek greater transparency and fairness in the procurement process.

Foreign firms face barriers due to standards and specifications used by Japanese utilities that often discriminate against or disproportionately burden foreign suppliers. Problems remain in the use of narrow, dimension-based technical standards rather than performance-based technical standards, and requirements that suppliers provide detailed information for spare parts originating from outside sources. In addition, because each utility uses its own specifications (in some cases, different departments of a utility use their own specifications), suppliers must prepare more than ten production lines in order to sell to Japan's ten electric power companies. Some Japanese utilities also require that foreign and domestic suppliers register with the utility, a process that can involve submission of product and test data and can be extraordinarily time consuming. In addition, there have been allegations that Japanese utilities rejected registration applications by foreign suppliers because the foreign companies are not consumers of electricity generated by Japanese utilities. Finally, sufficient access to procurement information is difficult to obtain.

Transport/Ports

U.S. carriers serving Japanese ports have long encountered a restrictive, inefficient and discriminatory system of port transportation services. In October 1997, after repeated diplomatic efforts to remove these restrictions, the U.S. Federal Maritime Commission (FMC) assessed a \$100,000 fee on each ocean voyage to the United States by Japanese shipping lines. This prompted Japan to agree in October 1997 to substantial regulatory reform of its ports sector and the fees were suspended in November 1997. The U.S.-Japan understanding also noted side agreements designed to reduce the power of the Japan Harbor Transport Association (JHTA) from deterring competition in the sector. Japan amended its Port Transportation Business Law (effective November 2000) to eliminate the need for new entrants to prove there is surplus demand. Charges for harbor services in nine large ports are subject to a prior notification requirement and there is an approval requirement for other ports by the Ministry of Land, Infrastructure and Transport (MLIT). The nine large ports are Keihin (Tokyo, Yokohama and Kawasaki), Chiba, Shimizu, Nagoya, Yokkaichi, Osaka, Kobe, Kanmon (Shimonoseki and Kitakyushu), and Hakata. In May 1999, the FMC removed its rule imposing the fees, and imposed a semi-annual reporting requirement on two U.S. and three Japanese shipping lines.

Since 1999, the United States has expressed its concern that reforms have not lessened JHTA's ability to deter new entry and restructuring in the ports sector. The United States has noted that the revised Port Transportation Business Law did eliminate the economic needs test and licensing requirement at the nine large ports, although the amended law still maintains a permission system for new entrants to port services operations in those ports. The Port Transportation Business Law introduces new requirements that run counter to the need for efficient port operations and discriminate against new entrants wishing to offer port services. For example, minimum manning levels for new entrants was set at 150 percent; new terminal operators are required to conduct all terminal operations as a joint venture or under a close ties relationship with established Japanese operators; a new licensing rule was introduced, requiring excessive and unnecessary information such as business plans; and the Japanese government now has the authority to disallow rates for port services found to be anticompetitive. In addition, MLIT has not addressed concerns about the prior consultation process conducted by the JHTA nor about the apparent threat of illegal strikes against foreign carriers who obtain permission to operate their own container terminals.

In August 2001, citing its continuing concern that these issues had not been resolved, the FMC ordered the five U.S. and Japanese carriers and several other major shipping lines serving the U.S.-Japan trade to report detailed information on the effects of recent changes in Japanese port laws and ordinances. The ongoing semi-annual reporting requirements continue only for the two U.S. carriers and the three Japanese lines named in the original proceeding. The United States will continue to closely monitor how these changes affect port operations and to urge faster regulatory reform in the port sector. Both the Japanese and U.S. positions, however, have solidified over the years. At the 2005 High-Level Regulatory Reform meeting, the U.S. Government reiterated its position that the Japanese government has failed to implement important aspects of the wide-ranging port deregulation promised in 1997.

KAZAKHSTAN

TRADE SUMMARY

The U.S. goods trade deficit with Kazakhstan was \$563 million in 2005, an increase of \$345 million from \$218 million in 2004. U.S. goods exports in 2005 were \$538 million, up 68.0 percent from the previous year. Corresponding U.S. imports from Kazakhstan were \$1.1 billion, up 104.5 percent. Kazakhstan is currently the 77th largest export market for U.S. goods.

The stock of U.S. foreign direct investment (FDI) in Kazakhstan in 2004 was \$4.8 billion, down from \$5.0 billion in 2003.

Kazakhstan has been negotiating membership in the WTO since January 29, 1996. Kazakhstan is still negotiating market access agreements with a number of WTO members, including the United States, and made progress in 2005 with several other WTO Members, including China, Pakistan, Turkey, and the Republic of Korea. In the area of WTO rules, additional legislative changes to eliminate WTO-inconsistent practices and fully implement WTO provisions will be necessary in several sectors, including subsidies based on use of local materials, customs practices, SPS, TBR, and taxation.

The U.S.-Kazakhstan Bilateral Trade Agreement, which came into force in 1993, grants reciprocal, normal trade relations treatment. A bilateral investment treaty (BIT) came into force in January 1994.

IMPORT POLICIES

Kazakhstan is a member of the Eurasian Economic Community (EAEC) along with Russia, Kyrgyzstan, Belarus, and Tajikistan. Moldova and Ukraine currently have observer status. Trade among the five EAEC countries is generally duty-free, but protective measures, including tariffs, may be applied in selected areas. The countries have not yet established a common external tariff. The EAEC is developing coordinated customs procedures, which it hopes to complete in 2006, that would reduce the cost of transshipment through the EAEC member states of U.S. goods destined for Kazakhstan. Kazakhstan is also (with Russia, Ukraine, and Belarus) part of the Single Economic Space (SES), a nascent common market. Kazakhstan is committed to deeper integration with its neighbors through SES, but the progress of this organization has been hampered by uneven levels of enthusiasm from its members, as well as by the sheer number of founding documents that must be negotiated.

FOREIGN TRADE BARRIERS

The average weighted applied import tariff in Kazakhstan is approximately 7.9 percent. Goods imported for short-term use in Kazakhstan under a temporary import regime can be fully or partially exempt from duties, taxes and non-tariff regulations. The government has the right to issue a list of goods that cannot be temporarily imported into Kazakhstan. Typical examples of goods not eligible for duty exemptions are food products, industrial wastes, and consumables.

As with the 1994 Foreign Investment Law, the Law on Investments, enacted in January 2003, provides customs duty exemptions for imported equipment and spare parts, but only if Kazakhstan-produced stocks are unavailable or not up to international standards.

Kazakhstan's new Customs Code became effective on May 1, 2003, superseding the previous law which had been in effect since 1995. There are positive changes in the Code, such as provision for WTO-compliant customs valuation methodologies. In practice, however, customs administration remains a problematic aspect of trade. In addition, key provisions for such practices as voluntary disclosure are not included in the Code.

The customs authorities continue to discuss the automation of customs procedures, but little progress has been made. Since October 2002, Kazakhstan has maintained a "customs audit" procedure administered by a private contractor. The contractor determines customs value based on a database of world prices, in contravention of international standards. Under this system, approximately 20 percent of all goods crossing Kazakhstan's borders are subject to valuation uplifts. While the government pays for inspections, the declaring party pays penalties in the event of discrepancies. There are concerns that this process is used to generate extra-legal revenues. Courts have overruled the Customs authorities on over 85 percent of all appeals under this system. In addition, Ministry of State Revenues Order 402 sets conditional prices for certain imports, a practice inconsistent with international norms.

U.S. companies have consistently identified Kazakhstan's requirement that they obtain a "transaction passport" to clear imported goods through customs as a significant barrier to trade. This regulation is designed to stem capital outflows and money laundering by requiring importers to show copies of contracts and other documentation to legitimize and verify the pricing of import/export transactions. The practice retards the growth of trade, as the regulations place relatively tight restrictions on transaction parameters. For example, the regulations allow a maximum financing term for imports of 120 days, after which time the transaction passport lapses. This limits the range of business activity and creates a potential bias towards short-term financing in the economy.

STANDARDS, TESTING, LABELING AND CERTIFICATION

Kazakhstan's system of Metrology, Accreditation, Standards and Quality (MAS-Q) has long been considered by businesses to be weak and fragmented. Many businesses complained of mandatory certification requirements that have no technical basis or aim. The Committee on Standards, Metrology and Certification – Gosstandart (the national governing body operating under the Ministry of Industry and Trade) was plagued by frequent management changes that make stable, long-term progress difficult. Government observance of existing standards, testing, labeling, and certification requirements was reported to be uneven.

FOREIGN TRADE BARRIERS

In response to these well-known deficiencies, Kazakhstan adopted new legislation in 2005. The legislative base governing technical regulation and metrology in Kazakhstan now consists of the laws “On Technical Regulation,” “On Ensuring Uniformity of Measurement,” and on supporting government regulations, which were adopted in furtherance of the government’s 2004-2006 programs for the development of national systems of standardization and certification. Of the government’s regulations, the most fundamental is entitled “On the Mandatory Confirmation of Compliance of Products in the Republic of Kazakhstan.”

The law “On Technical Regulation” was signed on November 9, 2004, and came into effect on May 13, 2005. This new law supersedes two previous laws, “On Standardization” and “On Certification.” The main purpose of the new law is to define the division of responsibilities between the state and private sector. The government is responsible for product safety, while the private sector is responsible for quality control.

Though this new law cancels the laws “On Standardization” and “On Certification,” some approaches from the old laws have been maintained. Under the new law, a wide range of goods is subject to mandatory certification requirements. The certification requirements apply to both domestically produced and imported goods. A related regulation lists the categories of products subject to certification, which include but are not limited to machines, cars, agricultural equipment, clothes, toys, food, and drugs.

Standards for imported goods are addressed further in the law “On Technical Regulation.” That law specifies that contracts for the delivery of imported goods subject to mandatory certification should be required to confirm compliance with the mandatory certification. Such contracts should be accompanied by documents describing the products and listing the country of origin, the producer, the expiration date, storage requirements and code of use in both the Kazakh and Russian languages. In addition, the law states that foreign certificates, testing protocols and compliance indicators will be in accordance with international treaties.

The government has accepted placement of Kazakh language stickers on products as compliance with the law, instead of requiring entirely new labels. The government has also issued a wide-ranging regulation exempting pharmaceutical products and several other categories of goods from the Kazakh labeling requirement.

GOVERNMENT PROCUREMENT

Kazakhstan is reforming and harmonizing its system of state procurement. Some potential U.S. investors have raised concerns about the transparency and efficiency of Kazakhstan’s government tender process.

The State Procurement Agency was established by Presidential decree in December 1998, and the “Regulation on the State Procurement Agency” was approved in March 1999.

In October 2004, the State Procurement Agency was merged with the Committee on Financial Control and was accordingly subordinated to the Ministry of Finance. The procurement process in Kazakhstan is regulated by the law “On State Procurement” and by the Budget Code, the current version of which applies to budgets for 2005 onward.

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The government has taken steps to improve the transparency of the procurement process. In particular, the Committee on Financial Control published on its website the state register of agencies and state enterprises subject to state procurement regulations, the “Rules of Inclusion and Exclusion” that determine whether an agency or a state enterprise is subject to government procurement regulations, and a blacklist of unfair and unreliable suppliers of goods and services.

However, the government procurement situation remains inadequate. Since January 2005, about 240 court claims against ministries and state enterprises have been filed. An inspection by the Finance Ministry identified procurement violations in the amount of 81 billion tenge (about \$602.2 million) during the first nine months of 2005. Further legislative improvement in this area is needed.

The “Rules on Oil and Gas Procurement,” which went into effect in 2003, also give significant preferences to local suppliers, and establish what many firms, foreign and domestic, consider unwarranted state interference in even small tenders. Despite governmental promises to amend the rules, they remain as originally drafted although it does not appear that the government enforces them.

U.S.-funded assistance projects are helping Kazakhstan to establish a database to assist in procurement. The database was launched by the State Procurement Agency in 2003, but is still incomplete.

INTELLECTUAL PROPERTY RIGHTS PROTECTION

The 1992 U.S.-Kazakhstan Agreement on Trade Relations incorporates provisions on the protection of intellectual property rights (IPR). As part of its effort to join the WTO, Kazakhstan began in 2003 to bring its IPR legislation into compliance with the WTO’s Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS Agreement) and other international conventions and agreements. In 2004, Kazakhstan was identified on USTR’s Special 301 “Watch List” and an industry-initiated case is pending to review Kazakhstan’s status as a beneficiary country under the U.S. Generalized System of Preferences (GSP) program.

In 2004, Kazakhstan ratified the World Intellectual Property Organization (WIPO) Treaties on Copyrights and the Uses of Performances and Phonograms, and amended the Law on Copyrights to guarantee retroactive protection to copyrighted works. In addition to legislative initiatives, Kazakhstan has worked cooperatively with law enforcement agencies, public organizations and international organizations to fight piracy.

In 2005, the Government of Kazakhstan worked toward improving its IPR regime. A new law lowered the minimum threshold for criminal liability for IPR violations, increased penalties for both criminal and administrative infringements, and expanded the government’s power to protect intellectual property. A new government working group, comprised of key enforcement agencies along with private industry groups, was formed to combat piracy. Since these changes are so recent, it remains to be seen what effect the new penalties and IPR working group will have on enforcement and piracy/counterfeiting rates nationwide. In addition, although the

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Customs Code provides for the seizure at the border of items that violate IPR, there is little border protection against the import of illegal material, as illegal sound recording continue to be imported, particularly from Russia and China.

SERVICES BARRIERS

The Oil and Gas Procurement Regulations, enacted in June 2002 (see Investment Barriers, below), stipulate that oil companies must purchase services only from Kazakhstan-based companies unless the required service is unavailable in Kazakhstan.

INVESTMENT BARRIERS

According to major foreign investors and law firms, Kazakhstan's Investment Law represented no significant improvement over prior legislation. Investors have concerns about the Law's narrow definition of investment disputes and its lack of clear provisions for access to international arbitration.

There has been a trend over the past few years to favor domestic over foreign investors in most state contracts. The 1999 amendments to the Oil and Gas Law required mining and oil companies to favor local goods and services. The rules implementing these legal provisions were enacted in June 2002 (Decree 612), but were not being enforced as of December 2005. The decree creates onerous requirements for government involvement in, and approval at, each stage of private procurement.

Amendments to the Law on Subsurface Use adopted in December 2004, require investors to state in their tender proposals what affirmative actions they will take to satisfy local content requirements. Operations can be suspended for up to six months if a company is found to have failed consistently to meet the requirements.

The July 2005 Law on Production-Sharing Agreements (PSAs) contains explicit requirements regarding local purchase of goods and services and the hiring of Kazakh nationals, and applies to all investment in offshore oil and gas exploration and production. The new law also requires that KazMunayGas, the national oil company, have a minimum 50 percent share in offshore projects, and it creates a new means by which the national oil company may obtain field rights outside of a tender process. Taken together, these clauses establish KazMunayGas as a necessary partner for international oil companies investing offshore, at least in the initial stages of an agreement.

In 2005, Kazakhstan added a controversial "pre-emption" amendment to its Law on Subsurface Use. The amendment guarantees the state a right of first refusal when a party seeks to sell any part of its stake in a mineral resource extraction project. The state claims this preeminent right even in cases where the controlling agreement assigns preemptive rights elsewhere (e.g. to other investors in a consortium.) The amendment applies the preeminent right retroactively, as well. This new amendment raises serious questions about the government's respect for contract sanctity.

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In October 2005, the government asserted even broader pre-emption rights under national law. The government now claims for itself pre-emptive rights when an investor seeks to purchase a company that possesses drilling rights. Theoretically, this latest assertion of pre-emptive rights (which has not yet been tested) could be read as a statement that the Government of Kazakhstan has a preferential right to purchase or prevent the sale of stock in any company that is involved in the oil, gas, or mining sectors in Kazakhstan.

The Law on Subsurface Use prohibits gas flaring except in emergency cases. Amendments adopted in October 2005 mitigate this requirement, providing for a transition period up to July 1, 2006, for subsurface users to draft and present to the government a program for gas utilization.

Kazakh law allows citizens of Kazakhstan and foreigners to own land under commercial and non-commercial buildings, including dwellings and associated land. Such land may be leased for up to 49 years. The new land code, which came into effect in June 2003, for the first time allows the private ownership by Kazakhs of agricultural land, in addition to industrial, commercial, and residential land. Foreign individuals and companies may still only lease agricultural land for up to 10 years, however, and the wording of the law is unclear with regard to the purchase of such land by local legal entities, either wholly-owned or joint ventures.

Kazakh authorities often require, as part of a foreign firm's contract with the government, that the firm contribute to social programs for local communities.

Foreign insurance companies are limited to operating in Kazakhstan through joint ventures with Kazakh companies. Overall capital of all foreign insurance companies may not exceed 25 percent of the non-life insurance market and 50 percent of the life insurance market. The total registered capital of banks with foreign participation must remain below 25 percent of the total registered capital of all banks in Kazakhstan. Foreign ownership of individual mass media companies is limited to 20 percent. Legislation is under consideration that would lift the restrictions on foreign participation in the registered capital of Kazakh banks, but would leave other restrictions in place.

Foreign investors continue to have difficulty obtaining work permits for employees who are not Kazakh nationals. A quota system established in 2001 limited the number of work permits for that year to 10,500, with exceptions for investors' lead representatives. The quota is set each year, based on a percentage of foreign labor as a share of the total national work force. Many companies report that permits for key managers and technicians are routinely rejected or granted for unreasonably short periods, or are conditioned upon demands for additional local hires. Companies also note that hiring regulations are confusing and interpreted inconsistently by local officials and by the Ministry of Labor and Social Protection.

The government, however, has been steadily increasing the number of work permits available. In 2003, the number of permits was limited to 0.14 percent of the economically active population (reckoned to be about 8 million people). The figure increased to 0.21 percent in 2004 and to 0.32 percent in 2005. In the first half of 2005, 15,086 foreigners held valid work permits.

FOREIGN TRADE BARRIERS

Kazakhstan adopted a new international commercial arbitration law in late 2004. The law sets the role for international arbitration institutions in Kazakhstan at all stages: from the adoption of an arbitration clause in a contract through the execution of an arbitral decision. The law defines the organizational and legal elements of arbitral proceedings in Kazakhstan, and the conditions for recognition and execution of arbitral decisions made in foreign states. In practice, the Government of Kazakhstan has not consistently observed international practices relating to arbitral awards.

OTHER BARRIERS

There are other structural barriers to investment in Kazakhstan, including a weak system of business law, a lack of effective judicial system for breach-of-contract resolution, and an unwieldy government bureaucracy. Many companies report significant logistical difficulties serving the Kazakh market. In addition, there is a burdensome tax monitoring system for all companies operating in Kazakhstan. Many companies report the need to maintain excessively large staffs in Kazakhstan to deal with the cumbersome tax system and frequent inspections.

In 2001, Kazakhstan adopted transfer pricing legislation that gave tax and customs officials the authority to monitor export and import transactions in order to prevent manipulation of export prices. However, foreign investors are concerned because the government rejected the use of OECD standards to determine proper market prices, creating instead a methodology that fails to account for all cost and quality differences. The government also holds that transfer pricing can take place even in transactions between unaffiliated parties.

KENYA

TRADE SUMMARY

The U.S. goods trade surplus with Kenya was \$284 million in 2005, an increase of \$243 million from \$42 million in 2004. U.S. goods exports in 2005 were \$632 million, up 60.5 percent from the previous year. Corresponding U.S. imports from Kenya were \$348 million, down 1.2 percent. Kenya is currently the 72nd largest export market for U.S. goods.

The stock of U.S. foreign direct investment (FDI) in Kenya in 2004 was \$93 million, up from \$91 million.

IMPORT POLICIES

Tariffs

Kenya is a member of the WTO, the Free Trade Area of the Common Market for Eastern and Southern Africa (COMESA), and the East African Community (EAC). High import duties and value-added tax (VAT) pose trade barriers, especially in the agricultural sector. Kenya's import regulations on agricultural products are sometimes altered to reflect fluctuations in domestic supply and demand as well as political factors. With the establishment on January 1, 2005 of the EAC Customs Union (between Kenya, Uganda, and Tanzania), the government established three tariff bands: zero duty for raw materials and inputs, 10 percent for processed or manufactured inputs, and 25 percent for finished products. A selected list of sensitive items was assigned rates above 25 percent, including milk and milk products, wheat, corn, rice, and wheat flour. (Wheat flour is imported duty free from member states of COMESA and the EAC.) Tree nuts are not classified under the sensitive products list but witnessed an increase in duty. Unshelled almonds increased from 0 percent to 10 percent, and shelled almonds and other nuts increased from 15 percent to 25 percent. The duty on used clothing, a major U.S. export to the EAC region, was increased to 45 percent or \$0.30 per kilogram, whichever is higher. In 2004, the government introduced an export tax on hides, skins, and scrap metal to encourage local processing rather than the export of these items. Other measures introduced in 2005 include the removal of import duties on pharmaceuticals, diapers and sanitary pads, liquid petroleum, coal, media containing computer software, safety belts, speed governors, and splints for manufacture of matches, and the exemption of duty for refrigerated trucks and hotel equipment.

The Kenyan government sometimes manipulates the application of the VAT to support policy priorities, both to protect "strategic" sectors such as transportation and agriculture and to address short-term needs. For example, in 2004, Kenya eliminated the VAT and duty on a limited quantity of imported maize to address severe food shortages.

Non-Tariff Measures

Kenya has removed most non-tariff measures; however, some barriers still remain. Kenya still maintains import controls based on health, environmental, and security concerns. Until

FOREIGN TRADE BARRIERS

September 28, 2005 all imports with a free on board value of more than \$5,000 were subject to pre-shipment inspection for quality, quantity, and price, and required a Clean Report of Findings by a government-appointed inspection agency. On September 29, 2005, the government introduced a new Pre-shipment Verification of Conformity (PVC) program. Under the new system, goods are only allowed into the country if they have a Certificate of Conformity from the country of origin, demonstrating conformity to Kenyan standards. For consignments shipped without inspections, importers may apply for a destination inspection subject to Kenya Bureau of Standards (KEBS) acceptance. For destination inspection, a penalty of 15 percent and a 15 percent bond of the CIF (cost, insurance, freight) value plus the costs of the test will be charged to the importer. KEBS has appointed two private firms to implement the PVC program on its behalf.

Customs Procedures

Kenya is a party to the WTO Customs Valuation Agreement and uses the transaction value for valuation of goods imported from other WTO signatories. Concerns have been raised, however, that this system is not applied consistently. Kenya's customs procedures are detailed and rigidly implemented, often leading to delays in clearance of both imports and exports. In September 2005, Kenya Revenue Authority introduced a new electronic clearing system at the Port of Mombasa, Kenya's major port of entry for imports. Poor implementation, capacity, and information-sharing have created significant delays for some importers. The two private sector firms that administer Kenya's Pre-shipment Verification of Conformity regime have been charged with ensuring that up-to-date customs valuation and risk assessment methods are applied.

STANDARDS, TESTING, LABELING AND CERTIFICATION

Commercial and research applications of agricultural biotechnology in Kenya are currently regulated through guidelines that are neither formal regulations nor enacted law. The guidelines, published in 1998, describe a committee-based approach for review and approval of agricultural biotechnology imports, including specific review of end uses (e.g., planting seeds for trials). Substantial quantities of agricultural biotechnology products have been imported into Kenya for food aid purposes since the establishment of the Biosafety Committee, and significant volumes of food products derived from agricultural biotechnology crops are available commercially. Kenya also imports maize from South Africa, where biotechnology varieties are commercially available. Kenya is a party to the Cartagena Protocol on Biosafety.

Certain Kenyan standards do not conform to international standards, and this has adversely affected foreign investment in the country. The Kenya Plant Health Inspectorate Service (KEPHIS) subjects certain imported agricultural goods to further inspection. The Inspectorate also regulates the import and export of plant materials and trade in biosafety control organisms (organisms that require special handling to ensure they are not accidentally released into the environment). KEPHIS evaluates commercial hybrid grain seeds for a period of three years before the seeds can be released to market. The Ministry of Agriculture restricts cereal seed imports by setting quantitative ceilings. However, once a variety is certified, the quantitative restrictions are lifted. Industry has found this certification process to be tedious and restrictive.

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U.S. agricultural plant products require special permits and certificates before they can be imported. KEPHIS requires submission of a Plant Import Permit. Genetic modification status must be declared, and details stated on the phytosanitary certificate, or a certificate of analysis from a credible laboratory obtained.

GOVERNMENT PROCUREMENT

Kenya is not a signatory to the WTO Agreement on Government Procurement. However, in 2005, Kenya enacted the Public Procurement and Disposal Act, which provides for a Public Procurement Oversight Authority. The Authority's nine-member Oversight Advisory Board is appointed by the Minister of Finance. This new authority entered into force on January 1, 2006, but certain elements of its implementation are uncertain. The legislation is designed to make procurement more transparent and accountable, requiring procurement agencies to carry out an annual update of pre-qualified firms, especially when dealing with restricted tenders, such as military tenders. The new law establishes penalties for violations of the law, with penalties for individuals up to Ksh4 million (about \$52,000) in fines, or imprisonment for three years, or both; and for corporations, fines of up to Ksh10 million (about \$130,300).

The new law gives exclusive preferences to Kenyan citizens where the funding is 100 percent from the government of Kenya or a Kenyan body and the amounts are below a yet-to-be determined threshold. The law allows for restricted tendering under certain conditions, such as when the complex or specialized nature of the goods or services limits the competition to pre-qualified contractors. Restrictions can also be imposed if the time and costs required to examine and evaluate a large number of tenders would be disproportionate to the value of the tender. There remains some uncertainty about how much transparency the new law will apply to tenders for national security-related projects, which have been the subject of a number of high-profile corruption cases in recent years.

Other reforms in public procurement have also been put in place in recent years. For example, the government increased transparency in bidding by removing from its tenders a clause that reads, "[T]he government reserves the right to accept or reject any bid and is not obliged to give any reasons for its decisions." The Central Tender Board now publishes its decisions and, if a bidder asks, provides reasons for rejecting certain bids.

The World Bank, IMF, European Union, and other donors have conditioned some of their official assistance programs, including direct budget support, on reform of public procurement. The donor community is hopeful that the revised public procurement laws will improve Kenya's public procurement performance, which has been frequently marred by flawed contracts, awards to noncompetitive firms, and awards to firms in which government officials have a significant interest. Kenya's meager conflict-of-interest regulations are rarely enforced.

EXPORT PROMOTION

Kenya's Manufacturing Under Bond (MUB) program is designed to encourage manufacturing for export. The program is open to both local and foreign investors. Enterprises operating under

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the program are exempted from duty and VAT on imported raw materials and other imported inputs and have 100 percent investment allowance on plant, machinery, equipment, and building. Firms operating in Export Processing Zones (EPZs) are exempted from all withholding taxes on dividends and other payments to non-residents during the first 10 years. They are also exempted from import duties on machinery, raw materials, and intermediate inputs. There are no restrictions on management or technical arrangements, and EPZ companies have access to expedited licensing procedures.

EPZ firms are allowed to sell up to 20 percent of their output on the domestic market. However, they are liable for all taxes on products sold domestically plus a 2.5 percent penalty. There is no general system of preferential financing, although sectoral government development agencies in areas such as tourism and tea are supposed to provide funds at below-market rates to promote investment and exports. Kenya's EPZs have become the center of Kenya's successful garment and apparel sector, with most of the production being exported to the United States under AGOA preferences.

INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

Kenya is a member of most major international and regional intellectual property conventions – the World Intellectual Property Organization (WIPO), the African Regional Industrial Property Organization, the Paris Convention for the Protection of Industrial Property, and the Berne Convention on the Protection of Literary and Artistic Works. The Kenya Industrial Property Act (as amended) is the implementing legislation for Kenya's obligations under the WTO Trade-Related Aspects of Intellectual Property Rights (TRIPS) Agreement. The U.S.-based International Intellectual Property Alliance has called on the Kenyan government to take a more active role in enforcing intellectual property protection and combating the spread of counterfeit and pirated goods. Pirated and counterfeit products in Kenya, mostly from East Asia, present a major impediment to U.S. business interests in the country

Amendments to Kenya's Trademark Act, designed to bring Kenya into conformity with the Madrid Agreement and Protocol as well as the TRIPS Agreement, were passed and came into force in 2004.

Computer programs sound recordings, broadcasts, and literary, musical, artistic, and audiovisual works are protected under the Copyright Act. The Kenya Copyright Board is supposed to coordinate all licensing and treaty activity and has the authority to inspect, seize, and detain suspect articles and to prosecute offenses; however, the KCB has minimal staff and has not, to date, performed this role effectively. The Kenya Copyright Board coordinates all licensing and treaty activity and has the authority to inspect, seize, and detain suspect articles and to prosecute offenses. Infringement of copyright, especially on music and films, is pervasive, and enforcement remains sporadic at best.

Kenyan artists have formed organizations to raise awareness of intellectual property rights and to lobby the government for better enforcement, but merchants are still free to peddle pirated versions of Kenyan and international works without fear of arrest or prosecution. Pirated

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materials and counterfeit goods produced in other countries are readily available in all major towns.

These materials include pre-recorded audiocassette tapes, DVDs, CDs, and consumer products. General understanding of the importance of intellectual property is limited. In October 2005, however, the High Court ruled in favor of the plaintiff in a copyright infringement case (Alternative Media Limited vs. Safaricom Limited) for the first time in Kenyan history.

In June 2004, the Kenya Revenue Authority, through a newly created Counterfeit Department, said that illegal trade costs the Kenyan economy an estimated Ksh 20 billion (about \$256 million) in unpaid taxes. Imported drugs, shoes, textile products, office supplies, tubes and tires, batteries, shoe polish, soaps, and detergents are the most commonly counterfeited items. Historically, penalties and enforcement for copyright infringement have been low.

SERVICES BARRIERS

In general, individuals and companies supplying services, whether local or foreign, are accorded the same treatment.

Telecommunications

Kenyan telecommunications are dominated by three state bodies: Telkom Kenya, the monopoly fixed line services provider; the Communications Commission of Kenya (CCK), the regulatory body; and the Postal Corporation of Kenya. In January 2005, the government ended Telkom Kenya's monopoly on Very Small Aperture Terminals (VSATs) and Internet bandwidth, and subsequently licensed a number of competing firms. In July 2004, the government suspended an award for a second national operator (SNO) for fixed-line telephone services. Subsequent court challenges have been resolved and the CCK is believed to be moving to re-bid that tender despite widespread skepticism that there is a commercial basis for a second license in light of subsequent changes in the market. In a new National Information and Communication Technology Policy released in late 2005, the government proposed major changes in the sector, including further restructuring of Telkom Kenya prior to its long-delayed privatization.

Two firms, Safaricom (a joint venture of Telkom Kenya and Vodafone) and Celtel (a joint venture of Vivendi and Sameer Investments), are licensed to provide mobile cellular telecommunications. These two companies have over five million subscribers as of December 2005. By comparison, Telkom Kenya provides only about 280,000 landlines. A 2003 award for a third mobile operator, Econet Wireless, remains mired in court challenges brought by the government.

As of June 2005, there were 72 registered Internet service providers (ISPs), but only 16 were actively providing commercial service; there were 14 public data network operators and 6 commercial VSAT hub operators. Foreign ownership of an ISP is restricted to 40 percent.

FOREIGN TRADE BARRIERS

Since 2004, Kenya's updated regulatory framework includes:

- Permitting cellular mobile operators (GSM) to construct and operate their own international gateways;
- Issuing additional licenses to provide Internet backbone and gateway, broadcast signal distribution, and commercial VSAT services on a first-come, first-served basis;
- Allowing public data network operators (PDNOs) to establish international gateways for data communication services; and
- Allowing Internet backbone and gateway operators, broadcast signal distributors, commercial VSAT operators, and public data network operators to carry any form of multimedia traffic. However, regulations liberalizing Voice Over Internet Protocol remain in development.

INVESTMENT BARRIERS

Kenya revised its investment promotion laws in late 2005. Investors who seek to benefit from incentive programs under the new law must obtain a certificate from the newly established Kenya Investment Authority and confirm that the amount to be invested is equivalent to at least \$100,000.

The investment climate in Kenya, however, remains problematic. A recent World Bank study indicated that the share of investors who perceive the investment climate to be deteriorating outnumbers the share of those who perceive it to be improving. In order to attract meaningful foreign investment, Kenya needs to address persistent concerns about corruption, security, and degraded road, rail, and telecommunications infrastructure. Kenya also must address relatively high energy and labor costs and an overabundance of national and local government regulations. A Foreign Investment Advisory Service (FIAS) report found that many regulatory systems are outdated and do not serve an identifiable purpose, and are exploited by low-level officials to extract bribes. The report also found that the current business registration system in Kenya is archaic, inefficient and unreliable. Starting a business takes on average over 54 days, compared to five in the United States. Licensing procedures were similarly found to be overly complex and, more importantly, to contain significant redundancies. Reviews of the legal sector found that the court system is in disarray, with a huge and growing backlog of cases.

The Kenyan government allows up to 75 percent foreign ownership (personal or corporate) of firms listed on the Nairobi Stock Exchange (NSE). If foreign ownership in a company is 75 percent at the time of listing on the NSE, the foreign owner is allowed to maintain (or reduce) but not to increase its share. Foreign investors may be allowed to increase their investment with prior written approval from the Capital Market Authority (CMA) if the shares reserved for local investors are not fully subscribed. Foreign brokerage companies and fund management firms must be locally registered companies, with Kenyan ownership of at least 30 percent and 51 percent, respectively.

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Foreigners are not permitted to have a freehold land title anywhere in the country, but can be granted leasehold titles - normally 99 years for land in towns and coastal beachfronts, and 999 years elsewhere. The cumbersome and opaque process required to purchase land, and concerns about security of title because of past abuses relating to distribution of public land, constitute serious impediments to new investment. Lack of confidence in the speedy and fair resolution of disputes and requests from officials for illicit payments continue to dampen the country's ability to attract more foreign investment.

Kenya has been slow to open public infrastructure to competition because the state-owned companies that control infrastructure are considered "strategic" enterprises. As a result, the reform and partial privatization of telecommunications, power, and rail sectors has fallen behind schedule. The Kenyan parliament passed a Privatization Bill in 2005 that outlines how the government will divest its shares in the state corporations.

Kenya applies fees and security bonds in an attempt to discourage the employment of foreign labor. New foreign investors with expatriate staff are required to submit plans for the gradual phasing out of non-Kenyan employees. Some investors have complained that it is difficult to obtain work permits for expatriate staff.

OTHER BARRIERS

Recent changes by the Kenya Revenue Authority for electronic customs clearances have created some confusion and delays at Kenya's ports of entry. Until the PVC program is improved, revised, or eliminated in favor of port of entry inspections, it will pose an added expense and administrative burden on exporters to Kenya. Also, allegations of corruption and on-going delays in cargo handling at the Port of Mombasa, the region's major trade hub, continue to add unnecessary costs for exporters.

Corruption remains a major deterrent to greater investment, both foreign and domestic, though foreign direct investment rose in 2004. According to the International Finance Corporation's Investment Climate Assessment for Kenya, corruption was rated as a severe or major obstacle by three-quarters of firms surveyed, with two-thirds of respondents stating they were expected to pay bribes for government contracts. In late 2005 and early 2006 there were public disclosures of high-level, grand-scale graft in both the previous and current administrations. Calls for greater accountability on the part of the media, civil society, and donors led to the unprecedented resignation of three cabinet ministers in early 2006, generating hopes that such activities may at last be on the wane. The Kenya Anti-Corruption Commission (KACC) launched several investigations over the past year against senior government officials. None of these cases has been successfully prosecuted, however, in large part due to bottlenecks in the Attorney General's Office and loopholes in the judiciary.

FOREIGN TRADE BARRIERS

KOREA

TRADE SUMMARY

The U.S. goods trade deficit with Korea was \$16.1 billion in 2005, a decrease of \$3.6 billion from \$19.8 billion in 2004. U.S. goods exports in 2005 were \$27.7 billion, up 4.8 percent from the previous year. Corresponding U.S. imports from Korea were \$43.8 billion, down 5.2 percent. Korea is currently the 7th largest export market for U.S. goods.

U.S. exports of private commercial services (i.e., excluding military and government) to Korea were \$9.1 billion in 2004 (latest data available), and U.S. imports were \$4.8 billion. Sales of services in Korea by majority U.S.-owned affiliates were \$4.0 billion in 2003 (latest data available), while sales of services in the United States by majority Korea-owned firms were \$247 million.

The stock of U.S. foreign direct investment (FDI) in Korea in 2004 was \$17.3 billion, up from \$13.0 billion in 2003. U.S. FDI in Korea is concentrated largely in the manufacturing, banking, and finance sectors.

FREE TRADE AREA NEGOTIATIONS

USTR notified Congress of the President's intent to initiate negotiations on a Free Trade Agreement (FTA) with the Republic of Korea on February 2, 2006. In making this announcement, the Administration noted that Korea is our 7th largest trading partner with over \$72 billion in total trade during 2005. An FTA between the two countries promises to increase trade still further across a wide range of goods and services and, thereby, promote economic growth and the creation of better paying jobs in both countries. The announcement highlighted how an FTA with Korea would produce gains from increased agriculture and industrial goods trade, increased services trade, improvements in the protection that Korea affords to intellectual property, and the promotion of bilateral investment. Building on the close cooperation between the United States and Korea in the Asia-Pacific Economic Cooperation (APEC) forum and in the Doha Round of negotiations in the World Trade Organization (WTO), an FTA will help strengthen Korea's partnership with the United States in multilateral and regional fora. An FTA also will reinforce the shared interests of the United States and Korea and promote common values, facilitating our efforts to work together on a wide range of issues.

IMPORT POLICIES

Tariffs and Taxes

Korea's average applied tariff rate is 11.2 percent for all products. Further, the simple average of Korea's WTO bound tariffs on all agricultural products is 52 percent, which poses a significant barrier to the export of U.S. agricultural goods. Although Korea bound 94.5 percent of its tariff lines in the WTO Uruguay Round negotiations, tariffs on most fishery products are not bound. The United States continues to press Korea to reduce its applied tariffs on agricultural and food products.

Duties remain very high on many high-value agricultural and fishery products. Korea imposes tariff rates of 30 percent or higher on most fruits and nuts, many fresh vegetables, starches, peanuts, peanut butter, various vegetable oils, juices, jams, beer, and some dairy products. Many products of interest to U.S. suppliers, including apples, beef, canned peaches, canned fruit cocktail, grape juice and grape juice concentrate, herbal teas, pears, table grapes, and a variety of citrus fruits are subject to tariff rates of 40 percent or higher.

Other products of interest to U.S. industry on which Korea imposes high tariffs include cherries, distilled spirits, frozen french fries, prepared or mashed potatoes, restaurant equipment, soups and mixed vegetable juices. In many instances Korea applies prohibitively high tariffs despite the absence of domestic production of certain agriculture products.

Korea also has established tariff-rate quotas (TRQs) that were intended to provide minimum access to previously closed markets or to maintain pre-Uruguay Round access. (*See also "Quantitative Restrictions, TRQs and Import Licensing."*) In-quota tariff rates may be very low or zero, but the over-quota tariff rates for some products are prohibitive. For example, natural and artificial honey are subject to an over-quota tariff rate of 243 percent; skim and whole milk powder, 176 percent; barley, 324 percent; malting barley, 513 percent; potatoes and potato preparations, more than 304 percent; and popcorn, 630 percent.

In order to protect domestic agricultural, fishery and plywood producers, Korea also uses "adjustment tariffs" and compounded taxes to boost applied tariff rates. Most of the adjustment tariffs are imposed on agricultural and seafood products, including frozen croaker and skate, which are products of interest to U.S. exporters. The U.S. Government has expressed concerns regarding these practices to the Korean government. In 2005, Korea renewed adjustment tariffs on 18 items, and reduced the tariff rates for five of these 18 items.

As a result of its Uruguay Round commitments, Korea also has reduced bound tariffs to zero on most or all products in the following sectors: paper, toys, steel, furniture, and farm equipment. Korea has harmonized its chemical tariffs to final rates of zero percent, 5.5 percent, or 6.5 percent, depending on the product. In addition, tariffs on scientific equipment have been reduced 65 percent from pre-Uruguay Round levels. However, on textile and apparel products, Korea's bound tariffs are relatively high: 30 percent on several man-made fibers and yarns, 30 percent on

many fabrics and most made-up and miscellaneous goods (for example, pillow cases and floor coverings), and 35 percent on most apparel items.

In September 2005, the United States, Korea, Japan, the European Union and Taiwan concluded a draft agreement under which each party would reduce the tariff rate on multi-chip integrated circuits (MCPs) to zero. All parties to this agreement are working to complete domestic procedures with a view to having the zero duty in place early in 2006. Once implemented, Korea will no longer apply a tariff of 2.6 percent on MCPs. *(For discussion of the MCP Agreement, please see Chapter 4 D, "Semiconductor Agreement")*

Internal Supports

As part of its commitments under the 1994 WTO Agreement on Agriculture, Korea reduced its domestic support (Aggregate Measurement of Support, or AMS) of agricultural products by 13 percent by 2004.

Quantitative Restrictions - Tariff-Rate Quotas (TRQs)

Most imported non-food products no longer require prior government approval, but some products, mostly agricultural and fishery items, face import restrictions such as quotas or tariff-rate quotas (TRQs) with prohibitive out-of-quota tariffs. Korea implements quantitative restrictions through its import licensing system, which is administered by domestic producer groups or government buying agencies such as the Korea Agro-Fisheries Trade Corporation (KATC) and the Public Procurement Services (PPS). A government export-import notice lists restricted products.

Korea also continues to restrict imports of value-added soybean and corn products. By aggregating raw and value-added products under the same quota, Korea restricts market access for value-added products such as corn grits, popcorn, and soy flakes. Domestic producer groups, which administer the quotas, invariably allocate the more favorable in-quota rate to their larger members, who import raw ingredients.

Rice

In the Uruguay Round, Korea received a ten-year exception to tariffication of rice imports in return for establishing a Minimum Market Access (MMA) quota. Under the MMA quota, Korea's rice imports grew over ten years from zero percent to four percent of domestic consumption during the base period. The Korean government, through state trading enterprises, exercised full control over the purchase, distribution, and end-use of imported rice. While Korea did not purchase any U.S. rice in the early years of the MMA program, in recent years the U.S. share of Korea's total MMA rice imports increased to roughly one-fourth, and the United States became Korea's second largest supplier of imported rice, after China.

The original MMA arrangement expired at the end of 2004. However, Korea successfully negotiated a ten-year extension of the MMA arrangement. Under the extension, the MMA quota

will increase from 225,575 metric tons in 2005 to 408,698 metric tons in 2014, of which a portion will be allocated on a country-specific basis (including at least 50,076 metric tons annually from the United States). The quality of access will also improve for the first time as a portion of the MMA quota will be marketed to consumers as table rice. The table rice portion will increase from 10 percent of the quota in 2005 to 30 percent in 2010. Korea's National Assembly ratified the rice agreement on November 23, 2005. However, insufficient time remained for Korea to fulfill its rice tendering obligations under the agreement in 2005. As a result, the 2005 tendering commitments to the United States were fulfilled in February 2006, and 2006 tendering commitments will likely begin in the middle of 2006, if not sooner. The U.S. Government will continue to monitor this situation closely to ensure that Korea fulfills its commitments.

Import Clearance Procedures

Import clearance for most agricultural products in Korea typically takes three to ten days for processed products containing no unapproved food additives. Obtaining approval for unapproved additives can take six months to one year.

Customs Procedures

The Korea Customs Service (KCS) frequently classifies "blended products" under the Harmonized System (HS) heading for the major ingredient of that product, rather than under the HS heading for the blended product, which usually has a lower tariff rate. Changes in classification are often based on arbitrary standards and are at odds with practices followed by other OECD members.

(For example, in order for dehydrated potato flakes to be classified as a blended product, they must include at least 10 percent non-potato ingredients.) "Blended products" disadvantaged by this practice include potato flakes, soybean flakes, flavored popcorn, and peanut butter chips. The U.S. Government is seeking a definition of "blended products" from the World Customs Organization before proceeding on discussions about this issue.

STANDARDS, TESTING, LABELING AND CERTIFICATION

Standards and Conformity Assessment Procedures (Sampling, Inspection, Testing and Certification)

Korea maintains certain standards and conformity assessment procedures, such as sampling, inspection, testing and certification, which are burdensome and have a disproportionate impact on imports. For example, Korea has not effectively adopted the "generally recognized as safe" standard. As a result, certain Korean standards are more restrictive than internationally recognized standards; consequently, imports of "generally recognized as safe" food are frequently detained. The Korean Food and Drug Administration (KFDA) defines product categories eligible to use specific food additives narrowly; if a particular product does not fit in the defined product category, it is then classified within the "other products" category, making it

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considerably more difficult to obtain approval for microbial standards and food additives. Additionally, KFDA's determination that a product is new if formula ratios are changed, or if substitute ingredients are used, sets its procedures apart from other OECD countries.

Progress has been made in several areas, however. Korea announced its revisions to the sanitary standards for importing cod heads on August 3, 2005. Korea subsequently requested that the United States negotiate a memorandum of understanding incorporating these revisions and the U.S. Government is reviewing this request. The Korean government in July 2005 also revised its construction standards to allow houses of wood frame construction to be built to five stories rather than the previous height limit of three stories; this should expand the market for U.S. timber exports.

For non-agricultural products, Korean government agencies require prior approval to import pharmaceuticals, chemicals, computers, medical equipment, telecommunications equipment, and other products (including all food additives). While many other countries require prior approval for some products, Korea's requirements cover a much broader range of products.

Beef

Korea banned imports of U.S. beef in December 2003, after Bovine Spongiform Encephalopathy (BSE) was detected in an imported cow in the state of Washington. Before the ban, Korea was the third largest export market for U.S. beef and beef products and other ruminants, with annual exports valued at \$1.3 billion in 2003. In June 2005, Korea's Ministry of Agriculture and Forestry (MAF) indicated that it had obtained all the information it needed to issue findings concerning the safety of U.S. beef. After a second animal tested positive for BSE in Texas in June 2005, MAF requested epidemiological data on that animal before submitting its findings to the Korean Animal Health Committee (AHC). The report of the epidemiological investigation of the June 2005 case was delivered to Korea on August 31, 2005. In December 2005, the AHC recommended to the MAF Minister that trade in U.S. beef could be resumed. The Minister accepted the AHC finding and announced on December 19, 2005, that the two governments could commence talks to discuss the specific conditions for resuming imports. On January 13, 2006, the United States and Korea reached an initial agreement allowing resumption of U.S. boneless beef imports from cattle aged 30 months or less under a Beef Export Verification Program, with an anticipated reopening in April.

The U.S. Government will continue to urge Korea in the strongest terms to open its market without delay to all U.S. beef products, including bone-in beef, variety meats, and offal in accordance with international guidelines. Together these products historically accounted for approximately 50 percent by quantity of U.S. beef and beef product exports to Korea.

Throughout the ban on beef products, Korea continued to permit the imports of certain products containing ruminant ingredients, such as pharmaceuticals and cosmetics. However, U.S. exporters of those products have noted that since the ban on Korean beef was imposed, Korea's requirements for BSE-free certification have become increasingly burdensome and have begun to impede the flow of U.S. exports of these other products to Korea.

Poultry

In February 2004, Korea banned U.S. poultry meat imports (worth \$53 million in 2003) in response to detection of low pathogenic avian influenza (LPAI) in Delaware and a subsequent case of highly pathogenic avian influenza (HPAI) in Texas. The ban was substantially more disruptive to trade than necessary since Korea applied the ban on a country-wide basis rather than limiting the ban to the outbreak areas, as called for in international guidelines established by the World Organization for Animal Health (OIE). After intensive bilateral consultations, on May 2, 2005, Korea lifted the ban on U.S. poultry meat imports. The U.S. Government has requested that the Korean government accept the “regionalization” concept to ensure that U.S. poultry is not banned again should there be another outbreak of HPAI, even in remote places such as Alaska. The Korean government is awaiting the results of a study on regionalization before reengaging with the United States on this matter.

Biotechnology

Korea’s voluntary safety assessment program for biotechnology crops for human consumption was changed to a mandatory program for soybeans, corn, and potatoes on February 27, 2004 and for all other biotechnology crops on February 26, 2005. To date, 39 biotechnology crops and 11 biotechnology additives have undergone KFDA safety assessments and have received KFDA approval.

Korea has stated its intention to ratify and implement the Cartagena Protocol on Biosafety to the Convention on Biological Diversity (the CPB) in 2006. Environmental risk assessments for biotechnology crops will become mandatory when the CPB is implemented in Korea. So far, 27 applications have been submitted for voluntary environmental assessments (13 for corn, one for soybean, six for cotton, one for alfalfa, and six for canola) and 18 of those have been completed to date. The U.S. Government continues to urge Korea to notify the appropriate WTO Committee of new requirements resulting from the implementation of the CPB in a timely manner and to implement minimally restrictive requirements, which would avoid major disruptions of trade. (*See also “Biotechnology” in “Labeling Requirements”*)

Maximum Residue Level (MRL) Testing

In 2003, a new import inspection program mandated annual maximum residue limit (MRL) testing of agricultural products on a packinghouse basis with an inspection fee of approximately \$1,960 paid for by the importer. Domestic agricultural products, however, are subject only to random tests, which are paid by the Korean government.

In 2004, in response to concerns voiced by the U.S. Government and other Korean trading partners, KFDA reduced the number of chemicals subject to testing from 196 to 47 and the fee for MRL testing from \$1,960 to approximately \$500. In August 2005, KFDA also revised its import inspection program to exempt imported food products recognized by the KFDA Commissioner as safe from mandatory laboratory inspection. These changes to Korea’s import

inspection regime have led to savings in testing fees for U.S. exporters. These changes also reduce delays and rejections of shipments.

Functional Foods

On June 28, 2003, KFDA announced its "Proposed Standards and Specifications for Health Functional Foods," with the objective of regulating health foods and nutritional supplements. Essentially, only products classified as functional foods (i.e., foods that may provide health benefits beyond basic nutrition) can carry "efficacy claims" on their labels. The KFDA amended the final version of its regulations, which were implemented on January 31, 2004, to address certain U.S. concerns regarding vitamins and minerals. However, KFDA has not addressed U.S. concerns regarding the lack of provision for sport nutrition or herbal products in the functional food categories, although these categories are widely accepted in other countries. For instance, according to industry, sports nutrition products, such as glutamine and creatine powder, and herbal ingredients, such as milk thistle, bilberry and garlic, are not permitted by KFDA for use in making functional foods although these ingredients are widely used in sports nutrition or herbal products in the United States. Further, according to KFDA requirements, only tablets, capsules, granules, liquids and powders may be marketed as functional foods although sports nutrition products also come in other forms such as nutrition bars.

Organic Foods

In 2004, KFDA changed its enforcement of regulations regarding imported organic foods. After reviewing the National Organic Program (NOP) of the United States, KFDA decided to accept copies of NOP certificates issued by USDA-accredited certification agents located in the United States for import clearance of processed organic food. However, KFDA only accepts certificates issued to producers, manufacturers, or processors even though certificates issued to brokers or other handlers also meet the NOP requirements. Further, an original ingredient statement issued by the manufacturer must be presented for import clearance.

Also, insufficient communication between KFDA headquarters and regional KFDA offices about the changes in required import clearance documents, and the arbitrary interpretation of regulations by KFDA field inspectors, continue to cause delayed clearance for imported organic products. The U.S. Government has expressed its concern with these practices and delays and urged the KFDA to take steps to eliminate them.

KFDA announced a revision of "Labeling Standards for Food," on March 7, 2005 which maintains a policy of zero tolerance for the presence of biotechnology products in processed food that is labeled as organic. According to the Korean government, this revision was a correction to a long-standing policy. In many countries, including the United States, Japan, and the European Union, organic standards are process-based (i.e. agriculture products must be produced and handled in certain ways in order to be certified as organic). As a result, the United States, Japan, the European Union and others have established regulations that allow for trace levels of biotechnology products in certified organic products. The United States will continue to urge

KFDA to recognize this system-based approach and to reconsider its zero tolerance policy for presence of biotechnology products in foods that are labeled as organic.

Pharmaceuticals and Medical Devices

The KFDA's Drug Master File (DMF) requirements call for manufacturers to submit significant quantities of proprietary manufacturing data to the KFDA as part of the drug approval process. By September 2005, Korea had implemented DMF requirements for 77 active pharmaceutical ingredients (APIs). Although the DMF does not discriminate between imported and locally-manufactured drugs or between innovative research-based drugs and generics, some concerns remain with respect to the scope of the data requirement, the lack of adequate protection of intellectual property, and the great difficulty in providing data for older products. In addition, site inspections appear to be automatically required as part of the DMF, which is particularly problematic to innovative companies with multiple APIs. U.S. industry has suggested that KFDA consider taking a risk-based approach to inspections, relying on the manufacturer's history of complying with Good Manufacturing Practices (GMP).

The frequent need for companies to duplicate clinical trials in Korea that have already been completed elsewhere is of particular concern because such trials are costly and delay market access for U.S. products. Duplicate trials were expected to decrease following Korea's 1999 announcement that it would implement the International Conference on Harmonization (ICH) guidelines, but the KFDA typically does not consider Koreans to be members of the general Asian population for drug testing purposes and presumes that the effect of drugs on Koreans is unique unless proven otherwise. The U.S. Government will continue to press Korea to adopt more streamlined clinical trial application processes.

The KFDA requires pharmaceutical importers to perform a full set of quality control tests for each imported batch prior to market release and to retain on file the locally issued Certificate of Analysis (CoA) for each subsequently imported batch. Similarly burdensome regulations exist for medical devices, with specific quantities of finished goods, high fees, and long timelines required for testing these products.

The KFDA also insists that importers must have or use local testing facilities in Korea. This is often impossible or prohibitively expensive. (*See also "Intellectual Property Rights Protection" and "Pharmaceuticals."*)

Telecommunications Standards

The U.S. Government has strongly encouraged the Korean Government to adhere to a policy of technology neutrality and avoid mandating trade-restrictive standards. The Korean government appears to be encouraging the development and selection of homegrown "Korea-only" technology standards, although there were no exclusive mandates of such standards in 2005. (*See also "Telecommunications."*)

Automotive Standards

(See "Motor Vehicles.")

Labeling Requirements

U.S. exporters continue to cite Korea's non-transparent and burdensome labeling requirements as barriers to entry for a variety of goods, despite recent changes to these requirements by the Korean government. For instance, the distilled spirits industry has raised concerns with the cost of complying with both existing and constantly changing labeling requirements. The U.S. Government will continue to address these issues with the Korean government.

The U.S. Government continues to question Korea's rationale for restricting package size based on "gross dead space." The United States has argued that the "net space" displaced by such containers, once collapsed and measured (Korea's Ministry of Environment does not allow this), is minimal and well within the objective of the Korean standard.

Biotechnology: Korea has mandatory labeling requirements for biotechnology corn, soybeans, soybean sprouts, and fresh potatoes, and for processed foods containing biotechnology enhanced corn and soybeans. The United States has expressed concern to Korea that these labeling requirements appear far more burdensome than necessary to achieve their stated goal of providing Korean consumers clear information. As a result, MAF officials have agreed to exempt fresh potatoes from biotechnology labeling requirements as biotechnology potatoes are no longer produced in the United States. Korea also accepts a notarized self-declaration as certification that products meet the criteria for exemption from biotechnology labeling.

GOVERNMENT PROCUREMENT

The WTO Agreement on Government Procurement (GPA) entered into force for Korea on January 1, 1997. As a signatory to the GPA, Korea agreed to include coverage for the procurement of goods and services over specific thresholds by a number of Korean central government agencies, several provincial and city governments, and approximately two dozen government-invested companies. An area of concern remains Korea's high thresholds for the procurement of construction services by its sub-central government entities and government enterprises.

EXPORT SUBSIDIES

Korea has phased out known export subsidy programs that are not permitted under the WTO Agreement on Subsidies and Countervailing Measures or the OECD Export Credit Arrangement. However, Korea continues to promote economic development based on undue reliance on exports, particularly from its traditional export-oriented industries such as automobiles, semiconductors, shipbuilding, and steel. In addition, Korea is encouraging the development of export-oriented "next generation" industries, including semiconductors and telecommunications equipment. The U.S. Government continues to strongly urge Korea to ensure that its government support programs fully comply with its WTO obligations.

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In February 2002, the Korean government revised the "Act for the Export-Import Bank of Korea" to enable the Export-Import Bank of Korea (KEXIM) to become more active in undertaking risks and extending credit lines to exporters. Under these regulations, KEXIM is able to undertake risks that commercial banks are reluctant to assume. In addition, KEXIM's financing sources were expanded to include non-bank guarantee fees, thereby boosting exports from Korean companies. KEXIM financing was an issue in the trade dispute between Korea and the EU on alleged government subsidies to the Korean shipbuilding industry. On March 7, 2005, a WTO panel stated that certain individual KEXIM programs were prohibited export subsidies. The U.S. Government participated as a third party in the shipbuilding dispute and we will continue to monitor modifications made to the KEXIM Act to ensure that they are consistent with Korea's WTO obligations.

Government Support for Certain Industrial Sectors

The U.S. Government continues to be concerned with support extended to Hynix Semiconductor, Inc. (Hynix), Korea's second largest semiconductor manufacturer, by Korean government-owned financial institutions. A formal countervailing duty (CVD) investigation was conducted and completed by the U.S. Commerce Department and the U.S. International Trade Commission in 2003. As a result of this investigation, Hynix's exports to the United States have subsequently been subject to countervailing duties of 44.29 percent to offset the large subsidies provided to the company. In June 2003, Korea initiated dispute settlement proceedings in the WTO and a panel was established in January 2004 to review the Commerce Department's subsidy findings. On June 27, 2005, the WTO Appellate Body upheld the Commerce Department's final subsidy determination. The EU and Japan also have CVD orders on imports of semiconductors from Hynix.

The U.S. Government also continues to focus on concerns raised by the U.S. paper industry regarding targeted Korean government aid to its coated paper sector, including low-cost facility investment loans and loan guarantees, tax benefits for facility expansion, government-sponsored creation of a paper manufacturing complex and government sale of debt obligations. The U.S. Government will continue to consult closely with U.S. industry to determine the best course of action to address concerns in this sector.

The U.S. Government also has concerns about the role played by the government-owned Korea Development Bank (KDB) in supporting Korean industries across all sectors. Traditionally, the KDB has been one of the government's main sources for policy-directed lending to favored industries. Lending and equity investments by the KDB appear to have contributed to overcapacity of certain Korean industries. The U.S. Government will continue to monitor the lending policies of the KDB and other government-owned or affiliated financial institutions.

INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

Major improvements to Korea's intellectual property rights (IPR) protection regime were made in 2005. Korea was downgraded from the Special 301 "Priority Watch List" to the "Watch List" in April 2005 to acknowledge the meaningful measures the Korean government undertook during the review period. The meaningful improvements made by Korea include: introducing legislation that will create protection for sound recordings transmitted over the Internet (using both peer-to-peer and web casting services); implementing regulations that restore the ability of the Korea Media Rating Board to take necessary steps to stop film piracy; and increasing enforcement activities by Korea's Standing Inspection Team against institutions using illegal software. The Korean government also developed a "Master Plan" in 2005, under the leadership of the Prime Minister's Office, to provide overall policy guidance to the government as it works to improve IPR protection in the country. According to the Korean government, this "Master Plan" will continue to evolve to address new concerns as they arise.

The importance of IPR protection has increased in recent years, as the digitization of Korea's economy has significantly increased the opportunity for unauthorized copying of copyrighted material. With Korean films and music increasing in popularity throughout the Asia-Pacific region, and Korea's industrial products and trademarks enjoying global success, Korean creators of intellectual property would benefit from the improvements the United States has advocated, both to Korea's own intellectual property regime and internationally.

The U.S. Government continues to urge Korea to strengthen its legal regime to protect intellectual property in the following areas: protection of temporary copies, technological protection measures, internet service providers' (ISP) liability, *ex parte* relief, the lack of full retroactive protection for pre-existing copyrighted works and copyright term extension. In addition, concerns remain on book piracy in universities, street vendor sales of illegally copied DVDs, counterfeiting of consumer products, protection of confidential pharmaceutical test data, and lack of coordination between Korean health and IPR authorities to prevent marketing approvals for patent-infringing products.

IPR Enforcement

According to Korean government data on the level of fines and jail sentences imposed on infringers, there is an accelerating rate of investigations, trials and convictions in many areas. For instance, during the first three quarters of 2005, fines were issued in 17,015 cases involving IPR violations. Jail sentences were issued in 780 cases, with 103 cases resulting in imprisonment. The United States continues to urge Korea to further strengthen penalties for IPR violations in order to increase their deterrent effect against piracy.

The Standing Inspection Team (SIT) of the Ministry of Information and Communication has police powers and is authorized to conduct raids on commercial firms and other institutions suspected of using illegal software. Korean police and prosecutors' raids against software end-users have become more consistent and are more frequently based on leads provided by the software industry. The United States remains concerned, however, about the lack of

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transparency of the Standing Inspection Team's enforcement process, including whether the SIT acts on leads provided by industry and whether rights holders will be able to participate in raids to the maximum extent possible and be notified about all SIT raids, even when discovered infringements are minor.

The establishment of Korea's Copyright Protection Center (CPC) in 2005 for copyright investigations is an encouraging sign and the U.S. Government has urged the Korean government to make effective use of the CPC's investigative capabilities and to make its services available to all rights holders, Korean and international.

Temporary Copies

Currently, Korean law does not extend the reproduction right to cover copies made in the temporary memory of a computer, a significant and still growing manner for use of copyrighted works. The United States continues to urge Korea that both the Copyright Act and Computer Program Protection Act, Korea's two principal copyright laws, should be strengthened by revising the laws to clarify that the copyright owner has the exclusive right to make copies, temporary or permanent, of a work or phonogram.

Transmission Rights for Sound Recordings

Responding to concerns expressed by Korean and foreign music copyright holders, an amendment to the Copyright Act was proposed in 2005 that would give copyright holders, performers, and phonogram producers significantly enhanced rights to control the transmission of their phonograms. As of the publication of this report, that legislation remained pending at the National Assembly.

Copyright Act

In 2005, the Korean government proposed several measures to amend the Copyright Act to include provisions to protect rights to public performances of copyrighted works and eliminate the complaint requirement in certain cases. These measures were considered at the end of 2005, but as of the publication of this report, these copyright amendments had not been passed.

At the time the Copyright Act amendments were submitted to the National Assembly, a Presidential Decree strengthening the amendments was issued and went into effect in March 2006. This decree restricts unauthorized public performances of motion pictures in motels, computer game rooms, and public baths and saunas.

The United States continues to discuss further improvements to the Copyright Act with the Korean government. For instance, the Act does not appear to include technological protection measures (TPMs) that control who can access a work, nor does it prohibit the act of circumventing TPMs, only prohibiting the creation or distribution of circumvention tools. Secondly, while certain provisions of the Copyright Act that define internet service provider liability were harmonized with the Computer Program Protection Act (CPPA) in 2003, further

clarification is required. The Copyright Act amendments still leave unclear the scope of the underlying liability of service providers and the limitations on, and exceptions from, liability. In addition, there are concerns that the documentation requirements for the rights holders in a “takedown” request are too burdensome.

The U.S. Government has told the Korean government that the private copy exceptions in Article 27 and Article 71 of the Copyright Act should be re-examined in light of the growth of digital technologies. These exceptions generally should not be applicable to the Internet environment, which by its very nature extends far beyond private home use. In the digital environment, the market harm threatened by the unauthorized creation of easily transmittable perfect digital copies far exceeds the harm threatened by analog personal copying. Legislation on this issue was introduced in early 2005, but it remains unclear what next steps may be taken by Korea.

With regard to library exceptions under Korea’s Copyright Act, the U.S. Government believes that a notice period of at least 30 days should be given to rights holders prior to the unauthorized digitization of their works to minimize any negative effects. Under the current law, library exceptions still apply only to literary works and not to broadcasts, performances and sound recordings.

The U.S. Government has also urged Korea to delete the reciprocity limitations relating to database protection in the Copyright Act, as it discourages the introduction of databases from countries without such legislation, including the United States.

Korea currently provides copyright protection for the life of the author plus 50 years. In line with international trends, the United States is urging Korea to extend the term of copyright protection for works and sound recordings to the life of the author plus 70 years or 95 years from date of first publication where the author is a legal entity.

Computer Program Protection Act (CPPA)

The amendment of Korea’s Computer Program Protection Act (CPPA) to meet current challenges as well as to comply with new global norms continues incrementally. An amended CPPA has been proposed that would increase the power of the Program Deliberation and Mediation Committee (PDMC) and increase penalties for assorted violations of Korean IPR-related laws. The U.S. Government continues to urge the Ministry of Information and Communications (MIC) to further amend the CPPA to provide for protection of temporary copies, improved protection for technological protection measures, and a term of protection of the life of the author plus 70 years or, where the term is not calculated on the basis of a human life, 95 years from the date of publication. It is also important that the dispute mediation function of the PDMC be performed only where all parties to the dispute have voluntarily agreed to subject themselves to the judgment of the PDMC. Moreover, it is important that mediation by the PDMC not be a prerequisite for any civil, administrative, or criminal adjudication of rights. The U.S. Government believes that the amendments should include minimum penalties for offenses under the CPPA. The United States has also recommended that the Korean government clarify the availability of injunctive and *ex parte* relief in civil enforcement actions under the CPPA, as required under the TRIPS Agreement.

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Data Protection

KFDA decided on March 31, 2005 that slightly altered versions (such as using a different “salt”) of original drugs undergoing post-marketing surveillance (PMS) in Korea are subject to Korea's data protection regulations. This means that the manufacturers of the altered version have to supply a full portfolio of clinical data in order to obtain market approval if they intend to market their drug while the original drug is still under PMS, in line with Article 39.3 of the WTO TRIPS Agreement.

Book and Video-DVD Piracy

The Publication and Printing Business Promotion Act allows private sector involvement in enforcement measures against book piracy. The U.S. Government has urged Korean authorities to coordinate with foreign book publishers and rights holders in order to provide effective enforcement against book piracy, especially textbooks, and will continue to monitor implementation of this law.

Pirated audio-visual DVDs, sold on the street by informal vendors, continue to be a problem in Korea. This type of piracy is increasing due to the growing sophistication of illegal production facilities and advanced distribution technologies. The U.S. Government has urged the Korean government to meet this digital piracy challenge with stronger enforcement efforts and deterrent penalties.

Patent and Trademark Acts, and Trade Secrets

The Korean Intellectual Property Office (KIPO) has amended relevant laws to address U.S. concerns regarding restrictions on patent term extension for certain pharmaceutical, agrochemical and animal health products (which are subject to lengthy clinical trials and domestic testing requirements, see *"Standards, Testing, Labeling and Certification"*). An issue of continuing concern, however, has been the lack of coordination with the Korean Food and Drug Administration and the KIPO, which results in the granting of marketing approval for products that may infringe on existing patents. U.S. firms have also pointed to the Korean courts' apparent unwillingness to provide injunctive relief in cases where a rights holder's patent has been infringed, allowing the infringing products to remain on the market until a final determination has been made. Although Korean civil courts have the authority to issue injunctive relief, in practice they rarely, if ever, do so in patent-related cases.

Korea's Trademark Act has been amended over the years to strengthen provisions that prohibit the registration of trademarks without the authorization of foreign trademark holders by allowing examiners to reject any registrations made in "bad faith." Despite this change, the complex legal procedures that U.S. companies must follow to seek cancellation discourages U.S. companies from pursuing legal remedies. In particular, problems still arise with respect to "sleeper" trademark registrations filed and registered in Korea without authorization in the late 1980s and early 1990s, when KIPO was still developing a more effective and accurate trademark examination and screening process.

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The Korean government agreed to cooperate with the U.S. Government's "Strategy Targeting Organized Piracy" (STOP!) initiative in October 2004 in an effort to halt trade in counterfeit goods, and discussions continued on best practices and possible areas for cooperation during 2005.

Korean laws on unfair competition and trade secrets provide a basic level of trade secret protection in Korea, but are insufficient in some instances. For example, some U.S. firms, particularly certain manufacturers of chemicals, pet food, and chocolate, face continuing problems with government regulations requiring submission of very detailed product information, such as formula or blueprints, as part of registration or certification procedures. U.S. firms report that, although the release of business confidential information is forbidden by Korean law, in some instances, government officials do not sufficiently protect this proprietary information and the trade secrets were made available to Korean competitors or to their trade associations.

SERVICES BARRIERS

Korea continues to maintain restrictions on some service sectors. In these sectors, foreign investment is prohibited or severely circumscribed through equity or other restrictions. (*See also "Investment Barriers."*)

Advertising

Korea is among the world's top twelve largest advertising markets; however, the market remains highly restricted. Because broadcast advertising time is still sold exclusively through the state-sponsored Korea Broadcast Advertising Corporation (KOBACO), advertisers and their agencies must work through KOBACO to advertise on broadcast television. Further, U.S. industry has noted its concerns with Korean restrictions on broadcast advertising of beverage alcohol products containing 17 percent or greater alcohol by volume.

Screen Quota

On January 26, 2006, the Korean government announced that it will reduce its screen quota requirement to 73 days of the year. This reduction is scheduled for implementation on July 1, 2006. Korea had required that domestic films be shown on each cinema screen for a minimum of 146 days of the year, corresponding to a 40 percent market share.

The domestic market share for Korean films has, for the last several years, far surpassed 40 percent. In 2005, for instance, Korean films captured 55 percent market share in Seoul.

Foreign Content Quota for Broadcast Television

Korea restricts foreign activities in broadcast television by limiting the percentage of monthly broadcasting time (not to exceed 20 percent) that may be devoted to foreign programs. Annual quotas also limit broadcasts of foreign programming to a maximum of 75 percent for motion pictures, 55 percent for animation, and 40 percent for popular music. Foreign investment is not permitted for broadcast television operations.

Foreign Content Quota for Cable Television

Korea restricts foreign participation in the cable television sector by limiting per channel airtime for most foreign programming to 50 percent. Annual quotas limit foreign broadcast motion pictures to 70 percent and 60 percent for foreign animation. The Korean government also restricts foreign ownership of cable television-related system operators, network operators, and program providers to 49 percent. For satellite broadcasts, foreign participation is limited to 33 percent.

Satellite Re-Transmission

The Integrated Broadcast Law mandates that Korean firms that wish to re-broadcast satellite transmissions of foreign programmers must have a contract with the foreign program provider in order to obtain approval from the Korean Broadcasting Commission (KBC). Foreign re-transmission channels are limited to 20 percent of the total number of operating channels. This artificial restriction limits the amount of international broadcasting which could otherwise be made available to Korean consumers and limits foreign investment in the broadcasting sector.

Restrictions on Voice-overs and Local Advertisements

Presently, the Korean Broadcasting Commission's guidelines for implementation of the Broadcasting Act contain restrictions on voice-overs (dubbing) and local advertising for foreign re-transmission channels. Allowing Korean language voice-overs would make broadcasts more accessible to Korean consumers (especially for breaking news and children's cartoons); it would also benefit the Korean economy by creating more studio-production jobs and attracting foreign investment. The prohibition on local advertising for foreign re-transmission channels restricts the long-term viability of these channels in the Korean market

Legal Services

The Korean government announced in March 2005 that it intends to open the legal services market in stages. The first step would be to regularize the legal status of foreign legal consultants, and the Ministry of Justice is reportedly currently drafting the requisite legislation.

The U.S. Government has also been informed that the law being drafted would allow foreign law firms to open offices in Korea, although they would not be allowed to hire Korean attorneys or advise on domestic law. While the Korean government hoped to introduce this legislation in 2005, as of this writing it had not been submitted to the National Assembly.

The U.S. Government continues to urge the Korean government to allow foreign law firms to practice law in Korea.

Insurance

Korea is the second largest insurance market in Asia, with \$58.7 billion in premiums paid in the fiscal year ending March 31, 2005. Although Korea's laws and regulations do not restrict foreign entry into insurance markets, no life insurance licenses have been issued since 2001. Further, while there are no restrictions on partnering with Korean financial companies or on hiring Korean insurance professionals, a considerable gap remains between Korea's practices and those found in more developed insurance markets.

Korean and foreign companies (including U.S. firms) active in Korea's insurance and savings markets have complained that the Financial Service Office of the government-run Korea Post (KP) maintains an unfair advantage in these sectors. KP does not have to pay any corporate or local taxes and its assets are backed by a government guarantee. Korea Post is now the fourth largest insurer in Korea. It is also the eight largest banking entities, although it does not have to pay deposit insurance premiums and directly participates in the insurance and banking sectors. Commercial banks, although they are allowed to offer "bancassurance" products through insurance vendors, cannot directly combine banking and insurance activities.

Insurance companies and banks are regulated by experienced officials of the Korean Financial Supervisory Service (FSS). The Ministry of Information and Communication, which does not have the same regulatory expertise, oversees Korea Post. Unlike private sector insurance companies, which must follow more stringent regulations prior to introducing new products or in training new staff, KP enjoys a streamlined, less regulated ability to introduce new products and is not subject to the same training and exam restrictions for its insurance sales staff.

The United States raised these issues with the Korean government in 2005, urging it to consider ways to eliminate any unfair advantages Korea Post maintains over domestic and foreign firms in the insurance and financial sectors. In response, the Korean government appears to be considering ways to improve the Ministry of Information and Communication's regulation of Korea Post's financial activities. The United States government will continue to raise these issues with Korea.

Banking

Although almost all banks have been privatized, the Korean government-controlled Korea Deposit Insurance Corporation still owns nearly 79 percent of Woori Financial Holdings which fully controls Woori Bank, the country's second largest bank. The Korea Deposit Insurance Corporation also directly owns 67.7 percent of Industrial Bank of Korea, the fourth-largest bank in Korea.

Foreign banks are permitted to establish as subsidiaries or branches. Capital markets are open to foreigners, permitting foreign financial institutions to engage in non-hostile mergers and acquisitions of domestic financial institutions.

Korea allows foreign bank branches to borrow from their head offices and to include the net borrowing as "Class B capital." However, the Korean government does not allow foreign branches to use capital from head offices to meet regulatory lending limit requirements and continues to restrict the operations of foreign bank branches based on branch capital requirements. These restrictions limit: (1) loans to individual customers; (2) foreign exchange trading; and (3) foreign bank capital adequacy and liquidity requirements. Foreign banks are subject to the same lending ratios as Korean banks, which require them to allocate a certain share of their loan portfolios to Korean companies that are not one of the top four *chaebol* conglomerates and to small and medium-sized enterprises.

All banks in Korea continue to suffer from a lack of transparency in the regulatory system and must seek approval before introducing new products and services - an activity at which foreign banks are particularly adept. Korea has largely deregulated foreign exchange and capital account transactions for individuals, but a few restrictions (applied to both domestic and foreign institutions) on foreign exchange transactions and derivatives trading by corporations and financial institutions still remain. In January 2005, members of Korea's National Assembly introduced draft legislation that would have imposed nationality and residency requirements for members of the boards of directors of Korea's banks. This was seen as a reaction to the public perception that there was too much foreign investment in the financial sector. The bill did not pass, in part due to opposition from the Korean government. The United States has noted that the adoption of these or similar measures would send a negative signal to foreign investors in Korea's financial sector.

Securities

There are no limits on local currency issues of stocks and bonds by foreign firms. The Korean government places no limits on foreign ownership of listed bonds or commercial paper, does not restrict foreign ownership of securities traded in local markets, and has removed almost entirely foreign investment ceilings on Korean stocks. By the end of 2004, foreigners owned more than 40.1 percent (41.9 percent of KOSPI shares and 15.4 percent of KOSDAQ shares) of the shares on Korean stock exchanges, according to Korean government statistics. Despite this liberalization, foreign securities firms in Korea continue to face some non-prudential barriers to their operations.

INVESTMENT BARRIERS

The Roh Administration has continued Korean government support for the establishment of a more favorable investment climate in order to facilitate foreign investment in Korea. U.S. companies that made major announcements in 2005 regarding plans for investment in Korea included Intel, CSX World Terminal, Kimberly-Clark, and 3M.

The positive attitude toward foreign investment on the part of the Korean government, many in private industry, and by a growing number of Koreans, is helping to open the Korean economy. However, while progress has been made in recent years, additional reforms would make Korea more attractive to foreign investors, such as resolving certain labor market issues (e.g. better pension mobility, more flexibility in hiring and firing workers, expanded unemployment compensation, less rigid worker visa rules, and better job training and placement services), reducing labor-management disputes, and improving regulatory transparency.

Capital market reforms have eliminated or raised ceilings on aggregate foreign equity ownership, individual foreign ownership, and foreign investment in the government, corporate, and special bond markets. These reforms have also liberalized foreign purchases of short-term financial instruments issued by corporate and financial institutions. However, the Korean government still maintains foreign equity restrictions with respect to investments in various state-owned firms and many types of media, including basic telecommunications service providers, cable and satellite television services and channel operators, as well as schools and beef wholesalers.

Although the Korean government has taken several important steps to privatize state-owned corporations, there were no new privatizations in 2005. In addition, the government on November 30, 2005 announced that it would seek to more tightly control state-run companies and no longer had immediate plans to privatize Korea Gas Corporation or Incheon International Airport Service. As noted in the “Banking” section of this report, the Korean government has also postponed any announcement of a definitive schedule for the privatization of its nearly 79 percent share in Woori Financial Holdings, which owns the country’s second largest bank.

There are no restrictions on the direct purchase of land by foreigners. However, foreigners cannot produce certain agricultural products for commercial purposes nor remove agriculturally zoned land from agricultural production.

The Korean government also has opened Free Economic Zones (FEZs) with an extensive range of incentives including tax breaks, tariff-free importation, relaxed labor rules, and improved living conditions for expatriates in areas such as housing, education, and medical services. While establishing these zones is an important step in making Korea's business environment more open, liberal, and responsive to economic needs, the FEZ's is not likely to not address some of the key factors inhibiting additional foreign investment in Korea.

FOREIGN TRADE BARRIERS

ANTICOMPETITIVE PRACTICES

Competition Policy

The Korea Fair Trade Commission (KFTC) has been playing an increasingly active role both in enforcement of Korea's competition law and in advocating for regulatory reform and corporate restructuring. In addition to KFTC's powers to conduct investigations and to impose penalties, including broad authority over corporate and financial restructuring, KFTC can levy heavy administrative fines for violations or for failure to cooperate with investigations. In response to concerns raised by U.S. companies, the U.S. Government is monitoring KFTC activities closely and has encouraged it to develop a balanced approach to address its antitrust policy concerns without imposing unnecessary restrictions on commercial activity.

ELECTRONIC COMMERCE

Korea is considered to be a global leader in technology. Korea has more high-speed Internet connections per household than any other country in the world, and the government has actively pursued legislation to encourage electronic commerce.

The Korean government has been working to address data privacy issues by drafting a Personal Information Protection Act, formerly the Basic Privacy Act, and revising or adding sector-specific laws. Industry-specific issues will be addressed separately by regulations to be put in place over a period of six months to two years following the passage of the Act. However, as of the publication of this report, a draft of the Act remains pending in the National Assembly. The U.S. Government looks forward to working with Korea to ensure that resulting regulations do not inhibit the cross-border flow of information, which would negatively impact Korean and American companies and would limit consumer choice. Numerous privacy issues have been discussed on the margins of the APEC Privacy Framework, an initiative to which Korea has contributed. Non-governmental organizations in Korea are asking for stricter requirements in a number of areas which may impact cross-border data flows, thus hindering e-commerce. Korea is also considering establishment of a central office responsible for data privacy, similar to data protection authorities that exist in other countries.

OTHER BARRIERS

Regulatory Reform and Transparency

A lack of transparency in Korea's rule making and regulatory system is a cross-cutting issue affecting U.S. firms in many different sectors, including the automotive, pharmaceutical, agricultural, financial services and telecommunications sectors, and continues to be one of the principal problems cited by U.S. traders and investors seeking to compete in the Korean market. In an effort to address these systemic issues, beginning in 2004, the United States and Korea deepened their focus on regulatory reform and transparency issues.

FOREIGN TRADE BARRIERS

Korean laws, regulations, and rules often lack specificity, and Korean officials exercise a great deal of discretion in applying broadly drafted laws and regulations. This results in the inconsistent application of regulations and uncertainty for businesses on how to fully comply with them.

Korea's Administrative Procedures Act (APA) stipulates that the public comment period for draft regulations that are subject to the APA shall be no less than 20 days. However, in many cases, the 20-day time minimum is too abbreviated, and since ministries rarely provide more time, public comment periods are often unreasonably short. In 2005, the Korean Government promulgated a recommendation that all ministries provide a longer (60 day) time frame for public comment periods for regulations subject to the APA that are "economy-related," but there has been no evidence that this extended time frame is being followed. In many instances the final versions of regulations do not reflect the comments provided.

Regulations are applied inconsistently or can be reinterpreted and applied retroactively, resulting in penalties for those companies that followed prior Korean government guidance.

During bilateral trade consultations in 2005, the United States continued to emphasize the need for increased transparency in Korea's regulatory system. These bilateral efforts on regulatory transparency coincide with a Korean government focus on regulatory reform. In Korea, the Roh administration has charged the Deregulation Taskforce Team, the Corporate Difficulties Resolution Center, and the standing Regulatory Reform Committee to focus on different aspects of regulatory reform, both systemic and sector-specific. During trade consultations in 2005, Korea agreed that it would work closely with the United States and with the U.S. business community to include recommendations to these three bodies on which Korean regulations might usefully be eliminated or amended.

Motor Vehicles

During quarterly trade consultations with Korea over the past year, progress was made on a number of automotive standards issues of concern to the United States. On license plate size and shape, the Korean government agreed to allow small sellers to be exempted from a requirement to use European standards. On fuel economy, Korea agreed to extend until the end of 2009 a grace period for foreign vehicles to meet average fuel economy targets and to review the application of this system to foreign cars in the second half of 2009. Korea also revised an automobile emissions regulation to provide a grace period for compliance until the end of 2008 for small volume sellers of vehicles, including U.S. automakers, in the Korean market.

The United States and Korea have also worked together in the bilateral "Automotive Standards Experts Working Group" that was created in 2001. The meetings of this group have been productive, and the United States believes this forum offers the potential to build a stronger cooperative relationship on standards and certification issues. For instance, during 2005, the Working Group made progress in resolving concerns on radio frequencies associated with remote keyless entry systems and tire pressure monitoring systems.

The United States and Korea concluded a Memorandum of Understanding (MOU) in October 1998, designed to improve market access for foreign motor vehicles. Although the Korean government has implemented many of its commitments under the 1998 MOU, the United States continues to urge the Korean government to take additional meaningful actions to open the automotive sector, including eliminating or at least reducing Korea's eight percent tariff on imported automobiles, which is more than three times the U.S. tariff. The effect of the tariff is compounded by the cascading effect of multiple automotive taxes applied in addition to the tariff, which raises the effective rate to above 12 percent. A Korean study showed that if Korea's automotive tariff were reduced to 2.5 percent, foreign automotive market share could increase to 12 percent within five years – a level much closer to that of Korea's main automotive trading partners.

The United States has also expressed concern that Korea's current system of auto taxes discriminates against the larger vehicles that exporters tend to sell in the Korean market. Noting the MOU commitment to restructure and simplify the automotive tax regime in a manner that enhances market access for imported vehicles, the U.S. Government has urged the Korean government to lower the overall tax burden, reduce the number of taxes assessed on vehicles, and move away from engine-displacement taxes towards a value-based system. The U.S. Government has stressed that these commitments should be met through the development of a transparent and comprehensive plan, which would allow manufacturers and consumers adequate time to make adjustments. While the Korean government has taken some specific actions on automotive taxes over the last several years, to date, it has not produced a transparent plan to meet the long-term MOU goals. The U.S. Government will continue to press for Korea to lower automotive tariffs and to undertake reforms of its overall automotive tax system in an open and transparent manner that fully involves all stakeholders throughout the process and enhances market access for U.S.-made vehicles.

The U.S. Government appreciates the efforts made by the Korean government and Korean automotive industry in relation to public anti-import sentiments that might serve as barriers to the purchase of an imported automobile. Korea's first joint foreign-domestic automotive show was held in 2005, and featured attendance by Korean President Roh Moo-hyun.

Motorcycles

Although progress was made over the past several years to resolve U.S. concerns over Korea's noise standard on motorcycles, several market access issues remain including a highway ban, tariff and tax levels, absence of ownership titles, and standards and certification procedures. Korea's ban on driving motorcycles on expressways and on designated bridges severely restricts the market penetration potential for heavyweight motorcycles even though they are designed for safe highway use. Korea is the only major world market in which heavy motorcycles are denied access to major highways and designated overpasses in cities.

Pharmaceuticals

The U.S. and Korean governments worked extensively during 2005 through the quarterly consultative process to address a number of market access issues in the pharmaceutical sector, including encouraging transparency in pricing and reimbursement policies, and appropriately valuing innovation. In addition to governmental consultations, the government-industry pharmaceutical working group met once in 2005.

Transparency: A key focus of United States-Korea pharmaceuticals consultations during 2005 was the lack of transparency in Korea's procedures for pricing and reimbursing innovative drugs under its national health insurance system. During bilateral discussions on these issues, the United States made two proposals for improving transparency including: (1) establishment of a truly independent appeals mechanism to review contested reimbursement status and pricing decisions, working with the multinational pharmaceutical industry to design and implement such a mechanism; and (2) review of past decisions on awarding more favorable "A-7" pricing to new drugs with the goal of establishing consistent, objective criteria (*See discussion in this section on "Pricing" for a description of this methodology*).

The United States also raised concerns regarding proposals by the Health Insurance Review Agency (HIRA) that, if implemented, would change the calculation methodology of Korea's "triennial re-pricing exercise." MHW responded that it would take a "cautious" approach toward this matter.

Early in 2005, MHW began to provide written justifications for pricing decisions that differed from the applicant company's requested price, a key transparency improvement that the United States had long advocated. MHW has agreed to consider ways to improve the quality of these written justifications.

The United States has put forward suggestions on how Korea's HIRA reimbursement guideline-setting process could be more transparent; these suggestions are still under discussion. In addition, the United States is carefully watching developments related to a Korean government-commissioned health insurance reform study released in September 2004 to ensure that policy changes are made in consultation with all domestic and foreign stakeholders, including foreign industry and governments.

Pricing: In 1999, Korea announced how new "innovative" drugs were to be priced (based on the average ex-factory price of seven major developed markets: United States, United Kingdom, Germany, France, Italy, Switzerland, and Japan – called "A-7") and reimbursed (based on Actual Transaction Price [ATP]). Since its implementation, anomalies have surfaced. An industry survey revealed that A-7 prices were granted to only 24 percent of new products between April 2000 and June 2005, with most approvals occurring in the early months of A-7 implementation. Because of Korea's restrictive application of the A-7 pricing methodology, U.S. drug companies have decided not to introduce at least nine new products in Korea since 2000.

In addition, the ATP system, intended to deter corruption and market distortion, has been poorly enforced. ATP reimbursement prices are based on a weighted average of sales prices from the previous quarter. ATP was designed to end hospitals' fraudulent practice of demanding discounts from drug makers and then keeping for themselves the difference between the discounted price and the price reimbursed by the government-operated health insurance system. U.S. industry sources reported that such practices remained common in 2005. In 2005, the United States continued to press Korea to offer A-7 pricing to all new innovative medicines produced by U.S. companies and to better enforce the ATP system.

Reimbursement Guidelines: As part of its efforts to trim health-care costs, HIRA has applied restrictive reimbursement guidelines to the more expensive, newer drugs of foreign pharmaceutical companies without a rigorous, transparent scientific review or justification. The guidelines for a new product are initially set by the Korea Food and Drug Administration, but can later be modified by HIRA. The process by which HIRA establishes these modified guidelines lacks transparency. Although an appeals process exists, it is not codified in law and appeals are not considered by an independent panel, but by the same office that made the initial ruling. The U.S. Government has raised concerns regarding the guidelines with MHW and HIRA, and the United States continues to urge the Korean government to develop a transparent process for setting reimbursement guidelines.

Corruption in the Healthcare System

Corruption continues to be a widespread problem in the Korean healthcare system. As noted above, the complex distribution system and lack of transparency in the government decision-making process are large contributors to this problem. The U.S. Government will continue to work with the Korean government to bring about a more transparent, fair, science-based health care system that provides predictability for U.S. companies in pharmaceutical pricing, reimbursement guideline setting, and regulatory affairs.

Medical Devices

Since 2000, HIRA has taken actions that have resulted in the lowering of reimbursement prices for medical devices already on the market. Additional reductions were implemented in early 2004. These price reductions are based upon what appear to be subjective judgments of whether a product is an update to, or improvement upon, an existing medical device. This policy has resulted in several U.S. companies questioning whether to continue introducing innovative devices into the Korean market.

The Medical Device Act (MDA) went into effect in May 2004 and established a new legal framework for the regulation of medical devices, separate from the Pharmaceutical Affairs Act. The new legislation established a new four-class system which is consistent with global trends and should allow U.S. device firms to use global data for registration approvals with less need for data specific to Korea.

Nevertheless, instances of unnecessary and costly duplicative testing of medical devices continue to occur. In 2006, the U.S. Government will work with KFDA to assess how its safety concerns can be addressed while facilitating greater access to the Korean market for U.S. medical device manufacturers.

The KFDA requires re-registration of all products transferred to a manufacturing site outside its original country of origin. This re-registration is equivalent to a new registration, including the clinical trial requirements mentioned above. The U.S. Government would like to expand existing licenses to cover dual sites and permit notification of the change to KFDA without the need for re-registration.

The KFDA requires medical devices to include Directions For Use (DFUs) in the local language. The industry accepts this burden, as this practice better insures patient safety. It is currently accepted practice in many other regions to provide an electronic version of a DFU. The product package references a Website or CD-ROM containing the proper DFU. The U.S. Government has urged that KFDA formally create, publish, and implement guidelines that define how manufacturers can provide DFUs and required labeling in an electronic format.

Telecommunications

As one of the world's most advanced telecommunications markets, Korea is actively commercializing a variety of cutting-edge wireless technologies, as well as introducing terrestrial and satellite-based mobile digital TV broadcasting. Given the tremendous commercial opportunities provided by this market, the United States will continue to work with Korea to ensure that it sets standards and licensing requirements consistent with its bilateral and multilateral trade obligations, and that any such measures do not subject foreign firms to discriminatory treatment.

The Korean government has the ability to influence the development of the telecommunications sector both directly, through licensing conditions and mandated technology standards, and indirectly, through industry associations and quasi-governmental commissions. While no acute problems arose in this context in 2005, the U.S. Government will continue to encourage the Korean Government to adhere to a policy of technology neutrality and avoid mandating trade-restrictive standards.

The United States strongly advocated during quarterly trade discussions in 2005 for further liberalization of the Korean telecommunications services market, and called on Korea to remove limits on foreign shareholdings of Korean facility-based (Type I) telecommunications operators. The United States will continue in both bilateral and multilateral contexts to encourage Korea to eliminate such caps on foreign ownership in the telecom sector.

KUWAIT

TRADE SUMMARY

The U.S. goods trade deficit with Kuwait was \$2.4 billion in 2005, an increase of \$649 million from \$1.7 billion in 2004. U.S. goods exports in 2005 were \$2.0 billion, up 30.0 percent from the previous year. Corresponding U.S. imports from Kuwait were \$4.3 billion, up 34.2 percent. Kuwait is currently the 47th largest export market for U.S. goods.

The stock of U.S. foreign direct investment (FDI) in Kuwait in 2004 was \$478 million.

The United States and Kuwait signed a Trade and Investment Framework Agreement (TIFA) in February 2004, providing a forum to address U.S. concerns. There were no TIFA-related meetings in 2005.

IMPORT POLICIES

Tariffs

As a member of the Gulf Cooperation Council (GCC), Kuwait applies the GCC common external tariff of five percent for most products, with a limited number of country-specific exceptions. Kuwait's exceptions include 417 food and agriculture items, which will remain duty-free, as well as tobacco products, which are subject to a 100 percent tariff.

Import Licensing

Kuwait prohibits the importation of alcohol and pork products, and requires a special import license for firearms. Also prohibited are any books, periodicals, or movies that insult religion and public morals, and all materials that promote political ideology.

Documentation Requirements

In Kuwait, the import clearing process is time-consuming, requiring numerous transfers, large quantities of paperwork, and numerous redundancies. This process is prone to errors and fraud, since human judgment plays a major role in processing the transactions, especially auditing, valuation, and inspection. In most instances, the same task is repeated two or more times at different stages of the process in order to gather customs-related data or to validate documentation. However, the Customs Department is currently undergoing a major privatization effort. Customs has contracted with a private company to provide customs support services, including customs clearing software. The implementation of a state-of-the-art computer system should also make the import process less complicated and more efficient. On October 17, 2005, Customs began implementation of the Micro-Clear system at the Kuwait airport, and will begin implementing the system at other ports of entry soon.

FOREIGN TRADE BARRIERS

Customs Valuation

Kuwait began implementation of the WTO Customs Valuation Agreement in September 2003.

Textiles

Textiles (dutiable at 5 percent) accounted for approximately six percent of Kuwait's imports in 2004.

STANDARDS, TESTING, LABELING AND CERTIFICATION

Kuwait maintains restrictive standards that impede the marketing of some products. Kuwait strictly enforces government-mandated shelf life standards on 44 of 75 food products listed in Gulf Standard 150/1993, but recognizes the shelf-life established by manufacturers on all other food products. Shelf-life requirements for processed foods are far shorter than necessary to preserve freshness and result in processed U.S. goods being non-competitive with products shipped from countries geographically closer to Kuwait. Standards for medical, telecommunications, and computer equipment tend to lag behind technological developments, with the result that government tenders frequently specify the purchase of obsolete, often more costly items.

In late December 2004, Kuwait removed its December 2003 ban on imports of U.S. beef and beef products, originally imposed due to concerns over Bovine Spongiform Encephalopathy (BSE), but kept in place a ban on imports of beef originating in the state of Washington. Such a regional ban has caused concern in the U.S. industry.

In December 2002, Kuwait notified WTO members of its proposal for an International Conformity Certification Program (ICCP). Kuwait's proposal was similar to a program maintained by Saudi Arabia. According to Kuwait, the program was necessary because it lacked laboratory facilities to properly conduct its own inspections of product conformity to specified standards. On March 17, 2003, Kuwait implemented the ICCP, which applies to five import groups: (1) household appliances and electronics; (2) new and used cars and vehicles; (3) chemicals, including motor oil and paint; (4) building materials, including cement, gypsum, and bricks; and (5) paper and plastic items. Covered products must be tested and certified by a single private company before being exported to Kuwait.

In July 2004, the regulatory authority responsible for the ICCP, the Public Authority for Industry (PAI), held a one-year review of the program. At that time, the PAI said that over 30,000 individual products had been issued ICCP certificates, and that it was considering expanding the types of products requiring certification. Importers and representatives of foreign businesses all voiced serious concerns with the program. The United States and other WTO members have raised concerns about the ICCP bilaterally and during meetings of the WTO Technical Barriers to Trade Committee.

In November 2004, the PAI indicated that it would introduce changes to the ICCP and transition, over a period of 18 months, to a new Kuwait Conformity Assessment Scheme (KUCAS). However, Kuwait has recently announced that once the contract with the company administering the ICCP expires in March 2006, the program will be discontinued and replaced by the KUCAS. The United States is evaluating the potential impact of Kuwait's proposed changes and their conformity with WTO requirements.

GOVERNMENT PROCUREMENT

Kuwait's government procurement policies require the purchase of local products when available and prescribe a 10 percent price advantage for local firms in government tenders. In 2004, the Council of Ministers agreed to increase this price advantage to 15 percent. Implementation of this increase, however, requires amendment of the GCC countries' unified agreement, which has not yet occurred.

In January 2002, the Kuwaiti government transformed its offset program into the major mechanism for inducing foreign investment in Kuwait. Under that program, an offset obligation applied with respect to any civilian contracts with the Kuwaiti Government valued at 10 million Kuwaiti dinar (approximately \$33 million) or more and any defense contracts valued at KD 1 million (approximately \$3.3 million) or more. A supplier was required to invest 35 percent of the contract value of any such contract in an approved offset business venture. The supplier had to sign a memorandum of agreement with the Offset Program Division at the Ministry of Finance before the contract could be signed. The supplier also had to present a bank guarantee totaling 6 percent of the value of the offset obligation.

In September 2004, the Council of Ministers decided to suspend implementation of the offset program for all new government contracts in the military and civilian sectors pending further review by the Finance Ministry. During the review, the Finance Ministry announced that the program would be reinstated in modified form. All contracts awarded during the review period were not subject to the offset requirement. The offset program was re-started in March 2005, after the review was completed. However, no changes or modifications have been announced and, thus, the program remains the same as the previous iteration.

Kuwait is not a signatory to the WTO Agreement on Government Procurement.

INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

Kuwait has drafted amendments to its copyright law to implement the TRIPS Agreement and has submitted them to the National Assembly, but the draft has not yet been taken up for discussion. Kuwait's revised patent and trademark legislation took effect on January 14, 2001. It appears that Kuwait does not provide for the protection of geographical indications. In 2005, however, Kuwait's IPR enforcement efforts improved a change from previous years.

Following Kuwait's elevation to the Special 301 Priority Watch List in 2004, and its retention of that ranking in 2005, the Ministry of Commerce and the General Administration of Customs have increased their efforts to protect intellectual property rights by conducting more frequent

FOREIGN TRADE BARRIERS

raids. These raids have decreased the number of retail vendors openly selling pirated and counterfeit goods, but have not curbed their growth. The Ministry of Information (which is statutorily responsible for ensuring intellectual property rights) has started to place a higher priority on IPR protection, but the Ministry of Interior has generally declined to use its police resources for enforcement efforts. Kuwait Customs is now more aggressive and effective in enforcing IPR. Notwithstanding these recent efforts, sales of pirated and counterfeit goods remain high in Kuwait, and the use of unauthorized computer software continues in private enterprise. Uncertain and slow judicial action remains a hurdle, and penalties, when imposed, generally are inadequate to deter future crimes. In August 2004, the government submitted a draft law to the National Assembly that would increase penalties for those convicted of infringing intellectual property rights, but the Assembly has not approved the law.

SERVICES BARRIERS

Banking

Under Kuwait's 2001 Foreign Direct Investment law, foreigners could own up to 49 percent of existing or newly formed Kuwaiti banks, subject to approval by the Central Bank. In January 2004, the National Assembly gave final approval to a bill permitting 100 percent foreign ownership of banks. However, foreign-owned banks are restricted to opening only one branch. In August 2004, BNP Paribas was the first foreign bank granted a license to operate in Kuwait. Applications were approved in 2005 for HSBC and Citibank, and HSBC opened its branch in October 2005.

Agent and Distributor Rules

According to Kuwait's Commercial Agencies Law of 1964, only Kuwaiti nationals and corporations may act as agents and distributors for foreign companies and exporters.

INVESTMENT BARRIERS

Kuwait currently maintains restrictions on foreign direct investment and applies discriminatory taxation policies. In May 2000, Kuwait's National Assembly approved legislation that allows foreign nationals to own up to 100 percent of all listed companies on Kuwait's stock exchange, except banks, which are subject to the restrictions noted above.

In March 2001, the National Assembly passed a foreign direct investment bill that authorizes majority foreign ownership in new investment projects and 100 percent foreign ownership in the following sectors: infrastructure projects such as water, power, waste water treatment or communications; investment and exchange companies; insurance companies; information technology and software development; hospitals and pharmaceuticals; air, land, and sea freight; tourism, hotels, and entertainment; housing projects and urban development. The law also authorizes tax holidays of up to 10 years for new investors. The law went into effect on February 23, 2003. Despite this legislation, foreign companies still report numerous delays in getting approval to operate in Kuwait and the law does not appear to have significantly improved Kuwait's investment climate. Foreign firms still may not invest in the upstream petroleum

FOREIGN TRADE BARRIERS

sector, although they are permitted to invest in petrochemical joint ventures. Legislation introduced into Parliament in January 2004 would allow for limited, controlled investment in the petroleum sector, but it has not been passed. This law was submitted specifically to allow for investment in, and development of, Kuwait's northern oilfields, but may be used to allow for other investment in the petroleum sector in the future.

ELECTRONIC COMMERCE

Kuwait and the other GCC member states are currently negotiating a unified electronic commerce law.

OTHER BARRIERS

Corporate Tax Policies

Foreign firms are currently subject to a maximum income tax rate of 55 percent, although the government is currently drafting a new law that would reduce the tax rate.

In 2005, a number of corporations reported receiving income tax bills from Kuwaiti tax authorities although the companies had no commercial presence in Kuwait. Bills were typically sent to the companies' Kuwaiti distributors and often included years of back taxes. Some companies have challenged the tax in court and others are working with the U.S. and Kuwaiti governments to seek a legislative or regulatory solution.

LAOS

TRADE SUMMARY

The U.S. goods trade surplus with Laos was \$6 million in 2005, an increase of \$3 million from \$3 million in 2004. U.S. goods exports in 2005 were \$10 million, up 66.8 percent from the previous year. Corresponding U.S. imports from Laos were \$4 million, up 24.2 percent. Laos is currently the 193rd largest export market for U.S. goods.

IMPORT POLICIES

Overview

The U.S. – Laos Bilateral Trade Agreement (BTA) entered into force on February 4, 2005. Under the terms of the BTA, the United States granted normal trade relations (NTR) treatment to products of Laos and Laos committed to implement a variety of market access concessions and trade rules, which are discussed in more detail below. Laos is currently in the early stages of WTO accession negotiations. Implementation of the BTA, which is proceeding slowly, will help Laos prepare to undertake the necessary WTO obligations.

Tariffs

Laos has implemented the ASEAN Harmonized Tariff Nomenclature (AHTN), in which about half of the 10,689 lines are four or six digits. The remaining are eight-digit lines. As an ASEAN country and a least-developed economy, Laos participates in the ASEAN Free Trade Agreement (AFTA). The average tariff on ASEAN-origin products is 5 percent. As 80 percent of Laos' external trade is with ASEAN countries, its participation in AFTA is a significant liberalizing step. However, Laos retains 88 items of special concern on which tariffs remain high – the highest number of such special status products in ASEAN.

Under the U.S.–Laos BTA, Laos is obligated to reduce tariffs on a variety of products of U.S. origin. Laos has implemented these tariff reductions, but has done so quite unevenly, as central control of provincial customs operations is very weak. Most trade in Laos still requires authorization from several national and provincial authorities, which can be a time-consuming and opaque process. In Laos, provinces collect customs levies at international border crossings in their respective provinces only a portion of which is rendered to the central government. Customs collection is subject to significant variation.

Non-Tariff Barriers

Import Prohibitions: Lao law prohibits the importation of weapons, illegal drugs, toxic chemicals, hazardous materials, pornographic materials, and agricultural products which are grown domestically in quantities sufficient to meet demand.

FOREIGN TRADE BARRIERS

Import Licensing: Laos requires import licenses. Although somewhat streamlined in recent years, the procedures for obtaining these licenses are still complicated and opaque, and is not always clear what part of the government controls the process.

Applications for import licenses must also be made to the provincial trade authority where the importing enterprise is located and the application procedure varies from province to province. Importers must submit an annual importation plan to the Ministry of Commerce or to relevant provincial authorities, and may only import against the plan throughout the following year.

Customs: Border control is weak throughout the country, and border trade is poorly controlled. Almost every incoming container that enters Laos at a formal border checkpoint is inspected, which has led to allegations of corruption. Although the Lao government has given assurances that transaction value will be the basis for valuation for all products of the United States, the Lao Customs Department retains a reference list of prices and tariff rates based upon previous levies, which it uses routinely. Customs procedures in Laos have improved since the introduction of the ASEAN harmonized tariff system. However, a large number of approvals are still required and informal payments to get those approvals remain common. Laos does not have a system of entry under bond.

Taxes: Laos generally applies a turnover tax and also subjects some goods to excise taxes. Goods which are subjected to high excise taxes include: distilled spirits (50 or 60 percent); soft drink and beverages (30 percent); cigarettes (50 percent); perfume and other cosmetic products (20 percent); and vehicles (10 percent to 104 percent). Eleven goods classified as luxury goods must pay additional excise taxes, which are often higher for imports than for domestic products. Goods falling under this classification include soft drinks, water, fruit juice, alcoholic beverages, cigarettes, motorcycles and vehicles. The United States has made it clear to the Lao government that national treatment is required in the application of excise taxes.

STANDARDS, TESTING, LABELING AND CERTIFICATION

Laos has no specific law on standards for imported or exported goods. Imported goods are allowed to enter based on the certification of the country of export. Laos has no special labeling or marking requirements.

GOVERNMENT PROCUREMENT

Government procurement is opaque in Laos, with no detailed published guidelines and little accountability. The Lao government's published budget and leading prospectus for the following fiscal year can serve as a rough guide to procurement expenditure levels, though procurements by ministry are not clearly given. Nearly all capital goods and equipment, and most commodities, are outright gifts or are purchased with Official Development Assistance (ODA), the donors of which typically require a public bidding process for contractors. The individual line ministries therefore routinely publish calls for bids on development projects.

FOREIGN TRADE BARRIERS

INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

IPR protection in Laos is under the purview of the Science, Technology, and Environment Agency (STEA), a three-person unit in the Office of the Prime Minister. The STEA personnel appear to be well-trained in IPR theory, but have little authority. In particular, STEA lacks the power to arrest, and appears to have no coordination with the police.

IPR enforcement in Laos is therefore very weak, and enforcement at the border is almost impossible, due to its all but complete porosity. The national market volume in pirated trademark and copyright materials is low.

Laos became a member of the World Intellectual Property Organization (WIPO) in 1995, the Paris Convention in 1998, and subsequently accepted international assistance in drafting an IPR law. The IPR law has not been completed. Laos has not yet acceded to the Bern Convention. In general, implementing regulations are still lacking. Laos issued a trademark decree in 1995. STEA controls the issuance of trademarks on a first-come, first-registered basis. Applicants do not have to demonstrate prior use. There are currently about 9,300 trademarks registered in Laos.

Laos became a member of the ASEAN Common Filing System on Patents in 2000, but lacks qualified patent examiners. A decree protecting patents, petty patents, and industrial designs was approved in January 2002. No system yet exists to actually issue copyrights. A draft copyright law was developed in 2005.

SERVICES BARRIERS

Banking: The Lao financial sector is dominated by the central Bank of Lao PDR (BOL) and two state-owned commercial banks, which to varying degrees all serve as policy implementation banks. Foreign banks, including six which are actively represented in Laos, offer limited services primarily to foreigners. Foreign banks may only operate in the capital, Vientiane, which severely hampers their competitiveness in providing financial services to the southern part of the country where business is concentrated. Foreign businesses usually arrange financing on international markets.

In general, regulatory supervision of the state-owned commercial banks (SOCBs) is lacking. Enforcement of prudential guidelines is ineffective and standards for credit worthiness are low, often resulting from directed lending to inefficient state-owned enterprises (SOEs). Although the SOCB's were re-capitalized in 1994, a 1997 audit indicated that the institutions were once again insolvent, with non-performing loans accounting for most of their debt portfolio. The situation had improved somewhat by late 2004, and some capital again became available for lending. However, there was a decline in reserves over the first half of 2005, necessitating assistance from international financial institutions.

The need for legal sector reform, with laws and regulations for loan collection and collateral enforcement, is a fundamental obstacle to improvements in the financial sector

FOREIGN TRADE BARRIERS

Legal: Foreign attorneys are not permitted to represent clients in Lao courts. Judgments against foreign business people in the past have been irregular and prejudicial. Many areas of business and finance are not yet covered by viable statutes. Several international organizations are helping the Lao government to develop the legal sector, and new laws are gradually emerging in draft form. Enforcement remains a significant challenge.

Insurance: Foreign insurance companies can operate in Laos; at present, only one does.

Education: Foreign entities are technically forbidden to teach in Laos, but this regulation is routinely ignored. There is a Lao American College in Vientiane, a private sector joint U.S.-Lao venture, and foreigners teach languages in many schools in and around the capital. However, the Ministry of Education maintains a close watch over the ideological content of curricula.

Accounting: Technically, foreign accounting firms may not operate in the field of accounting in Laos. However, one international accounting firm does offer auditing (rather than accounting) services.

Engineering/construction/architectural: Foreign engineering, construction and architectural entities may operate in Laos in support of internationally-funded development (ODA) projects or foreign direct investment (FDI) enterprises deemed to be in the national interest.

Foreign exchange system: There are no restrictions on foreign exchange within Laos, nor are there any legal limits on remitting foreign exchange abroad. There are practical limitations, however, in that the availability of foreign exchange is sometimes limited, which inconveniences large single-sale and large-volume businesses, such as those selling heavy equipment or fuel and petroleum products, both areas in which American businesses currently operate.

Telecommunications: Although it is listed as a sector of strategic and national security interest, in practice, telecommunications is the most open and competitive services sector in Laos, with the field presently divided among Lao, Thai, and Chinese telecommunications entities.

INVESTMENT BARRIERS

Laos has a challenging investment environment due to the lack of the rule of law, opaque regulations, and primitive, inefficient infrastructure and services, particularly in financial services. Laos is one of the most difficult countries in the world in which to set up a business, with licenses routinely taking up to a year to acquire. Foreign direct investment in Laos is not accurately reported by the Lao government (the official figures show approved, not actual, investments), and real investment levels are therefore difficult to estimate. Thailand, France, and Australia appear to constitute most of the foreign direct investment in Laos, though as in trade, the level of Chinese investment is growing. Current U.S. investment is officially (and very unreliably) listed at \$15.2 million between 2001 and 2005, consisting chiefly of small family-level business investments, some agricultural activities, and a part-interest in a mining venture. The real level of U.S. investment is probably well below \$10 million.

FOREIGN TRADE BARRIERS

The Law on the Promotion and Management of Foreign Investment is the basic law governing foreign direct investment in Laos, and divides foreign direct investment into two categories: joint-venture companies and wholly-owned companies. The sole investment advantage that Laos has over its neighbors is that foreign firms may wholly own and operate a business.

Foreign investors and their hired personnel are forbidden to take part in certain commercial activities without special permission. Among these are: forest exploitation, accounting, tourism, heavy vehicle or machinery operation, and rice cultivation. In fact, foreigners are engaged in most of these activities. A provision in the business law gives special, closely controlled status to an additional range of business activities deemed important to national security. These include petroleum, electrical power, water utilities, telecommunications, mines and minerals, the food industry, medicine, chemicals, liquor, and tobacco. While these restrictions are intended to protect state-owned enterprises, foreigners are occasionally active in these business categories, primarily in telecommunications.

Required documentation for foreign businesses remains comparatively large, and effectively separates business activity into foreign and domestic categories. Dispute arbitration and mediation is vaguely defined. The United States has urged Laos to move from a business licensing to a business registration system, chiefly through repeal of the Industrial Processes Law, which requires manufacturers to apply for permission to make even minor changes to their methods of production, and which has never been augmented with clear implementation regulations. Laos still requires a feasibility study for foreign businesses, a requirement better suited to development projects.

The required annual renewal of a Lao business license is contingent upon certification that all taxes have been paid. Due to the lack of clarity in the tax law, foreign investors complain that taxes are often assessed in an inconsistent manner. Lao officials acknowledge ambiguities in the law. The tax code was streamlined and simplified in January 1999, and again in 2002-03, but some investors still report significant difficulties in obtaining tax certifications and clearances in a timely manner.

ELECTRONIC COMMERCE

Internet is available in all the major towns in Laos, though e-commerce is not as yet widely used in the country. There is no body of law governing e-commerce, nor does the Lao government appear to recognize the need for constructing a venue for dispute resolution in Internet/e-commerce transactions.

OTHER BARRIERS

Corruption: Both giving and accepting bribes are criminal acts in Laos, in theory punishable by fine and/or imprisonment. The Prime Minister's Office issued an anti-corruption decree in November 1999, and at least one official has been arrested for corruption since that time, but implementation remains uneven. The Counter-Corruption Committee in the Prime Minister's Office is the Lao government agency responsible for combating corruption.

FOREIGN TRADE BARRIERS

Nonetheless, corruption in Laos continues to be an issue. Bribes to low-level officials to expedite time-sensitive applications, such as business licenses or importation of perishable items, are known to occur and some say could be growing due to increased investment in extractive industries.

MALAYSIA

TRADE SUMMARY

The U.S. goods trade deficit with Malaysia was \$23.3 billion in 2005, an increase of \$6.0 billion from \$17.3 billion in 2004. U.S. goods exports in 2005 were \$10.5 billion, down 4.3 percent from the previous year. Corresponding U.S. imports from Malaysia were \$33.7 billion, up 19.6 percent. Malaysia is currently the 18th largest export market for U.S. goods.

U.S. exports of private commercial services (i.e., excluding military and government) to Malaysia were \$1.2 billion in 2004 (latest data available), and U.S. imports were \$616 million. Sales of services in Malaysia by majority U.S.-owned affiliates were \$1.5 billion in 2003 (latest data available), while sales of services in the United States by majority Malaysia-owned firms were not available in 2003 (\$292 million in 1998).

The stock of U.S. foreign direct investment (FDI) in Malaysia in 2004 was \$8.7 billion, up from \$7.3 billion in 2003. U.S. FDI in Malaysia is concentrated largely in the manufacturing, and mining sectors.

FREE TRADE AGREEMENT LAUNCHED

USTR notified Congress of the President's intent to initiate negotiations on a Free Trade Agreement (FTA) with Malaysia on March 8, 2006. The announcement followed more than a year of discussions with Malaysia under their Trade and Investment Framework Agreement, concluded in 2004. In announcing its intent to launch negotiations, the Administration noted that Malaysia is our 10th largest trading partner with \$44.2 billion in total trade during 2005 and that the increased access to Malaysia's market that an FTA would provide would further boost trade in a wide range of both industrial and agricultural goods and services, enhancing employment opportunities in both countries. It highlighted expected gains from liberalization of foreign investment between the United States and Malaysia as well as from the strengthening of Malaysia's intellectual property and customs regimes. An FTA with Malaysia also would advance President Bush's Enterprise for ASEAN Initiative, under which the United States hopes to enhance our trade and economic ties to ASEAN countries, reinforcing a strong U.S.-ASEAN relationship, which is a force for stability and development in the Southeast Asian region. Finally, an FTA with Malaysia would deepen our relationship and support our cooperative efforts on key economic, political and security issues. Malaysia plays an important role in the WTO, developing and Muslim worlds as well as in ASEAN and has been a constructive partner on counterterrorism, counternarcotics and other issues.

FOREIGN TRADE BARRIERS

IMPORT POLICIES

Tariffs

Tariffs are the main instrument used to regulate the importation of goods in Malaysia. The simple average applied normal trade relations (NTR) most-favored nation (MFN) tariff rate is approximately 8.56 percent, but duties for tariff lines where there is significant local production are often higher.

The level of tariff protection is generally lower on raw materials and increases for those goods that have value-added content. In addition to import duties, a sales tax of 10 percent is levied on most goods. Neither import duties nor this sales tax is applied to raw materials or machinery used in export production.

Seventeen percent of Malaysia's tariff lines (principally in the construction equipment, agricultural, mineral, and motor vehicle sectors) are also subject to non-automatic import licensing designed to protect import-sensitive or strategic industries.

Import Restrictions on Motor Vehicles

Malaysia has long protected its automobile manufacturing industry from foreign competition using high tariffs and non-tariff trade barriers. Government policies also distinguish between "national" cars (i.e., domestic producers Proton and Perodua) and "non-national" cars, which include most vehicles manufactured in Malaysia by non-Malaysian owned firms.

The government has slowly started to dismantle some of its protections in order to meet its commitments under the WTO and the ASEAN Free Trade Agreement (AFTA Agreement). In October 2005, the government issued a new National Auto Policy (NAP) framework that may pave the way for further sectoral liberalization, though a complete NAP has yet to be issued. In January 2004, the government eliminated local content requirements that were inconsistent with its obligations under the WTO TRIMS Agreement. Nonetheless, government policies continue to block open trade in the automotive sector, for example, through the approved permit system, and offering tax rebates for national manufacturers.

The Ministry of International Trade and Industry oversees a system of approved permits (APs) that allows the holder to import cars and distribute them locally. The AP system was designed to provide *bumiputera* (ethnic Malay) companies easy entry into the automobile distribution and service sector. The AP system acts as quota by restricting the total number of automobiles that can be imported in a given year relative to the size of the domestic market. APs continue to be capped at an estimated 10 percent of the domestic market. In addition to restricting market access for imports, many of the permits are sold for profit, with the associated costs passed on to consumers further raising the cost of imported vehicles. Reforms of the AP system in the 2005 NAP framework are not expected to alter its trade-distorting impact in the short to medium term, though the framework proposes elimination of the AP system at an unspecified future date.

FOREIGN TRADE BARRIERS

The government amended the automotive tax regime in 2004 and twice in 2005 to meet its commitments under AFTA. The import duty rate for vehicles with at least 40 percent ASEAN content was set at 20 percent in October 2005 and will be lowered to 5 percent in 2008. However, the government imposed automobile excise taxes for the first time in 2004 and increased rates in 2005 to compensate for the revenue lost by cutting import tariffs. The high tax rates continue to overburden automakers and discriminate against foreign-owned manufacturers. Domestic car manufacturers Proton and Perodua, plus two locally incorporated joint ventures assembling imported kits, received a 50 percent rebate on excise taxes. The Government of Malaysia suggests that the rebate practice will discontinue upon adoption of the new NAP framework, though dates for changing this practice have not been disclosed. Elimination of the rebate would level the playing field significantly among non-national manufacturers.

The import duty/excise tax schedule is complex. In general, the current applied import tariffs and excise tax rates for completely built-up (CBU) and completely knocked-down (CKD) vehicles are as follows:

	ASEAN Tariff (%)	Non-ASEAN Tariff	Excise (%)
Automobiles (CBU)	15	30	80-200
Automobile (CKD)	0	10	80-200
Multipurpose Vehicles (CBU)	15	30	55-160
Multipurpose Vehicles (CKD)	0	0-10	55-160
4WD (CBU)	15	30	55-160
4WD (CKD)	0	10	55-160
Motorcycles (CBU)	15	30	20-50
Motorcycles (CKD)	0	0-10	20-50

Textiles

Import duties on textiles and apparel range between 0 percent and 30 percent. Malaysia does not require import licenses or impose burdensome labeling requirements on the import of textiles.

STANDARDS, TESTING, LABELING AND CERTIFICATION

Nutritional labeling

Malaysia requires that certain processed, packaged food products commonly consumed by Malaysians are labeled with nutritional information. These items include cereals, breads, milk, canned meat, canned fish, canned fruits and canned vegetables, fruit juices, soft drinks and salad dressings. Regulations on Nutrition Labeling and Claims issued in March 2003 outline what type of nutritional information is required and the format in which the information is to appear on the package. The regulations limit the kinds of nutritional claims, such as “reduced sodium,” “low cholesterol,” or “high fiber,” that can appear on food packaging. Effective July 1, 2005, more than 50 food products must meet these labeling requirements. To comply with these regulations, U.S. food product importers must affix separate labels at ports of entry, a labor intensive and costly task (the generally small volume of such U.S. exports to Malaysia keeps most U.S. producers from producing Malaysia-specific labels at the point of origin).

Meat Import Licenses and Halal Certification

Malaysia requires that all meat, processed meat products, poultry, and egg and egg products originate from plants inspected and approved by the Ministry of Agriculture’s Department of Veterinary Services (DVS). DVS requires these food safety inspections despite assurances from the U.S. Department of Agriculture (USDA) Food Safety and Inspection Service.

All meat, processed meat, poultry, egg, and egg product imports require import licenses issued by DVS. DVS often restricts imports of chicken parts through this import licensing requirement, especially when local producers believe they are facing low prices. The State of Sarawak actually issued a ban on certain chicken parts imports, which was subsequently rescinded after the issue was raised in the U.S.-Malaysia Trade and Investment Framework Agreement (TIFA). However, Sarawak put other restrictions in place that effectively banned imports. (The States of Sarawak and Sabah on the island of Borneo maintain separate quarantine restrictions from those of Peninsular Malaysia.)

All meat, processed meat products, poultry, eggs, and egg products must receive halal (produced in accordance with Islamic practices) certification from Pusat Islam (the Islamic Center). Slaughterhouses, meat processors and egg processors must also be inspected and approved by the Department of Islamic Development (JAKIM) for halal beef, lamb, poultry and egg exports. DVS and JAKIM travel together on the inspection visits. U.S. halal product suppliers must be under the supervision of an approved U.S. Islamic Center. U.S. producers have expressed concern that the halal certification process is confusing and non-transparent. Each individual product, rather than the plant, must receive halal certification. Malaysia’s halal requirements are considered relatively strict as compared to other countries.

This certificate is issued on the joint recommendation of Malaysia’s Department of Veterinary Services (DVS) in the Ministry of Agriculture and Pusat Islam following an on-site inspection. The government of Malaysia has the right to re-inspect approved plants after one year. In practice, up to three or more years may elapse before a Malaysian inspection team visits the

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United States, which limits the opportunities for new products to obtain certification as well as for companies to reapply if they fail the first inspection.

On March 7, 2006, Malaysia announced it would resume U.S. boneless beef imports from cattle under 30 months of age, lifting a ban which had been imposed since the December 2003 announcement of a case of Bovine Spongiform Encephalopathy (BSE) in the United States. U.S. officials continue to work with DVS to determine the steps necessary to ensure resumption of exports to Malaysia.

Although the Government of Malaysia applies no import duty on poultry parts, imports are regulated through licensing and sanitary controls. Import levels appear to be below the minimum access commitments established during the Uruguay Round.

GOVERNMENT PROCUREMENT

Malaysia is not a signatory of the WTO Government Procurement Agreement (GPA). Malaysia's official policy is explicitly discriminatory, calling for procurement to be used to support national public policy objectives. These objectives include encouraging greater participation of *bumiputera* (ethnic Malays) in the economy, transferring technology to local industries, reducing the outflow of foreign exchange, creating opportunities for local companies in the services sector, and enhancing Malaysia's export capabilities. As a result, foreign companies do not have the same opportunities as some local companies to compete for contracts and, in most cases, foreign companies are required to take on a local partner before their bids will be considered. In addition, a considerable proportion of government projects and procurement is awarded without transparent, competitive bidding. After taking office in October 2003, Prime Minister Abdullah Badawi announced that the government would introduce open tenders for government procurements and major projects, with direct negotiations limited to special cases.

Some U.S. companies have voiced concerns about the non-transparent nature of the procurement decision-making process in Malaysia. The government's new central tender website merely provides links to other ministries' websites, not all of which provide user-friendly information on government tenders. In September 2005, the Ministry of Finance announced that the purchase of roadway, decorative, and outdoor lighting fittings, together with equipment and accessories for all government projects, must be sourced from one of three local *bumiputera* manufacturers.

U.S. firms have also expressed concern about anticompetitive bias in the Malaysian government's software procurement policy. The policy, announced on July 16, 2004, is not technology-neutral. Instead, it establishes a preference in government procurements for Open Source Software (OSS) "in situations where the advantages and disadvantages of Open Source Software (OSS) and proprietary software are equal."

The government justifies its preference for OSS by noting its desire to control the source code. Malaysia's government has announced specific targets for the share of OSS in specific sectors.

FOREIGN TRADE BARRIERS

EXPORT SUBSIDIES

Malaysia offers several export allowances. Under the export credit-refinancing scheme operated by the Central Bank, commercial banks and other lenders provide financing to exporters at a preferential rate for both post-shipment and pre-shipment credit. Malaysia also provides tax incentives to exporters, including double deduction of expenses for overseas advertising and travel, supply of free samples abroad, promotion of exports, maintaining sales offices overseas, and research on export markets.

INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

Malaysia is a member of the World Intellectual Property Organization (WIPO) and is a party to the Berne Convention for the Protection of Literary and Artistic Works and the Paris Convention for the Protection of Industrial Property. Malaysia has not ratified the WIPO Copyright Treaty or the WIPO Performance and Phonograms Treaty, which extend traditional copyright principles to the digital environment.

In 2000, Malaysia's parliament amended the Copyright Act, the Patents Act, and the Trademarks Act, as well as legislation on layout designs of integrated circuits and geographical indications, in order to bring Malaysia into compliance with its obligations under the WTO TRIPS Agreement. In 2004, Malaysia passed the "Protection of New Plant Varieties Act 2004" in line with the requirements of Article 27.3 (b) of the TRIPS Agreement. Enabling regulations for this law are pending. Malaysia does not prohibit other companies from relying on test and other undisclosed information submitted by another company to the government to obtain marketing approval of pharmaceuticals and agricultural chemicals, as called for under TRIPS Article 39.3.

Optical Media Piracy

Malaysia has a significant problem with piracy of copyrighted materials, particularly those stored on optical media. Malaysia's production capacity for Compact Discs (CDs) and Digital Video Discs (DVDs) far exceeds local demand plus legitimate exports. U.S. industry estimates Malaysia's excess capacity is between ten to twenty times that needed for the legitimate market. The resulting surplus is exported globally-Pirated products believed to have originated in Malaysia have been identified throughout the Asia-Pacific region, North America, South America, Europe, and Africa. Better enforcement of licensed and unlicensed production facilities is needed, as is a concerted effort to reduce the outflow of pirate goods from the country.

The International Intellectual Property Association (IIPA) estimates 2005 industry losses in Malaysia due to piracy at \$147.3 million. IIPA estimates 2005 piracy rates at 60 percent for business software, 49 percent for music, and 50 percent for movies. Malaysia has remained on the Special 301 Watch List since October 2001, specifically because of its failure to substantially reduce pirated optical disc production and export.

Malaysia has tightened its laws on the protection of intellectual property. The Optical Disc Act of 2000 established a licensing and regulatory framework to control the manufacture of optical

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discs and to fight piracy. Under the Act, manufacturers are required to obtain licenses from both the Ministry of International Trade and Industry and the Ministry of Domestic Trade and Consumer Affairs (MDTCA), to place source identification (SID) codes on each disk, and to allow regular inspections of their operations. This law should be modernized to ensure inspection authority covers all locations where optical media production may occur and also include as offenses acts such as ‘gouging’ or tampering with the SID codes and ‘burning’ of recordable discs. In November 2005, the Recording Industry Association of Malaysia reported forensic evidence that 12 of the 44 licensed CD production factories in Malaysia were also producing pirated discs. Enforcement and prosecution are ongoing and significant challenges in Malaysia.

In 2005, Malaysia’s government continued to make progress in prosecuting manufacturers and vendors of pirated goods. The MDTCA did not renew the licenses of five CD factories found to have been involved in piracy activities and is investigating fourteen other licensed CD manufacturers. The government also made some headway in tackling the judicial backlog for infringement cases. Malaysia’s courts have imposed deterrent sentences of imprisonment and/or fines for the offenders. The Minister of Domestic Trade and Consumer Affairs has pledged the creation of a specialized IP court by mid-2006.

The government is making further efforts to reduce trade in pirated goods. A special task force, chaired by the Minister of Domestic Trade and Consumer Affairs and including representatives from all ministries and agencies with responsibility for IPR, has overseen the expansion of enforcement staff and a more vigorous program of raids on sellers of pirated products. The Ministry was expected to add over 700 more enforcement officers in 2006 to complement the existing 1400 officers.

Malaysia continues to impose a hologram-labeling requirement for optical discs containing copyrighted material.

Pharmaceuticals

Sales of counterfeit pharmaceuticals are a growing problem in Malaysia. Industry groups currently are working on a market survey that would provide an estimate of the extent of the problem. Counterfeit medicines that have been identified include "drugs" with the wrong ingredients, insufficient active ingredients, and those with fake packaging. The copied drugs are believed to originate in China. Unregistered generic copies of patented products, primarily imported from India, are also available in Malaysia. Both street vendors and health professionals sell the counterfeit products. The counterfeit medicines may create risks for consumers’ health, reduce sales by legitimate manufacturers, and leave legitimate companies vulnerable to lawsuits from patients who may have adverse reactions to the counterfeit products.

In 2005 Malaysia's Ministry of Health implemented a requirement that all medicines and health care products be affixed with a hologram label in an effort to combat rising counterfeiting. The labeling policy applies to pharmaceuticals and traditional medicines, though over-the-counter medicine and cosmetics are currently exempt. Pharmaceutical companies opposed the mandatory labeling requirement because of concerns about the cost and efficacy of this “one-size-fits-all”

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approach, and have called on the Ministry of Health to review the effectiveness of the directive on a regular basis. Industry reports of out-of-sequence numbering of hologram labels have raised concerns about the existence of counterfeit labels.

Trademarked Consumer Products

A number of U.S. consumer product companies have also suffered significant losses due to the manufacture and sale of counterfeit trademarked products. The volume is difficult to determine because of the broad scope of products involved. Counterfeiting in Malaysia goes beyond the counterfeiting of luxury branded products to include printer cartridges, plastic container systems, motor oil, household cleaning agents, shampoo and skin care items, herbicides, and penlight batteries. Counterfeiters have improved the quality of packaging and marketing so that consumers are misled into purchasing the products. The products have caused harm to individuals and damage to automobiles and household goods. Some of the pirated goods are produced in Malaysia, while many are brought into the country from China, Thailand, and India.

Enforcement by the local government is hampered by the lack of training and scarcity of information about ongoing counterfeit activities. Complicating enforcement of trademark-related violations is a Malaysian Court of Appeals interpretation of the trademark law that requires enforcement officials to have a "Trade Description Order" to conduct criminal raids when the counterfeit product seized is not identical to the trademarked original. High specificity requirements necessary to seize a shipment suspected of containing pirated or counterfeit products also represent an enforcement obstacle to U.S. industry.

SERVICES BARRIERS

Malaysia's services sector constitutes about 57 percent of the national economy and remains highly protected.

Basic Telecommunications

Under the WTO Basic Telecommunications Agreement, Malaysia made limited commitments on most basic telecommunications services and partially adopted the reference paper on regulatory commitments. Foreign companies are entitled to acquire only up to a 30 percent equity stake in existing fixed line operations, an investment ceiling codified as part of Malaysia's WTO services offer which limits market access commitments to facilities-based providers. These restrictions constitute one of the most restrictive regimes for an economy of Malaysia's level of development. Value-added service suppliers are similarly limited to 30 percent foreign equity. Restrictions on these activities tend to benefit the dominant provider, government-controlled Telekom Malaysia, and hamper the development of a more efficient information infrastructure.

Malaysia has made marginal improvements to this regime reflected in its January 2005 revised services offer in the WTO, reflecting new domestic licensing categories, but these changes remain disappointing.

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The new licensing categories introduced now allow for up to 49 percent foreign equity in suppliers categorized as “application service providers,” but precisely what this category encompasses is unclear.

Distribution Services, including Direct Selling

Malaysia’s requirements for the licensing and operation of direct selling companies include a provision that a locally incorporated direct selling company must allow for 30 percent Bumiputera equity. The Ministry also “recommends” local content targets. Local companies that seek multi-level direct selling licenses require paid-in capital of RM 1.5 million (\$397,000), while companies with foreign shareholders must have paid-in capital of RM 5 million (\$1.3 million).

The Malaysian government also included local content requirements in new "Guidelines on Foreign Participation in the Distributive Trade Services" that came into effect in December 2004. Among other provisions, department stores, supermarkets and hypermarkets must reserve at least 30 percent of shelf space in their premises for goods and products manufactured by *bumiputera*-owned small and medium size industries. The guidelines also require that at least 30 percent of a store’s sales consist of *bumiputera* products, a rule that does not take into account discretionary behavior on the part of consumers.

Legal Services

Foreign lawyers may not practice Malaysian law, nor may they affiliate with local firms or use their international firm’s name. Foreign law firms may not operate in Malaysia except as minority partners with local law firms, and their stake in any partnership is limited to 30 percent. Under the Legal Profession Act of 1976, the practice of Malaysian law is normally restricted to Malaysian citizens or permanent residents who have apprenticed with a Malaysian lawyer, are competent in Bahasa Malaysia (the official language), and have a local law degree or are accredited British Barristers at Law. The Attorney General has authority to grant limited exceptions on a case-by-case basis, provided the applicant has seven years of legal experience. Malaysian law does not allow for foreign legal consultancy except on a limited basis in the Labuan International Offshore Financial Center (see “Banking” below). Malaysia limits such foreign attorneys’ scope of services to advice concerning home country and international law. Persons not licensed as lawyers are subject to criminal penalties if they directly or indirectly undertake activities relating to the Malaysian legal system, including drafting documents.

Architectural Services

A foreign architectural firm may operate in Malaysia only as a joint-venture participant in a specific project with the approval of the Board of Architects. Malaysian architectural firms may not have foreign architectural firms as registered partners. Foreign architects may not be licensed in Malaysia but are allowed to be managers, shareholders, or employees of Malaysian firms. Only licensed architects may submit architectural plans.

Engineering Services

Foreign engineers may be licensed by the Board of Engineers only for specific projects, and must be sponsored by the Malaysian company carrying out the project. The license is only valid for the duration of a specific project. In general, a foreign engineer must be registered as a professional engineer in his or her home country, have a minimum of 10 years experience, and have a physical presence in Malaysia of at least 180 days in one calendar year. To obtain temporary licensing for a foreign engineer, the Malaysian company often must demonstrate to the Board that they cannot find a Malaysian engineer for the job. Foreign engineers are not allowed to operate independently of Malaysian partners, or serve as directors or shareholders of an engineering consulting company. A foreign engineering firm may establish a non-temporary commercial presence if all directors and shareholders are Malaysian. Foreign engineering companies may collaborate with a Malaysian firm, but the Malaysian company is expected to design is required to submit the plans for domestic approval.

Accounting and Taxation Services

Foreign accounting firms may provide accounting and taxation services in Malaysia only through affiliates. All accountants who wish to provide auditing and taxation services in Malaysia must register with the Malaysian Institute of Accountants (MIA) before they may apply for a license from the Ministry of Finance. Citizenship or permanent residency is required for registration with MIA. Malaysian citizens or permanent residents who received degrees from local universities or are members of at least one of the 11 overseas professional bodies recognized by Commonwealth countries may apply for registration. The American Institute of Certified Public Accountants (AICPA) is not recognized by Commonwealth countries.

Banking

The Malaysian government limits foreign participation in financial services to encourage the development of domestic financial services providers. The government's policies are guided by the Banking and Financial Institutions Act of 1989 (BAFA) and the ten-year Financial Sector Masterplan unveiled in 2001. The plan is focused on building competitive domestic banks, in large part through banking consolidation, and defers the introduction of new foreign competition until after 2007. Therefore, the government encourages the establishment of investment banks through mergers of commercial banks with merchant banks, discount houses and stock brokering companies. Foreign institutions are allowed to hold an equity stake in investment banks of up to 49 percent currently, foreign participation in commercial banks is still restricted to an aggregate maximum stake of 30 percent. Foreign banks currently operate in Malaysia under a grandfathering provision. No new licenses are being granted to either local or foreign banks; foreign banks must operate as locally controlled subsidiaries. Foreign commercial banks are only allowed to open new branches if they also add other branches as directed by Bank Negara. In 2004, Bank Negara pressed existing foreign banks, including U.S. banks, to expand back office operations or establish significant computing operations in Malaysia.

On October 14, 2004, Bank Negara completed the issuance of three Islamic banking licenses to three Middle Eastern Islamic banks. Bank Negara encourages all commercial banks operating in Malaysia to set up full-fledged Islamic banking subsidiaries in which foreigners may take a 49 percent equity stake.

On April 1, 2003, the government removed the restriction that foreign-controlled companies were required to obtain 50 percent of their local credit from Malaysian banks. However, sourcing of funds of more than RM 50 million (\$13.2 million) from local banks still requires approval from Bank Negara.

On April 1, 2005, the government abolished the requirement imposed on foreign-controlled companies for domestic borrowing. It has also allowed foreign-controlled companies to seek any amount of ringgit credit without Bank Negara's approval. On July 21, 2005, Bank Negara announced that the ringgit would no longer be strictly pegged at RM3.8 to \$1 US. Currently, the central bank is managing the ringgit against a trade-weighted basket of floating currencies. To date, the ringgit has appreciated less than 1 percent against the dollar and many analysts believe that it is still undervalued by approximately 5 percent.

On December 28, 2005, Bank Negara announced that locally incorporated foreign banking institutions currently operating in Malaysia would be allowed to open up to four additional branches in 2006 (one branch in a market center, two in semi-urban centers, and one in a non-urban center).

The Federal Territory of Labuan was established as an International Offshore Financial Center in October 1990. Foreign investors receive preferential tax treatment for offshore banking activities, trust and fund management, offshore insurance and offshore insurance-related businesses, and offshore investment holding business.

Insurance

The insurance industry remains dominated by foreign providers, including several U.S. firms. The 2001 Financial Sector Masterplan recommends phased liberalization of the insurance industry, including increasing caps on foreign equity, fully opening the reinsurance industry to foreign competition, and lifting existing restrictions on employment of expatriate specialists. Branches of foreign insurance companies were required to incorporate locally under Malaysian law by June 30, 1998, although Malaysia's government has granted individual extensions. Foreign shareholding exceeding 49 percent is permitted only with Malaysian government approval. As part of the 1997 WTO Financial Services Agreement, Malaysia agreed to allow existing foreign shareholders of locally incorporated insurance companies to increase their shareholding to 51 percent. New entry by foreign insurance companies is limited to equity participation in locally incorporated insurance companies, and aggregate foreign shareholding in such companies may not exceed 30 percent. However, this limit has been subject to negotiation.

Securities

Malaysia currently allows 49 percent foreign ownership in stock-broking companies and a 30 percent foreign stake in unit trusts. The Securities Commission's ten-year Capital Market Masterplan, released in February 2001, proposed liberalizing foreign participation limits by 2003, at which time foreigners would be permitted to purchase a limited number of existing stock-broking licenses and to take a majority stake in unit trust management companies. Fund management companies may be 100 percent foreign-owned if they provide services only to foreigners, but they are limited to 70 percent foreign ownership if they provide services to both foreign and local investors. On March 22, 2005, the government allowed five foreign stock brokerages and a foreign fund management company to set up operations in Malaysia. More foreign fund management companies are expected to utilize four of the remaining licenses. In September 2003, the Securities Commission began allowing foreign firms operating in Malaysia to seek listing on the Kuala Lumpur Stock Exchange. Futures brokerage firms may now be 100 percent foreign-owned. Advertising Commercials are restricted to a maximum of 20 percent foreign film content. The government recently relaxed enforcement of regulations governing the appearance of foreign actors in commercials shown in Malaysia. The Government of Malaysia has an informal and vague guideline that commercials cannot "promote a foreign lifestyle."

Audio-Visual and Broadcasting

Malaysia's government maintains broadcast content quotas on both radio and television programming. Eighty percent of television programming is required to originate from local production companies owned by ethnic Malays (an increase from the previous limit of 60 percent). However, in practice, local stations have been granted substantial latitude in programming due to a lack of local programming. Sixty percent of radio programming must be of local origin. Foreign investment in terrestrial broadcast networks is prohibited. As a condition for obtaining a license to operate, video rental establishments are required to have 30 percent local content in their inventories. Malaysia regularly censors movies and television shows deemed offensive on religious or sexual grounds.

INVESTMENT BARRIERS

Malaysia encourages foreign direct investment in export-oriented manufacturing and high-technology industries, but retains considerable discretionary authority over individual investments, and restricts foreign investment in other sectors. Especially in the case of investments focused toward the domestic market, it has used this authority to restrict foreign equity (normally to 30 percent) and to require foreign firms to enter into joint ventures with local partners. As noted above, foreign investment in the financial services industry is restricted; foreign investment in terrestrial broadcasting is prohibited. To alleviate the effects of the regional economic crisis, in 1998, Malaysia temporarily relaxed foreign-ownership and export requirements in the manufacturing sector for those companies that did not directly compete with local producers. In June 2003, the government extended indefinitely the policy, permitting 100 percent foreign ownership in new investment, if it was for the expansion of existing investments in manufacturing concerns. In September 2004, the government announced that venture capital firms could be 100 percent foreign-owned.

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Malaysia continues to suffer shortages of skilled and technical employees, particularly in the electronics sector. Most foreign firms face restrictions in the number of expatriate workers they are allowed to employ. In June 2003, the government released new guidelines liberalizing the policy on employment of expatriates in the manufacturing sector. Manufacturing companies with foreign paid-up capital of at least \$2 million receive automatic approval for up to 10 expatriate posts.

ELECTRONIC COMMERCE

Malaysia currently applies no onerous restrictions on products or services traded via electronic commerce. Products that are ordered via the Internet and physically delivered are subject to applicable import duties. Engineering services may not be provided via the Internet unless the engineer is properly licensed.

OTHER BARRIERS

Transparency

U.S. companies have indicated that they would welcome improvements in the transparency of government decision-making and procedures and some U.S. companies have indicated a desire for measures regarding perceived anticompetitive practices in Malaysia. For example, the Malaysian government has not provided details of its proposed competition policy to local and foreign industry and has not sought public comments, despite U.S. government and industry requests for the opportunity to provide input on this proposed policy. Malaysia's government also has declared that it is committed to fighting corruption. To promote that objective, Malaysia maintains an Anti-Corruption Agency (ACA) that is part of the Office of the Prime Minister. The ACA has the independent power to conduct investigations and is able to prosecute cases with the approval of the Attorney General. However, relatively few senior officials or politicians have been prosecuted for corruption offenses. Malaysia has signed but not yet ratified the UN Convention Against Corruption.

MEXICO

TRADE SUMMARY

The U.S. goods trade deficit with Mexico was \$50.1 billion in 2005, an increase of \$5.1 billion from \$45.1 billion in 2004. U.S. goods exports in 2005 were \$120.0 billion, up 8.3 percent from the previous year. Corresponding U.S. imports from Mexico were \$170.2 billion, up 9.2 percent. Mexico is currently the 2nd largest export market for U.S. goods.

U.S. exports of private commercial services (i.e., excluding military and government) to Mexico were \$18.0 billion in 2004 (latest data available), and U.S. imports were \$13.5 billion. Sales of services in Mexico by majority U.S.-owned affiliates were \$9.8 billion in 2003 (latest data available), while sales of services in the United States by majority Mexico-owned firms were \$1.3 billion.

The stock of U.S. foreign direct investment (FDI) in Mexico in 2004 was \$66.6 billion, up from \$59.1 billion in 2003. U.S. FDI in Mexico is concentrated largely in the manufacturing, banking, and finance sectors.

Mexico has signed a total of 11 free trade agreements with 43 countries, including the European Union, Chile, the five economies of the Central American Common Market, Israel, and Uruguay. Mexico also implemented an Economic Partnership Agreement with Japan on April 1, 2005.

North American Free Trade Agreement

The North American Free Trade Agreement (NAFTA), signed by the United States, Canada, and Mexico, entered into force on January 1, 1994. This free trade agreement progressively eliminates tariffs and non-tariff barriers to trade in goods; improves access for services trade; establishes rules on investment; strengthens protection of intellectual property rights; and creates an effective dispute settlement mechanism. The NAFTA is accompanied by supplemental agreements that provide for cooperation to enhance and enforce labor standards and to encourage environmentally friendly practices and bolster environmental protection in North America.

IMPORT POLICIES

Tariffs and Market Access

Under the terms of the NAFTA, Mexico eliminated tariffs on all remaining industrial and most agricultural products imported from the United States on January 1, 2003. In October 2005, Mexico announced a tariff-rate quota on U.S. high-fructose corn syrup (HFCS), with a duty-free in-quota rate. Mexico otherwise appears to apply its WTO-bound rate of 156 percent to 210 percent on U.S. exports of HFCS. The safeguard action for U.S. chicken leg quarters expires at the end of 2007 (see section on agriculture, below).

FOREIGN TRADE BARRIERS

Trade growth in agricultural products has been balanced since the NAFTA was implemented, with U.S. exports to Mexico increasing by \$5.7 billion from 1993 to 2005, and U.S. imports from Mexico increasing by \$5.6 billion. The numbers are less balanced, however, when considering nonagricultural trade. U.S. non-agricultural imports from Mexico grew \$125 billion compared with U.S. export growth of \$73 billion from 1993 to 2005.

A number of U.S. exports, both agricultural and non-agricultural, are subject to antidumping duties that limit access to the Mexican market. Products subject to these duties currently include beef, rice, epoxidized soy oil, apples, liquid caustic soda, ammonium sulfate, polyvinyl chloride, bond paper, industrial fatty acids, stearic acid, ethylene glycol monobutyl ether, and welded carbon steel pipe and tube. In 2005, Mexico terminated the antidumping investigations of crystal polystyrene and newsprint, and the self-initiated investigation of pork legs (hams), without imposing duties.

Agricultural Products

The United States exported \$9.3 billion in agricultural products to Mexico in 2005, setting a new record. Mexico became the United States' second largest agricultural market in 2004. Under NAFTA, Mexico has eliminated nearly all import tariffs and tariff-rate quotas on agricultural products from the United States. As of January 1, 2005, the only U.S. agricultural exports subject to tariffs or tariff-rate quotas are corn, sugar, dry beans, orange juice, chicken leg quarters, high-fructose corn syrup, and milk powder.

During the past year, Mexico's Secretariat of Economy (SECON) continued antidumping duties on beef, rice, and apples, and initiated a sunset review of existing duties on beef. In 2004, SECON terminated its antidumping investigation of U.S. pork, finding no cause for continuing the investigation. SECON subsequently self-initiated an antidumping investigation of U.S. pork legs (hams), and on December 21, 2005, Mexico announced it was terminating the investigation without imposing measures. Concerns about Mexico's methodology for determining injury to the Mexican domestic industry and for calculating dumping margins in the rice case led the United States to challenge the antidumping measure at the WTO. In June 2005, the WTO panel found in favor of the U.S. position. Mexico appealed the decision and the WTO Appellate Body subsequently agreed with nearly all of the panel's findings. SECON modified the beef dumping duties in 2004 in response to the findings of a NAFTA Chapter 19 panel, which determined that SECON did not sufficiently demonstrate that U.S. beef imports had damaged Mexico's beef industry. The panel's decision on remand, in which it must either uphold SECON's remand determination or issue additional remand instructions to SECON, is still pending. Mexican policies in this area have reduced the number of U.S. suppliers and altered product trading patterns. Industry representatives assert that \$100 to \$500 million in revenue is lost each year due to antidumping duties in the beef sector.

On December 29, 2004, SECON suspended the application of the 46.58 percent antidumping duty on U.S. red and golden delicious apples exported by members of the Northwest Fruit Exporters (NFE) and established a reference price system for NFE members. In February 2005, a Mexican court nullified the reference price system and on May 26, 2005, in response to an order from a Mexican court, SECON announced the elimination the 46.58 percent antidumping

FOREIGN TRADE BARRIERS

duty for NFE members and the beginning of a new antidumping investigation on U.S. red and golden delicious apples for those members. On September 29, 2005, SECON announced the preliminary results of its investigation and imposed a preliminary antidumping duty of 44.67 percent on red and golden delicious varieties for all but three members of the NFE, who received lower or no duties. The original antidumping duty of 46.58 percent still applies to red and golden delicious apples by exporters who are not members of the NFE. When it announced the preliminary results of its investigation, SECON requested additional information from NFE exporters as well as exporters who had not yet participated in the investigation but wished to do so. That information was due in November 2005.

In July 2003, Mexico imposed a NAFTA safeguard on U.S. chicken leg quarters that will remain in effect until December 31, 2007. The safeguard takes the form of a tariff-rate quota (TRQ) on chicken leg quarters. The TRQ preserves market access for U.S. exporters at levels achieved in recent years. Pursuant to the NAFTA, Mexico agreed to provide compensation to the United States, including a commitment not to impose any additional import restrictions on U.S. poultry products and to eliminate certain sanitary restrictions on U.S. poultry products. U.S. poultry product exports were up 74.7 percent from October 2003 to October 2005.

On December 31, 2001, the Mexican Congress approved a 20 percent tax on certain beverages made with sweeteners other than cane sugar, including HFCS. HFCS sales fell dramatically below prior volumes, as bottling companies in Mexico switched to cane sugar to avoid the paying the tax. Industry estimates that the annual cost of this trade barrier to the United States is roughly \$944 million in U.S. HFCS sales losses and sizeable investment losses. Industry analyst's estimate that full restoration of the Mexican market for HFCS sales would increase the price per bushel for corn \$0.06 nationally, or \$0.10 in key corn states. Although temporarily suspended by the Fox Administration, the Mexican Supreme Court ruled this action unconstitutional and reinstated the tax on July 12, 2002. The tax has been renewed each year by the Mexican Congress, including for 2006. On March 16, 2004, the United States requested consultations under the dispute settlement procedures of the WTO, and on July 6, 2004, a WTO panel was established to review the dispute. The panel announced its findings on October 7, 2005, which supported the U.S. position that the tax is inconsistent with Mexico's WTO obligations. Mexico appealed the panel's report to the WTO Appellate Body on December 6, 2005. The Appellate Body circulated its report upholding the panel's finding on March 6, 2006.

On September 30, 2005, SECON established a tariff-rate quota of 250,000 metric tons for imports of U.S. HFCS, which will be in place until September 30, 2006. Imports will be managed through a permit system, but will not be exempt from the 20 percent domestic tax applied to certain beverages. Several HFCS consuming firms in Mexico have obtained injunctive relief (amparos) exempting them from the tax. The TRQ action mirrored a U.S. decision to establish under NAFTA a FY 2006 duty free tariff-rate quota for imports of 250,000 metric tons of Mexican sugar.

On August 18, 2005, Mexico placed additional duties on imports of several products from the United States. Tariffs ranging from nine to 30 percent were imposed on chewing gum, other confectionaries, certain fortified milk products, and certain wines. Mexico took this action after the United States failed to comply with a WTO recommendation that the Continued Dumping

FOREIGN TRADE BARRIERS

and Subsidy Offset Act (CDSOA), known as the “Byrd Amendment”) be brought into conformity with U.S. WTO obligations. The U.S. Congress repealed the CDSOA in December 2005.

Sanitary and Phytosanitary Issues

In recent years, Mexican sanitary and phytosanitary standards have created barriers to exports of certain U.S. agricultural goods, including grains, seed products, apples, stone fruit, pork, beef, poultry, citrus, wood and wood products, dry beans, avocados, potatoes, and eggs. In addition, procedural requirements regarding sanitary and phytosanitary inspections at port of entry do not always reflect agreements reached between U.S. Department of Agriculture officials and the Mexican Secretariat of Agriculture, resulting in unnecessary delays at border points of entry, seaports, and airports. While the situation improved during 2005, significant quantities of imports were still rejected or delayed at the border.

Mexico banned imports of U.S. beef in December 2003, following the detection of a positive case of Bovine Spongiform Encephalopathy (BSE) in the State of Washington. In March 2004, Mexico announced that it would accept U.S. boneless beef from cattle less than 30 months of age, and it subsequently lifted restrictions on a number of offals and processed boneless beef products. Currently, bans or restrictions remain on bone-in beef, live cattle, certain offals and pet food. The United States is working intensively to fully re-open the market as quickly as possible.

The application of a zero tolerance for the presence of small amounts of bone in boneless beef led to the rejection of numerous U.S. beef shipments and the prohibition of exports from certain U.S. beef plants during 2005. An agreement to apply existing tolerances for bone as established in Mexican regulations has since greatly reduced the number of rejections.

In September 2005, Mexico’s Secretariat of Health implemented a rule regulating the meat sector that established a tolerance of zero for the presence of salmonella in raw meat. This scientifically unjustifiable standard could lead to unnecessary product recalls and export restrictions for U.S. meat exporters.

Despite the lack of a protocol for returning live animals and adequate inspection facilities in Mexico, in June 2004, the Mexican Congress approved a measure requiring that the inspection of imported live animals take place in Mexico. The lack of adequate inspection facilities has hampered the importation of live animals. While Mexico’s Congress appears to agree that the law should be changed, the provision remains in place pending agreement upon other modifications to the Animal Health Law.

In October 2005, Mexico lifted its Low Pathogenic Avian Influenza restrictions on poultry imports from nine U.S. states, but restrictions on 11 counties in Texas remain in place following a 2004 detection of High Pathogenic Avian Influenza.

Administrative Procedures and Customs Practices

U.S. exporters continue to be concerned about Mexican customs administrative procedures, including insufficient prior notification of procedural changes; inconsistent interpretation of regulatory requirements at different border posts; and uneven enforcement of Mexican standards and labeling rules. There have been relatively few specific complaints, however, and Mexican customs has been putting procedures in place to address issues of non-uniformity at border ports of entry. Agricultural exporters note that Mexican inspection and clearance procedures for some agricultural goods are long, burdensome, non-transparent, and unreliable. Customs procedures for express packages continue to be burdensome, although Mexico has raised the *de minimis* level from \$1 to \$50. However, Mexican regulations still hold the courier 100 percent liable for the contents of shipments.

To be eligible to import well over 400 different items, including agricultural products, textiles, chemicals, electronics and auto parts, Mexican importers must apply to the Secretariat of Finance and Public Credit (SHCP) and be listed on a special industry sector registry. U.S. exporters complain that the registry requirement sometimes causes costly customs clearance delays when new products are added to the list of subject items with immediate effect, thereby denying importers sufficient notice to apply. They also report that certain importers have been summarily dropped from the registry without prior notice or subsequent explanation, effectively preventing U.S. exporters from shipping goods to Mexico.

Mexico requires import licenses for a number of commercially sensitive products. It also uses estimated prices for customs valuation of a wide range of products imported from the United States and other countries, including apples, milled rice, beer, distilled spirits, chemicals, wood, paper and paperboard products, textiles, apparel, toys, tools, and appliances.

Since October 2000, the Mexican government has imposed a burdensome guarantee system for goods subject to estimated prices. Importers cannot post bonds to guarantee the difference in duties and taxes if the declared value of an entering good is less than the official estimated price. Instead they must deposit the difference in cash at a designated Mexican financial institution or arrange one of two alternative sureties (a trust or line of credit). The cash deposit is not returned for three months and then only if the Mexican government has not initiated an investigation and if the supplier in the country of exportation has provided an invoice certified by its local chamber of commerce. Mexican banks charge as much as \$500 to open an account for this purpose and \$50 for each transaction, making this a burdensome and costly regulation for businesses on both sides of the border. The governments of the United States and Mexico are discussing an exchange of customs data that would result in the elimination of the estimated pricing regime.

In addition, U.S. exporters have expressed concerns regarding post-importation verification practices implemented by Mexican Customs and administered by private entities. Mexico has indicated that all information will remain confidential and that verifications are intended to validate the accuracy of all information presented to Mexican Customs. However, U.S. firms remain apprehensive about sharing business confidential information with a third-party. The U.S. government continues to monitor the situation.

U.S. firms also have raised concerns with a Mexican regulation (Annex 18) that requires additional documentation for imports of certain textile products. In particular, the regulation asks for detailed specification information, which certain exporters claim is proprietary and results in increased paperwork for the importer. Although the U.S. Government has confirmed with Mexican customs officials that the additional information is necessary for Mexican customs enforcement efforts, we continue to explore less burdensome alternatives.

STANDARDS, TESTING, LABELING AND CERTIFICATION

Under NAFTA, Mexico was required, starting January 1, 1998, to recognize conformity assessment bodies in the United States and Canada on terms no less favorable than those applied in Mexico. The United States is still awaiting action on a 2003 request by a U.S. certification body to be recognized in Mexico. On January 21, 2005, Mexico published the *convocatoria* (formal announcement, or “call”) in the *Diario Oficial* stating that one or more government agencies are requesting certification organizations for the standards involved. While the publication of the *convocatoria* has been considered a positive step, Mexican interests in the conformity assessment sector have vehemently resisted entry by non-Mexican entities, both before and after the publication of the *convocatoria*. To date, no U.S. certification bodies have been recognized by Mexico. In the telecommunications sector, Mexico has agreed to implement a Mutual Recognition Agreement to accept the results of testing to Mexican telecommunications regulatory requirements, by June 2006. If implemented, this will allow U.S. accreditors to accredit U.S. labs to test to Mexico’s requirements.

U.S. exporters have alleged that certain regulations are enforced more strictly for imports than for domestically-produced products, and that there has been inconsistent treatment for the same goods at various ports of entry. Mexico has over 700 technical regulations called “Normas Oficiales Mexicanas” (NOMs) issued by a number of different agencies, each with its own conformity assessment procedures. Only the Secretariat of Economy, the Secretariat of Agriculture (for a limited sub-set of its NOMs), the Secretariat of Communications and Transport (for one of its NOMs), and the Secretariat of Environment and Natural Resources have published some conformity assessment procedures. Key Mexican ministries such as Health, Energy and Labor have yet to publish their respective procedures.

The United States is Mexico’s largest export market for tequila, accounting for 50 percent of Mexican production. In 2003, the United States imported over \$402 million of tequila. Approximately 77 percent of the total volume was tequila in bulk form. In August 2003, the Mexican government, citing the need to ensure the quality of Mexican tequila, considered amending the official standard for tequila to require that tequila be “bottled at the source” in Mexico. The existing Mexican standard had required that only 100 percent agave tequila be bottled at the source. (Tequila made from less than 100 agave tequila could be sold and exported in bulk form under the prior official standard.) On January 6, 2006, Mexico published a final revised tequila standard that establishes new requirements for bulk exports. This does not include a requirement that all tequila be bottled in Mexico, but does contain onerous administration and inspection requirements for all bottlers. On January 17, 2006, the United States and Mexico signed an agreement which will ensure that Mexican exports of bulk tequila to the United States continue without interruption. Mexico will be prohibited from regulating the

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marketing of tequila in the United States as well as the labeling, formulation, and marketing of distilled spirits specialty products (i.e., products that contain tequila, such as tequila-based liqueurs) outside of Mexico.

Mexico standards for all distilled spirits continue to include “analytical parameters” not based on science that could bar U.S. distilled spirits exports. Similarly, Mexico's alcohol content levels are inconsistent with international standards.

U.S. exporters of vitamins, nutritional supplements, and herbal remedies have reported that Mexico’s health law regulations are discriminatory and arbitrarily impede access to the Mexican market. While Mexico has stated that it is looking at ways to address these concerns, the U.S. Government has thus far seen no progress. According to industry’s estimates, the cost of this alleged trade barrier to the United States is over \$500 million annually.

GOVERNMENT PROCUREMENT

Mexico’s efforts to make its government procurement regime more transparent through policies and technologies have resulted in increased competition as well as savings for the government. The Mexican government has established several “e-government” Internet sites to increase transparency of government processes and establish guidelines for the conduct of government officials. “Compranet” allows on-line processing of government procurement and contracting. Implementation, while successful, still needs further regulatory and technological advances throughout the Mexican government.

The NAFTA Government Procurement Chapter allowed Mexico to cover only a temporary narrow list of services, based on the requirement that it would develop a permanent list of excluded services by July 1, 1995. After several years of discussion, the United States, Mexico, and Canada reached agreement in 2004 on a list of excluded services. The agreement means that Mexico will allow suppliers from its NAFTA partners to participate in the procurement of all of its services (by the entities covered under NAFTA and above specified contract values), except for the services that it expressly excludes. This means increased access for U.S. suppliers to Mexico’s purchases of services. The expanded access became effective in June 2005 when Mexico published its list of excluded services.

As of January 1, 2003, NAFTA limits the total value of contracts that Mexico’s parastatal petroleum and electricity monopolies, PEMEX and the Federal Electricity Commission (CFE), respectively, may remove from coverage under NAFTA to \$352 million per year. The United States has not been able to confirm whether this commitment has been properly implemented, as Mexico has not provided the statistics called for under NAFTA. Mexico has indicated it will send to the United States and Canada notice of the set-aside calculation, along with the methodology used in the calculation.

INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

Under NAFTA and the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS), Mexico is obligated to implement certain standards for the protection of intellectual property and procedures to address infringement, including copyright piracy and trademark counterfeiting. Despite a fairly comprehensive set of IPR laws and an increase in the number of seizures and arrests during 2004 and 2005, the extent of IPR violations in Mexico remains dramatic. Monetary sanctions and other penalties, when imposed, are minimal and largely targeted at the bottom-tier of the piracy chain, i.e. the small scale sellers of pirated materials, who are numerous and easily replaced. A concerted effort to target the highest levels of organized crime, which is increasingly behind piracy in Mexico, is necessary to make a real impact and deter piracy. The United States remains concerned about the continuing high levels of piracy and counterfeiting in Mexico and closely monitors how the Mexican government is addressing these problems. Mexico was taken off the Special 301 “Watch List” in 2000, but returned to the list in 2003 and remained on the “Watch List” in 2004 due to enforcement deficiencies.

Copyright Protection

Copyright piracy remains a major problem in Mexico, with U.S. industry loss estimates growing each year. Although enforcement efforts by the Mexican government seem to be improving, piracy levels continue to rise, resulting in closures of legitimate copyright-related businesses, according to industry sources. Pirated and counterfeit sound and motion picture recordings are widely available throughout Mexico, where piracy has shifted from traditional formats to optical discs (CD, DVD, CD-ROM). The International Intellectual Property Alliance (IIPA) estimates that trade losses due to copyright piracy in Mexico totaled \$1,253.4 million in 2005. That year, music piracy represented 65 percent of the total market; business software piracy, 64 percent; motion picture piracy, 62 percent; and entertainment software piracy, 75 percent. In July 2003, the Mexican Congress amended the Mexican copyright law, and finally in September 2005 published the law, thereby bringing it into effect. Industry associations and Indautor, the Mexican government agency that regulates copyrights, claim the new legislation brings Mexico in compliance with its obligations under the NAFTA IPR Chapter and the WTO TRIPS Agreement.

Mexican law enforcement agencies have conducted thousands of piracy raids and the U.S. copyright industries report good cooperation with the police in various jurisdictions around Mexico. In 2003, the Attorney General's Office created an IPR enforcement unit, which combines federal prosecutors and police to make the enforcement regime more effective and efficient. In 2004, the Attorney General's Office authorized its Organized Crime Division to investigate piracy. Very few IPR violations result in prison terms. As a result, pirates and counterfeiters are often released and return to their illegal activities. Well-known markets selling pirated and counterfeit goods, such as Tepito in Mexico City, remain ubiquitous.

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Patent, Trademark, Pharmaceutical and Agricultural Chemical Protection

Patents and trademarks are under the jurisdiction of the Mexican Institute of Industrial Property (IMPI), an independent agency that operates under the auspices of the Secretariat of the Economy.

U.S. pharmaceutical and agricultural/chemical companies are concerned about the lack of coordination between IMPI and other Mexican agencies with regard to government procurement of copies of patented pharmaceuticals. In 2003, the Mexican Ministry of Health agreed that starting with purchases scheduled for delivery on January 1, 2003, IMSS (Mexican Social Security Institute) and possibly ISSSTE (Social Security Institute for Government Workers) would purchase only legitimate versions of products patented in Mexico. Unfortunately, it appears this agreement is not being fully implemented due to alleged financial shortcomings at the agencies.

In September 2003, the Ministries of Health and Economy implemented a Presidential decree that requires applicants for safety and health registrations to show proof of patent and proof that test data was obtained in a legitimate matter. According to the regulation, failure to present proof of patent and test data will result in denial of the registration. Also, if a company is caught providing false information, it can now be subject to both civil and criminal proceedings. While this measure is a positive development, the regulation limits linkage to product patents only, excluding process patents. Moreover, U.S. industry reports that enforcement of the regulation is weak, as the Ministry of Health (MOH) continues to provide local companies authorization to market unauthorized copies of patented pharmaceutical products. It is hoped that compliance with this decree will help to eliminate copies of patented pharmaceuticals from the supply chain for IMSS and ISSSTE.

U.S. companies holding trademarks in Mexico have cited problems with trademark enforcement and administration. When counterfeit items are discovered, injunctions against trademark violators are often unenforceable and are consistently challenged before the courts. Although federal administrative actions are supposed to be completed within four months, actions related to trademark enforcement often take as long as 18 months. The time can be lengthened by jurisdictional and procedural disputes within the Mexican government, as well as by internal coordination problems within IMPI and between IMPI and the Attorney General's office. Trademark applications in Mexico are not subject to opposition.

Registrations are issued and can only be canceled after registration. On average, it takes two and a half years to cancel a trademark registration, and the registrant is allowed to continue using the mark for one year following cancellation.

Border Enforcement of IPR

NAFTA Article 1718 and Article 51 of the TRIPS Agreement obligate Mexico to allow U.S. intellectual property rights holders to apply to Mexican authorities for suspension of release of counterfeit trademark or pirated copyright goods. Intellectual property rights owners seeking to use the procedure must obtain an order from IMPI that directs customs officials to detain the

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merchandise. Companies requesting such actions generally report positive outcomes. However, U.S. industry has sought increased cooperation and communication between IMPI and Mexican customs in order to prevent the release of counterfeit goods into the Mexican market.

SERVICES BARRIERS

Telecommunications

The 2004-2005 Global Information Technology Report's Networked Readiness Index (NRI) of 104 nations's ranked Mexico number 60, down from 44, on a scale measuring the degree of Information and Communication Technology development. The outcome of this year's report reflects Mexico's struggle with constructing regulations to promote interconnection and technology convergence and improve competitiveness.

Among Mexico's greatest challenges, is promoting telecommunications competitiveness. Telmex continues to dominate the market and retain influence over the Secretariat of Communications and Transport (SCT) and the Federal Communications Committee (COFETEL). Both agencies have failed to adequately resolve disputes and act upon competitors' claims of market discrimination. The few times the government has attempted to take action to improve competitiveness, Telmex has successfully blocked enforcement by using court-ordered injunctions and other legal maneuvers.

This behavior is exemplified by the current debate over so-called Triple-Play services (voice, data, and video). Previously, Cable TV operators were given the legal capacity to offer telephony services through their networks only if they partnered with a licensed telecom carrier. This requirement limited the spread of VoIP services by restricting Cable TV operators. Due to the intervention of the Federal Competition Commission (COFECO), however, the ruling was recently over-turned and the partnering requirement abolished, enabling Cable TV operators to offer triple-play services. The ability of cable companies to provide triple-play services is expected to trigger regional consolidation among the approximately 200 cable companies as they attempt to successfully compete with Telmex. Industry sources suggest that COFETEL is considering granting Telmex the immediate ability to provide video or broadcasting services to placate Telmex for the perceived loss of market share. COFECO, among other agencies, has suggested that Telmex not be given the ability to provide the services for at least two years. However, Telmex has insisted that it will release video phone services in the near future and is prepared to legally fight such a ruling.

COFETEL and SCT have been hesitant to increase foreign direct investment in the sector. In accordance with the WTO dispute, Mexico – Measures Affecting Telecommunications Services, in August 2004, Mexico removed the provisions of Mexican law that created a uniform tariff and proportional return system for international traffic and the requirement that the carrier with the greatest proportion of outgoing traffic to a country negotiate the settlement rate on behalf of all Mexican carriers. In August 2005, COFETEL published a new set of regulations for resale-based telecommunications services in Mexico. Such services would be open to one-hundred percent foreign owned companies. However, these regulations and the resale rules constructed

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by SCT continue to prevent foreign carriers from using leased lines to bring calls directly into the domestic network.

A troubling development is COFETEL and SCT's desire to implement a long distance "calling party pays" system for wireless services that will shift all interconnection charges to the company (and ultimately customer) where the calls originate. If implemented, interconnection rates and tariffs could cost U.S. industry and consumers hundreds of millions of dollars annually, depending on the rate set. Acting on the advice of COFECO and Mexico's Federal Regulatory Commission (COFEMER), COFETEL and SCT have refrained from publishing their calling party pays regulations until they are able to provide a more favorable playing field for interconnecting companies and consumers. COFETEL has also pledged to ensure that any new rate imposed for terminating calls on wireless networks would be cost-oriented, consistent with Mexico's WTO obligations.

Many telecom experts believe that granting COFETEL further authority and independence would improve the Mexican government's ability to promote the convergence and interconnection of technology systems while avoiding conflicts of interest with SCT and Telmex. However, recent legislative efforts to increase COFETEL's transparency and allot it the power to apply sanctions, establish official standards, adopt OECD quality standards, and increase transparency in the contract/concessions process have not passed. The SCT, which has been criticized as unduly partial to Telmex's interests, continues to have the last word on regulatory decisions and enforcement. Legislation to strengthen COFETEL and grant it independence from SCT remains key to improving Mexico's competitiveness in the telecommunications sector.

INVESTMENT BARRIERS

Ownership Reservations

Mexico's oil and gas policy is highly restrictive when it comes to private equity investment. The sector remains closed to foreign investment other than in the Liquefied Natural Gas (LNG) sector and in the marketing of petroleum products. Only Mexican nationals may own gas stations.

The Mexican constitution mandates state ownership of hydrocarbons and provides that no concessions or other types of production-sharing agreements or risk contracts shall be granted in regard to hydrocarbon exploitation.

Mexico was able to meet its energy needs for many years under this restriction. Recently, the Mexican government has explored ways of allowing additional foreign investment in the energy sector consistent with its constitution, hoping to attract capital that will strengthen the highly leveraged national oil company, Pemex. So far the reform efforts have had little success.

Other laws limit certain sectors or activities (e.g., forestry exploitation) to Mexican nationals. Investment restrictions prohibit foreign ownership of residential real property within 50 kilometers of the nation's coasts and 100 kilometers of its land borders. However, foreigners may acquire the effective use of residential property in the restricted zones through trusts administered by Mexican banks. A national foreign investment commission reviews foreign

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investment in Mexico's restricted sectors, as well as investments in non-restricted sectors that exceed a 49 percent share of an investment with a value greater than \$150 million (as adjusted each year for growth in Mexico's nominal GDP). These restrictions are incorporated into the NAFTA.

MOROCCO

TRADE SUMMARY

The U.S. goods trade surplus with Morocco was \$85 million in 2005, an increase of \$75 million from \$10 million in 2004. U.S. goods exports in 2005 were \$528 million, up 0.4 percent from the previous year. Corresponding U.S. imports from Morocco were \$443 million, down 14.1 percent. Morocco is currently the 79th largest export market for U.S. goods.

The stock of U.S. foreign direct investment (FDI) in Morocco in 2004 was \$306 million, down from \$307 million in 2003.

IMPORT POLICIES

The United States – Morocco Free Trade Agreement (FTA) will improve the competitiveness of U.S. exporters' goods and services in this market. The FTA entered into effect on January 1, 2006. In addition to the high-standard obligations that Morocco has adopted in the FTA, the United States is helping to ensure continued legal and regulatory reform through targeted technical assistance.

Morocco also has an Association Agreement with the European Union (EU) that provides preferential tariff treatment for most exports of industrial and some agriculture goods from the EU to Morocco. The U.S.–Morocco FTA will help to remove any competitive disadvantages for U.S. firms. Morocco has also concluded an FTA with Turkey, and has concluded a regional FTA (that has yet to enter into force) with Jordan, Egypt and Tunisia.

Tariffs

Prior to the FTA, U.S. goods entering into Morocco faced an average tariff of over 20 percent. Under the FTA, more than 95 percent of bilateral trade in consumer and industrial products has become duty-free, with all remaining tariffs to be eliminated within nine years. Exports by key U.S. sectors such as information technologies, machinery, construction equipment and chemicals now enter Morocco duty free.

U.S. textile products have also gained enhanced access to the Moroccan market. For certain originating products, trade between the two countries is subject to tariff-rate quotas (TRQs), and the quota will expand in the future. These goods now receive duty-free treatment up to a limited annual quantity for the first five years of the Agreement. Other qualifying originating textile and apparel goods will receive preferential duty treatment over a time frame ranging from immediately to 10 years.

FOREIGN TRADE BARRIERS

Agriculture

The Moroccan agriculture sector is dominated by traditional small-scale farmers, many of whom focus on growing wheat. The Moroccan trade regime is designed to maintain this *status quo*, particularly through the imposition of high, prohibitive tariffs. These tariffs have created significant barriers to trade for U.S. exporters. For example, applied tariffs on poultry and beef products range up to 124 percent and 275 percent, respectively.

Tariffs on virtually all U.S. farm exports to Morocco will be phased out within 15 years, while the FTA also takes into account the unique circumstances facing Morocco's agriculture sector. U.S. producers of poultry and beef (products that have been kept out of the market due to high tariffs) will benefit from new TRQs that expand over time. U.S. wheat producers will benefit from new TRQs on durum and common wheat that have the potential to lead to significant increases in exports over recent levels.

Tariffs on goods such as corn and corn products, sorghum, soybeans, and soybean meal will be eliminated immediately or within a short timeframe.

Customs

The FTA requires improvement in the transparency, efficiency and administration of the Moroccan customs regime, thereby improving access to the Moroccan market for U.S. exports. The FTA requires rapid customs clearance of express delivery shipments. The FTA's rules of origin are designed both to ensure that only U.S. and Moroccan goods benefit from the increased access under the FTA and for ease of administration. These rules are consistent with those of other U.S. free trade agreements in the region.

STANDARDS, TESTING, LABELING, AND CERTIFICATION

Morocco generally has not provided adequate notice of new proposals or changes to standards, technical regulations, and conformity assessment procedures, thereby denying the opportunity for interested U.S. parties to comment on them before they are finalized. The FTA builds on WTO obligations that require Morocco to make its system more transparent and open. In particular, the FTA secures eventual foreign participation in the development of standards, technical regulations and conformity assessment procedures; creates opportunities for interested U.S. persons to provide comments on draft measures; and requires Morocco to explain how comments have been taken into account in the final drafting.

EXPORT SUBSIDIES

Morocco has provided export subsidies to reduce transportation costs for tomatoes. The FTA requires the Moroccan government to end this practice and otherwise not to provide export subsidies.

SERVICES BARRIERS

Morocco in the past has effectively prevented U.S. services firms from competing in large segments of Morocco's services sector. The government has either stipulated outright bans on foreign participation in the domestic services market and/or included onerous ownership requirements or business operating practices.

The FTA accords U.S. firms substantial market access across Morocco's entire services sector, subject to very few exceptions. Key services sectors covered by the agreement include audiovisual, express delivery, telecommunications, computer and related services, distribution, mining and construction, and engineering.

The FTA provides benefits for businesses wishing to supply cross-border services, as well as businesses wishing to establish a local presence in the other country.

Under the agreement, Morocco will also be required to permit U.S. financial service firms to establish subsidiaries and joint ventures in Morocco. In addition, banks and insurance companies will be permitted to establish branches, subject to a four-year phase-in for most insurance services.

The United States also gained enhanced access to the telecommunications market, including the right to interconnect with a dominant carrier in Morocco at non-discriminatory, cost-based rates. U.S. firms seeking to build a physical network in Morocco will have non-discriminatory access to key telecommunications facilities and will be able to lease lines from Morocco's dominant carrier and resell telecommunications services to build a customer base.

INVESTMENT BARRIERS

The United States and Morocco have a Bilateral Investment Treaty (BIT), which entered into force in 1991 and was superseded by the FTA. The FTA updates the legal framework for U.S. investors operating in Morocco. All forms of investment will be protected under the FTA, such as enterprises, debt, concessions, contracts, and intellectual property. The FTA removes certain restrictions and prohibits the imposition of other restrictions on U.S. investors, such as requirements to buy Moroccan, rather than U.S., inputs for goods manufactured in Morocco.

INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

Moroccan intellectual property rights (IPR) laws and enforcement of these laws in the past have been insufficient to combat intellectual property theft. Enforcement resources have been inadequate, and civil and criminal penalties have not been stiff enough to provide sufficient deterrence.

The FTA addresses many of the United States' IPR concerns. The agreement's strong anti-piracy provisions mandate both statutory and actual damages under Moroccan law for IPR violations. Under these anti-piracy provisions, monetary damages can be awarded even when it is difficult to determine the amount of actual economic harm. Each government also commits to

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granting and maintaining the right for authorities to seize, forfeit, and destroy counterfeit and pirated goods and the equipment used to make them. The agreement also requires each government to provide criminal liability for internet piracy, even if there is no motivation of financial gain.

The FTA further expands the protection of trademarks, copyrights, patents, and undisclosed test data. Protection extends to cover state-of-the-art elements such as provisions concerning disputes over Internet domain names, strong anti-circumvention provisions to prohibit tampering with technologies designed to prevent copyright infringement, and specific protections for temporary copies, which is critical in the digital environment. Under its FTA obligations, Morocco will offer increased IPR protection and enforcement for copyrights, trademarks, geographical indications, patents, and undisclosed test data. In addition, Morocco passed comprehensive IPR legislation in December 2005 to implement its FTA obligations.

OTHER BARRIERS

Lack of transparency and regulatory predictability has inhibited U.S. access to the Moroccan market. Under the FTA, each government must publish its laws and regulations governing trade and investment, and, beginning within one year of entry into force, publish proposed regulations in advance and provide an opportunity for public comment on them. The Moroccan government has committed to apply fair procedures in administrative proceedings covering trade and investment matters directly affecting companies from the other country.

NEW ZEALAND

TRADE SUMMARY

The U.S. goods trade deficit with New Zealand was \$508 million in 2005, a decrease of \$387 million from \$895 million in 2004. U.S. goods exports in 2005 were \$2.6 billion, up 27.7 percent from the previous year. Corresponding U.S. imports from New Zealand were \$3.2 billion, up 6.3 percent. New Zealand is currently the 41st largest export market for U.S. goods.

U.S. exports of private commercial services (i.e., excluding military and government) to New Zealand were \$1.1 billion in 2004 (latest data available), and U.S. imports were \$1.3 billion. Sales of services in New Zealand by majority U.S.-owned affiliates were \$1.9 billion in 2003 (latest data available), while sales of services in the United States by majority New Zealand-owned firms were \$18 million.

The stock of U.S. foreign direct investment (FDI) in New Zealand in 2004 was \$4.5 billion, up from \$3.9 billion in 2003. U.S. FDI in New Zealand is concentrated largely in the finance, manufacturing, and wholesale sectors.

IMPORT POLICIES

In general, tariff rates in New Zealand are low as a result of several rounds of unilateral tariff cuts that began in the mid-1980s and continued until the current Labor government, elected in 1999, froze further reductions until July 2005. The New Zealand government announced in September 2003 that it would resume unilateral tariff reductions starting July 1, 2006. New Zealand plans to initiate gradual reductions of its highest tariff rates (currently between 17 percent and 19 percent), taking them to 10 percent by July 1, 2009. The top rates apply mostly to clothing, footwear, carpets, and certain automobiles and auto parts. *Ad valorem* tariffs on other goods also will gradually be reduced to 5 percent by July 1, 2008. None of these low tariff rates are bound in the WTO. The New Zealand government will conduct a review in 2006 to determine rates for the period after July 1, 2009.

STANDARDS, TESTING, LABELING AND CERTIFICATION

Biotechnology Regulations

New Zealand's Environmental Risk Management Authority (ERMA) reviews applications for the release of new organisms, including biotechnology products, on a case-by-case basis. ERMA, an independent body, can issue three types of approval for the release of new organisms: contained trials, conditional release, and full, unconditional release. The agency can approve applications with conditions that aim to prevent, minimize or manage any identified risks. Contained trials are strictly regulated and monitored and can include field trials. A full release is unregulated and has no controls, making it extremely unlikely one would be granted for a biotechnology product. Conditional release fills the gap between these two extremes, providing controls and regulations determined on a case-by-case basis. This allows for specific conditions to be placed on the

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planting of a crop, which can be any size from a contained trial to a large commercial planting. The Ministry of Agriculture and Forestry (MAF) monitors implementation of such approvals. To date applications have been limited to a small number of contained trials.

Until October 2003, New Zealand maintained a voluntary two-year moratorium on the introduction of all biotechnology products, which precluded applications for the commercial planting of biotechnology crops, the commercial importation of genetically modified seeds, the release into the environment of genetically modified animals and, to a lesser extent, some human and veterinary medicines containing biotechnology products. The moratorium, however, did not apply to the use and sale of processed genetically modified foods and ingredients. With the moratorium's expiration, Parliament amended the Hazardous Substances and New Organisms Act 1996 to regulate the introduction of biotechnology products. The amendment, the New Organisms and Other Matters Bill of 2003, introduced the conditional release category for approval of new organisms.

Biotechnology Food Approval

Imported genetically modified foods for sale in New Zealand must be assessed and approved by Food Standards Australia New Zealand (FSANZ), which operates under the authority of the New Zealand Food Safety Authority (NZFSA). A mandatory standard for foods produced using modern biotechnology came into effect in mid-1999. The standard established under the Food Act 1981 prohibits the sale of food produced using biotechnology, unless such food has been assessed by FSANZ and listed in the food code standard. As of November 2005, FSANZ had received 34 applications for safety assessments of bioengineered foods. Of these, 28 applications had been approved (including four under review pending additional assessment), four applications were being processed, and two requests had been withdrawn.

Biotechnology Food Labeling

Mandatory labeling requirements for foods produced using gene technology took effect in December 2001. With few exceptions, a food in its final form that contains detectable DNA or protein resulting from genetic modification must be so labeled. Meeting New Zealand's biotechnology food labeling regulations can be burdensome and is especially relevant for U.S. agricultural exporters who deal primarily in processed food. New Zealand wholesalers and retailers frequently demand biotechnology-free declarations from their suppliers. This effectively places liability for any biotechnology labeling non-compliance on the importer. New Zealand food legislation requires businesses to exercise due diligence in complying with food standards, which usually is defined as maintaining a paper or audit trail similar to a quality assurance system.

The NZFSA conducts periodic compliance audits. Violators of food-labeling requirements can be assessed penalties under the Food Act 1981. The New Zealand government is reviewing penalties stipulated under the Act to ensure that they represent an adequate economic deterrent. The effect of these regulations is to discourage New Zealand food retailers from carrying biotechnology food products.

Sanitary and Phytosanitary Measures

New Zealand maintains a strict regimen of sanitary and phytosanitary (SPS) controls for virtually all imported agricultural products. The United States and New Zealand continue to discuss specific SPS issues that negatively impact trade in products supplied by the United States.

Imports of U.S. poultry meat (except canned product) remain suspended due to restrictions on countries that have infectious bursal disease. Imports of U.S. pork meat products are subject to a pre-cooking requirement because of the presence of Porcine Reproductive and Respiratory Syndrome in the United States. Imports of California table grapes were restarted in 2005 as a result of changes in import requirements, while cherries from Idaho, Oregon, and Washington also gained market access.

U.S. beef and beef variety meats were restricted from entering New Zealand following the December 2003 announcement of a case of Bovine Spongiform Encephalopathy (BSE) in the United States. Import restrictions also were imposed on live cattle, certain pet food and U.S. processed food products containing beef. The NZFSA had required case-by-case assessment of U.S. bovine products before importation. However, after completing an assessment of the U.S. BSE regime, NZFSA decided it will lift that restriction once both sides agree on certification that must accompany meat imports.

INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

The New Zealand government has proposed amendments to strengthen its copyright and patent laws and enhance the country's protection of intellectual property rights. With proposed amendments to the Copyright Act 1994, the government aims to address developments in digital technologies and international developments in copyright law and to bring New Zealand law into closer conformity with the WIPO Copyright Treaty (WCT) and the WIPO Performances and Phonograms Treaty (WPPT). The amendments are expected to be reviewed and approved by the Cabinet before they are introduced in Parliament in 2006. If this legislation is enacted, the New Zealand government then will determine whether to accede to the WCT and WPPT treaties.

The Ministry of Economic Development in December 2004 released draft legislation that is intended to replace the Patents Act 1953 and to bring New Zealand's patent law into closer conformity with international standards. This draft would keep the maximum patent term at 20 years, but would tighten the criteria for granting a patent, from a patentable invention being new in New Zealand, to being new anywhere in the world and involving an inventive step. At the end of 2005, the legislation had not yet been introduced in Parliament.

The U.S. music industry opposes a proposed amendment to the New Zealand Copyright Act that would legalize the duplication of sound recordings in other formats for a purchaser's private use. The government says this would enable consumers to employ new digital technologies and would legalize what already is common practice. The government also notes the amendment would limit copying to one copy per format, specify that the original sound recording must be legitimate, and exclude making copies from borrowed or rented recordings. The music industry warns that such an exception to copyright protection would make copyright infringement

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difficult to enforce, send the wrong message to consumers and cost the industry in sales revenue and profits. The industry adds that the exception would discourage the development of music products that would permit home copying under contractual arrangements between the consumer and the provider. The U.S. industry and government continue to discuss this exception.

Additionally, the industry favors a wider approach to technological protection measures (TPMs) than that provided in the governments proposed amendments. The government's proposal would prohibit the supply of devices or the means or information to circumvent TPMs that would result in infringing any of the copyright owner's exclusive rights, and not just copying as now specified in the legislation. The industry says the act of circumventing a TPM also should be illegal. It also wants protection against the circumvention of TPMs that control access to copyright material, in addition to TPMs that control copying.

U.S. industry also has expressed concern over a proposed exception to the Copyright Act that would allow the unauthorized delays for virtually all works communicated to the public. The industry warns that the exception would discourage rights holders from developing new approaches to meeting consumer demand for electronically delivered materials and reduce access and choice for New Zealand consumers to these materials.

Some U.S. industries, particularly producers and distributors of music and software, have voiced concerns about New Zealand law that allows parallel imports of certain copyrighted goods, saying such imports make it more difficult to detect and combat piracy and erode the value of their products in New Zealand and third-country markets. The New Zealand Parliament in October 2003 enacted a ban on the parallel importation of films, videos and Digital Video Discs (DVDs) for the initial nine months after a film's international release, but the ban does not apply to parallel importation of music, software and books. The ban is scheduled to sunset in 2008, unless extended.

The October 2003 legislation, which amended the Copyright Act 1994, makes it easier to challenge copyright violations in court by shifting the burden of proof in certain copyright infringement cases to the defendant, who must prove that an imported film, sound recording or computer software is not a pirated copy.

In New Zealand's draft patents legislation, a prohibition of patents for methods of medical treatment concerns some pharmaceutical companies. The industry also is concerned by the Cabinet's decision in mid-2004 to halt a study on the economic impact of extending patent terms for pharmaceuticals. The draft patents bill fails to address the issue of patent terms for pharmaceuticals. The pharmaceutical industry group, Researched Medicines Industry Association of New Zealand, contends that New Zealand's effective patent life for pharmaceuticals has substantially eroded. It asserts that extending the effective patent term would be in line with international best practices.

The pharmaceutical industry also is concerned by an amendment, enacted in December 2002, to the Patents Act 1953. This amendment states that it is not a patent infringement for a person to make, use, exercise or vend an invention for purposes related to gaining regulatory approval in New Zealand or other countries.

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This provision can be used to effectively expedite, or "springboard," the approval process for generic competition to products whose patents are expiring. The pharmaceutical industry strongly opposes this legislation.

SERVICES BARRIERS

Local Content Quotas

Radio and television broadcasters have adopted voluntary local content targets, but only after the New Zealand government made it clear that it would otherwise pursue mandatory quotas. Although New Zealand government officials have said they are sensitive to the implications of quotas under the WTO General Agreement on Trade in Services (GATS), they reserve the right to impose them.

Telecommunications

U.S. industry has expressed concern about the fees charged for completing calls using mobile networks in New Zealand, which are among the highest in the world. After a year-long investigation into mobile termination rates, the New Zealand regulating authority determined in June 2005 that mobile network operators were able to set unreasonably high rates because of limited market competition, and called for such charges to be regulated. The Communications Minister in August 2005 agreed with the authority's position that the termination rates should be significantly reduced, but asked the authority to reconsider its recommendations by examining several issues, including commercial offers by New Zealand's two mobile phone service providers for rate reductions and how best to ensure that end users benefit from reductions in wholesale rates. The authority released a draft report in December 2005, upholding its original conclusion that commercial offers by mobile operators could not be expected to reduce rates to reasonable levels and that the benefit of regulation to consumer welfare outweighed its cost.

Competitors of the formerly state-owned monopoly, Telecom, were disappointed by the New Zealand government's decision in May 2004 against unbundling the local loop. Although under competitive pressure, Telecom still dominates the market. The Communications Minister accepted the regulator's recommendation against ordering Telecom to open its national fixed-line network to competitors. Saying he aimed to increase competition in broadband services, the Minister also agreed with the regulator's recommendation to require bitstream unbundling, or access to Telecom's equipment by service providers in order to sell their own broadband services. TelstraClear, Telecom's primary land-line competitor, in November 2004 asked the regulator to determine the terms and conditions for access to Telecom's unbundled bitstream service. A final determination by the regulator was pending at the end of 2005.

INVESTMENT BARRIERS

Investment Screening

New Zealand screens certain types of foreign investment through the Overseas Investment Office (OIO). Amid growing public concern about purchases of coastal properties by foreigners, the

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New Zealand government enacted legislation in August 2005, that increased screening and monitoring of land purchases, but raised the minimum threshold for scrutiny of proposed business purchases. Under the legislation, the threshold for screening non-land business assets has increased from NZ \$50 million to NZ \$100 million, where a foreigner proposes to take ownership or control of 25 percent or more of a business. Government approval is required for purchases of land larger than 5 hectares (12.35 acres) and of land in certain sensitive or protected areas. Any application involving land in any form must meet a national interest test. For land purchases, foreigners who do not intend to live in New Zealand must provide a management proposal covering any historic, heritage, conservation or public access matters and any economic development planned. That proposal would have to be approved and generally made a condition of consent. In addition, investors would be required to report regularly on their compliance with the terms of the consent. Overseas persons also must demonstrate the necessary experience to manage the investment. The OIO, part of Land Information New Zealand, took over the functions of the Overseas Investment Commission in August 2005. The United States has raised concerns about the continued use of this screening mechanism. New Zealand's commitments under the GATS Agreement of the WTO are limited as a result of New Zealand's screening program.

OTHER BARRIERS

Pharmaceuticals

The U.S. Government continued to raise concerns about New Zealand's pharmaceutical sector policies, which do not value innovation and discourage investment in the research and development of innovative pharmaceutical products. New Zealand's Pharmaceutical Management Agency (PHARMAC), a stand-alone Crown entity, administers a Pharmaceutical Schedule that lists medicines subsidized by the New Zealand government and the reimbursement paid for each pharmaceutical under the national health care system. The schedule also specifies conditions for prescribing a product listed for reimbursement. PHARMAC accounts for 73 percent of New Zealand's expenditures on prescription drugs. The government also supports hospitals' pharmaceutical expenditures, bringing its share of total spending on prescription drugs in the country to about 80 percent.

New Zealand does not directly restrict the sale of non-subsidized pharmaceuticals in the country. However, private medical insurance companies will not cover the cost of non-subsidized medicines and doctors are often reluctant to prescribe them to patients who would have to pay the cost out of pocket. Thus, PHARMAC's decisions have a major impact on the availability and price of non-subsidized medicines and the ability of pharmaceutical companies to sell their products in the New Zealand market.

The U.S. government has serious concerns regarding the transparency, predictability and accountability of PHARMAC's operations. U.S. pharmaceutical suppliers maintain that the methodology used to determine Pharmaceutical Schedule decisions lacks transparency. Meanwhile, PHARMAC is reviewing the way it decides funding for high-cost medicines.

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Also, the Labour Party, in an agreement to form a new government in October 2005 with support from the United Future party, agreed to review the nation's long-term medicines strategy, including PHARMAC's role.

The New Zealand and Australian governments signed a treaty on December 10, 2003, to create a joint agency to regulate medical devices, prescription and over-the-counter medicines, dietary and nutritional supplements, and cosmetics such as sun creams. Aside from prescription pharmaceuticals, New Zealand does not currently regulate market entry of these products. Both governments must enact implementing legislation, which probably will not be introduced in their respective Parliaments until at least mid-2006. It is expected that the new agency will charge full cost-recovery fees to register products and require additional documentation and assessments for certain products, even if they already have U.S. Food and Drug Administration approval. Each country's government will continue to separately determine funding of prescription medicines. U.S. manufacturers and distributors of non-pharmaceutical therapeutic products in New Zealand have expressed concerns that those requirements will be overly burdensome and costly, and could serve to discourage exports of their products from the United States to New Zealand.

NICARAGUA

TRADE SUMMARY

The U.S. goods trade deficit with Nicaragua was \$561 million in 2005, an increase of \$163 million from \$398 million in 2004. U.S. goods exports in 2005 were \$620 million, up 4.6 percent from the previous year. Corresponding U.S. imports from Nicaragua were \$1.2 billion, up 19.3 percent. Nicaragua is currently the 74th largest export market for U.S. goods.

The stock of U.S. foreign direct investment (FDI) in Nicaragua in 2004 was \$220 million, down from \$271 million in 2003.

IMPORT POLICIES

Free Trade Agreement

The United States concluded free trade agreement negotiations with El Salvador, Guatemala, Honduras, and Nicaragua in December 2003 and with Costa Rica in January 2004. In May 2004, the six countries signed the United States–Central America Free Trade Agreement. During 2004, the United States and the Central American countries integrated the Dominican Republic into the free trade agreement. On August 5, 2004, the seven countries signed the Dominican Republic – Central America United States Free Trade Agreement (CAFTA-DR).

All of the signatory countries except Costa Rica have ratified the agreement. CAFTA-DR will enter into force between the United States and other signatories on a rolling basis as the United States determines that countries have taken sufficient steps to implement their commitments under the Agreement.

CAFTA-DR will remove barriers to trade and investment in the region and will further regional economic integration. CAFTA-DR will also require the Central American countries and the Dominican Republic to undertake needed reforms to provide market liberalization, transparency and certainty in areas including: customs administration; protection of intellectual property rights; services, investment, financial services; government procurement; sanitary and phytosanitary (SPS) barriers; and to liberalize other non-tariff barriers.

Tariffs

In 2002 and 2003, Nicaragua completed implementation of most of a broad package of tariff reductions that had been approved in 1997. In those same years, two tax reform bills introduced additional tariff changes. In 2005 additional reforms were introduced. The overall thrust of the changes in both legislation and practice over the last several years has been to reduce tariffs (though there have been a few increases), reduce non-tariff barriers, and greatly reduce the discretion of government officials to waive the application of tariffs. The reform process is in accordance with the reduction and harmonization of a common external tariff among members of

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the Central American Common Market (CACM) to between zero percent and 15 percent on most items.

Reforms introduced in 2005 affected tourism investments, ending exemptions on the taxation of certain imported items, including taxes on a list of luxury products and materials that are necessary to develop tourism attractions. The Ministry of Tourism and the private sector have been lobbying the National Assembly to re-establish tourism incentives and to approve a new law that would allow tourism companies to issue investment bonds.

Nicaragua imposes regular import duties of 10 percent or 15 percent on many final consumer goods, a duty of 0 percent to 5 percent on most primary goods and a duty of 5 percent to 10 percent on intermediate goods from outside Central America that compete with products produced in CACM countries. The tariff is assessed on a good's Cost, Insurance, and Freight (CIF) value. Once the CAFTA-DR goes into effect, about 80 percent of U.S. industrial and commercial goods will enter the region duty-free, with the remaining tariffs on such goods phased out over 10 years. Nearly all textile and apparel goods that meet the Agreement's rules of origin will be duty-free and quota-free immediately, promoting new opportunities for U.S. and regional fiber, yarn, fabric and apparel manufacturing. The Agreement's tariff treatment for textile and apparel goods may be made retroactive to January 1, 2004.

A small number of protected agricultural commodities, notably rice and chicken parts, have particularly high tariff rates. Processed rice faces tariffs as high as 61 percent, down from a maximum of 103.5 percent in 2002. Certain chicken parts face a tariff of 170 percent. Tariffs on corn, previously higher, now range from 10 percent to 15 percent. In May 2003, Nicaragua raised tariffs on cheese and certain other dairy products from countries outside the CACM region to a common external tariff rate of 40 percent, from a prior rate of 15 percent, an increase that was consistent with Nicaragua's WTO obligations.

Under the CAFTA-DR, Nicaragua will eliminate its tariffs on nearly all agricultural products within 15 years, including its tariffs on rice and yellow corn. Nicaragua will eliminate its tariffs on chicken leg quarters within 18 years and on dairy products within 20 years. For the most sensitive products, tariff rate quotas will permit some immediate duty-free access for specified quantities during the tariff phase-out period, which will expand over time. Nicaragua will liberalize trade in white corn through expansion of a TRQ.

Non-Tariff Measures

A "consumption tax" on luxury items is levied on a limited number of items. The tax is generally lower than 15 percent, with a few exceptions noted below. Although the ISC ("Impuesto Selectivo de Consumo" or "Selective Consumption Tax.") is not applied exclusively to imports, the value on which it is based varies depending on whether the product is produced domestically or abroad. While the ISC on domestic goods is based on a manufacturer's price, the ISC on imported goods is based on the CIF value. Alcoholic beverages and tobacco products are exceptions; for these products, the ISC is based on the price charged to the retailer.

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In accordance with April 2000 amendments to Nicaragua's tax laws, the ISC on soft drinks was lowered from a level of 18 percent in 1999 to 15 percent in 2000 and 12 percent in 2001. A further reduction to the target rate of 9 percent became effective in 2004.

STANDARDS, TESTING, LABELING AND CERTIFICATION

Products that meet domestic U.S. standards are generally accepted in the Nicaraguan market with little need for further certification. U.S. exporters of food products must meet minimal phytosanitary and labeling requirements. In Nicaragua, all brands of alcoholic beverages must be registered annually with the Ministry of Public Health, and import licenses are required to import beverage alcohol. Under CAFTA-DR, Nicaragua commits to abide by the terms of the WTO's Import Licensing Agreement.

U.S. industry has expressed concern with Nicaragua's proposed standards for rum and aguardiente. However, the five Central American countries, including Nicaragua, are in the process of developing common standards for several products, including distilled spirits, which could serve to increase market access and facilitate trade. Nicaragua committed under the CAFTA-DR to explicitly recognize Bourbon and Tennessee whiskey as distinctive products of the United States, an objective of our distilled spirits industry.

Law 291 established a regulatory process for approving genetically modified organisms for import or sale under the responsibility of the interagency commission for risk evaluation (CONARGEN). Imported agricultural products derived from biotechnology are supposed to be identified as such.

When the United States and Central America launched the free trade agreement negotiations, they initiated an active working group dialogue on SPS barriers to agricultural trade that met alongside the negotiations to facilitate market access. The objective was to leverage the impetus of active trade negotiations to seek changes to the Central American countries' SPS regimes. Through the work of this group, Nicaragua has committed to resolve specific measures affecting U.S. exports to Nicaragua. In particular, for meat, poultry, and dairy products, under CAFTA-DR, Nicaragua will recognize the equivalence of the U.S. food safety and inspection system, thereby eliminating the need for plant-by-plant inspections.

GOVERNMENT PROCUREMENT

Nicaragua is not a party to the WTO Agreement on Government Procurement. Nicaragua's law on government procurement, which went into effect in January 2000, provides for non-discrimination among suppliers and requires that most government procurement contracts be advertised in national newspapers and on the Internet. However, some suppliers have complained of inadequate notification of pending procurements. Nicaragua is moving toward the implementation of a computer-based system that would provide more transparency and efficiency in the bidding process.

The CAFTA-DR requires fair and transparent procurement procedures, including advance notice of purchases and timely and effective bid review procedures, for procurement covered by the

FOREIGN TRADE BARRIERS

Agreement. Under the CAFTA-DR, U.S. suppliers will be permitted to bid on procurements of most Nicaraguan government entities, including key ministries and state-owned enterprises on the same basis as Nicaraguan suppliers.

The anti-corruption provisions in the Agreement require each government to ensure that bribery in matters affecting trade and investment, including in government procurement, is treated as a criminal offense, or is subject to comparable penalties, under its law.

EXPORT SUBSIDIES

Nicaragua does not provide export financing. However, all exporters receive tax benefit certificates equivalent to 1.5 percent of the FOB port of exit value of the exported goods. Foreign inputs for Nicaraguan export goods from the country's free trade zones enter duty-free and are exempt from value-added tax. Under the CAFTA-DR, Nicaragua may not adopt new duty waivers or expand existing duty waivers conditioned on the fulfillment of a performance requirement (e.g., the exportation of a given level or percentage of goods). Nicaragua may maintain existing duty waiver measures provided such measures are consistent with its WTO obligations.

INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

Nicaragua has strengthened its legal framework for protection of intellectual property rights over recent years. Nonetheless, although the Nicaraguan government has dedicated three public prosecutors solely to IPR issues, enforcement remains weak. Protection of well-known trademarks is poorly enforced. According to industry sources, the government has made several attempts to crack down on music recording piracy since 2001, including raids in April 2005 and January 2006. The police took custody of 13,000 pirated CDs and DVDs during the most recent raid, though no arrests were reported. Although some pirated material has been destroyed by authorities, anecdotal evidence suggests an increase in the reproduction of pirated music and videos. The U.S. Government and industry are working with the Nicaraguan government to provide training for effective enforcement. Lack of regulation establishing procedures to guarantee the protection of pharmaceutical and agricultural product test data against unfair commercial use also remains a serious concern. Implementation of the CAFTA-DR obligations will require Nicaragua to protect undisclosed test data submitted for the purpose of product marketing approval of pharmaceutical and agricultural chemical products against disclosure and unfair commercial use.

Implementation of CAFTA-DR obligations should also strengthen Nicaragua's IPR protection regime. Implementation of those obligations should also provide stronger deterrence against piracy and counterfeiting by criminalizing end user piracy and requiring Nicaragua to authorize the seizure, forfeiture, and destruction of counterfeit and pirated goods and the equipment used to produce them. The CAFTA-DR text also mandates both statutory and actual damages for copyright and trademark infringement, to help ensure that monetary damages can be awarded even when it is difficult to assign a monetary value to the violation.

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SERVICES BARRIERS

Financial Services

Nicaragua has ratified its commitments under the 1997 WTO Financial Services Agreement. Nicaragua's WTO commitments cover most banking services, including acceptance of deposits, lending, leasing, guarantees, and foreign exchange. However, its WTO commitments do not cover security or asset management. Nicaragua allows foreign banks to operate either as 100 percent-owned subsidiaries or as branches, but no U.S. bank has yet re-entered the Nicaraguan financial market since several major U.S. banks withdrew in the 1970s, although a U.S. financial company is in the process of acquiring a 49 percent stake in a Nicaraguan-owned regional bank. The CAFTA-DR will make it easier for U.S. banks to enter the Nicaraguan market. U.S. financial service suppliers will have full rights to establish subsidiaries, joint ventures or branches for banks. Under the Poverty Reduction and Growth Facility (PRGF) agreement with the IMF, Nicaragua committed to strengthen the financial sector framework through reforms to laws on banks, the Superintendency of Banks and Other Financial Institutions (SIBOIF), and on the Guarantee of Deposits in Institutions of the Financial System (FOGADE). Legislation was enacted in October and November of 2005.

The country's banking system is stabilizing after having undergone severe restructuring in recent years. Banco del Istmo (BANITSMO), from Panama, started operations in Nicaragua in January 2005. Banco ProCredit (formerly Financiera ProCredit, a microfinance institution) was authorized to operate as a bank in October 2005.

Legislation passed in 1996 opened the insurance industry to private sector participation. Private insurance companies now compete with the government-owned firm INISER. No U.S. or other foreign insurance company has entered the Nicaraguan market. Under the CAFTA-DR, U.S. insurance suppliers will have full rights to establish subsidiaries, joint ventures or branches. Nicaragua will allow U.S.-based firms to supply insurance on a cross-border basis, including reinsurance; reinsurance brokerage; marine, aviation and transport (MAT) insurance; and other insurance services. Further, Nicaragua will accord substantial market access in services across their entire services regime, subject to very few exceptions.

The telecommunications sector is now fully privatized. In 2001 the government decided to sell a 40 percent stake in Enitel, the former state telephone company, to a consortium formed by Swedish telecoms group Telia Swedtel AB and Honduran electricity utility Emce. The remaining stake was sold to Mexican telecommunications company America Movil in December 2003. America Movil also obtained a license to operate the cellular company Alo PCS. In August 2004, América Móvil increased its interest in Enitel to 99.03 percent, and applied for authorization to merge Enitel Movil with Sercom Nicaragua. In October 2004, BellSouth completed the sale of its Nicaraguan unit TCN BellSouth to Telefónica Móviles. As a result, the mobile industry in Nicaragua is served by only two nationwide operators: Telefónica Móviles and América Móvil. Enitel controls switching for all cellular service, and therefore continues to exercise leverage over companies seeking interconnection.

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At the end of 2004, Enitel unilaterally imposed a 100 percent increase in termination rates for calls sent to wireless networks and blocked traffic to such networks when carriers refused to pay the increase. This action by Enitel was met with little effective intervention by the regulatory entity TELCOR to require Enitel to justify such rate increases. Additionally, TELCOR has encouraged competition in its licensing and regulatory practices, although the opening of the fixed-line and international telephony markets was delayed until October 2005 due to an institutional crisis. Under the CAFTA-DR, Nicaragua has committed to open its telecommunications sector to service and investment by U.S. providers.

The Law on Promotion of National Artistic Expression and on Protection of Nicaraguan Artists (Law no. 215, National Gazette 134, July 17, 1996) requires that foreign production companies contribute 5 percent of total production costs to a local cultural fund. In addition, the law requires that 10 percent of the technical, creative or artistic staff must be hired locally. Under the CAFTA-DR, Nicaragua would no longer require these contributions or local hiring for film production.

INVESTMENT BARRIERS

Poorly enforced property rights and the resulting proliferation of property disputes are among the most serious barriers to investment in Nicaragua. The Sandinista government confiscated nearly 30,000 properties during the 1980s. Many thousands of individuals have filed claims since 1992 for compensation or return of properties. As of July 2005, the Nicaraguan government had settled over 4300 U.S. citizen claims. Seven hundred eighty embassy-registered U.S. claims remain outstanding. While there has been progress in resolving claims, many valuable properties remain in the hands of the government or private parties, including former Sandinista government officials and military officers. Property claimants can sue for return of their properties, but the legal system favors the current occupants. The Nicaraguan government offers low-interest bonds as a means of compensation in most instances. The United States continues to urge the Nicaraguan government to resolve claims.

Nicaragua and the United States concluded a Bilateral Investment Treaty (BIT) in July 1995. Nicaragua's National Assembly ratified the BIT in June 1996, but the U.S. Senate has not ratified it. However, the investment chapter of the CAFTA-DR includes provisions for the protection of U.S. investors similar to those in the 1995 BIT by establishing a secure, predictable legal investment framework. Under the CAFTA-DR, all forms of investment will be protected, including enterprises, debt, concessions, contracts and intellectual property. U.S. investors will enjoy in almost all circumstances the right to establish, acquire and operate investments in Nicaragua on an equal footing with local investors. Among the rights afforded to U.S. investors are due process protections and the right to receive a fair market value for property in the event of an expropriation. Investor rights will be backed by an effective, impartial procedure for dispute settlement that is fully transparent. Submissions to dispute panels and panel hearings will be open to the public, and interested parties will have the opportunity to submit their views.

FOREIGN TRADE BARRIERS

ELECTRONIC COMMERCE

Electronic commerce is not well developed in Nicaragua. Currently, there are no laws or regulations restricting its use or regulating the treatment of electronic transactions. The CAFTA-DR includes provisions on electronic commerce that reflect the issue's importance in global trade and the importance of supplying services by electronic means as a key part of a vibrant electronic commerce environment. Under the Agreement, Nicaragua committed to provide non-discriminatory treatment of digital products and not to impose customs duties on such products, and to cooperate in numerous policy areas related to electronic commerce.

OTHER BARRIERS

Voices within and outside of Nicaragua have raised concerns that Nicaragua's legal system is weak and cumbersome. Many members of the judiciary, including those at high levels, are widely believed to be corrupt or subject to outside political pressures. Enforcement of court orders is uncertain and frequently subject to non-judicial considerations. Foreign investors are not specifically targeted but are often at a disadvantage in disputes against nationals with political connections. Recognizing Nicaragua's reputation for problems with corruption, President Bolaños has made anti-corruption a centerpiece of his administration's domestic policy. This contributed to Nicaragua's selection, during 2004, as a country eligible to apply for Millennium Challenge Account (MCA) assistance. MCA countries are deemed to have shown a commitment to rule justly (including by tackling corruption), investing in their people, and encouraging economic freedom. The anti-corruption provisions in the CAFTA-DR require each government to ensure that bribery in matters affecting trade and investment is treated as a criminal offense, or is subject to comparable penalties, under its law.

The Nicaraguan government accepts binding international arbitration of investment disputes between foreign investors and the state. The government of Nicaragua signed the 1958 New York Convention on the recognition and enforcement of foreign arbitration awards and submitted it to the National Assembly in early 2003. The National Assembly approved it in June 2003. Although the Nicaraguan government is party to both the Inter-American Convention on Arbitration and the New York Convention on Arbitration, and is a member of the International Center for the Settlement of Investment Disputes (ICSID), before the new arbitration law was published there was no law allowing for arbitration between private parties. In June 2004, the Nicaraguan Chamber of Commerce submitted a draft arbitration law to the National Assembly, based on the UN Model Law on International Commercial Arbitration. The new law was approved by the National Assembly in May 2005 and published in June 2005. Arbitration clauses in business contracts will allow companies to avoid dependence on the Nicaraguan judicial system; however, either party to an arbitration case may, under the 2005 law, submit a motion to the Supreme Court seeking to nullify the arbiter's decision.

FOREIGN TRADE BARRIERS

Law 364

U.S. multinational firms and the U.S. Chamber of Commerce have expressed concern regarding Nicaraguan Law 364, enacted in October 2000 and published in January 2001. Law 364, which some U.S. multinationals believe targets them, retroactively imposes liabilities on foreign companies that manufactured or used in Nicaragua the chemical pesticide DBCP, which was banned in the United States in 1979, when the Environmental Protection Agency cancelled its certificate for use (with exceptions). U.S. multinationals express concern that the law and its application under Nicaragua's judicial system lack due process, transparency and fundamental fairness, and that the Nicaraguan Government has not taken sufficient ameliorative action to date.

Concerns with Law 364 include onerous procedures and requirements such as: retroactive application of no-fault liability related to a specific product; waiver of the statute of limitations; irrefutable presumption of causality; truncated judicial proceedings; imposition of a \$100,000 non-refundable bond per defendant as a condition for firms to put up a defense in court; escrow requirements of approximately \$20 million earmarked for payment of awards; and minimum liabilities as liquidated damages (ranging from \$25,000 to \$100,000.)

In December 2002, the first judgment under this law was rendered in a consolidated lawsuit in the amount of \$489 million. A U.S. district court ruled in October 2003 that the judgment could not be enforced against the companies in the United States. Several hundred lawsuits claiming damages of over \$11 billion are pending. In April 2005 the Human Rights Ombudsman in Nicaragua presented the case to the UN's Human Rights Commission. Physical threats against the Ombudsman's staff in September 2005 by DBCP claimants precipitated the Ombudsman's public refusal to represent such claimants further.

NIGERIA

TRADE SUMMARY

The U.S. goods trade deficit with Nigeria was \$22.6 billion in 2005, an increase of \$7.9 billion from \$14.7 billion in 2004. U.S. goods exports in 2005 were \$1.6 billion, up 3.9 percent from the previous year. Corresponding U.S. imports from Nigeria were \$24.2 billion, up 48.9 percent. Nigeria is currently the 53rd largest export market for U.S. goods.

The stock of U.S. foreign direct investment (FDI) in Nigeria in 2004 was \$955 million, down from \$1.1 billion in 2003. U.S. FDI in Nigeria is concentrated largely in the mining, and wholesale sectors.

IMPORT POLICIES

Nigeria's high tariffs and numerous import bans have been a concern to many U.S. businesses and were also raised in the context of Nigeria's May 2005 Trade Policy Review in the World Trade Organization.

Tariffs

Tariffs provide the Nigerian government with its second-largest source of revenue after oil exports. In its last major tariff revision, in October 2005, the government implemented the Economic Community of West African States (ECOWAS) Common External Tariff, reducing the number of tariff bands in Nigeria from twenty to five. The five tariff bands are: zero duty on capital goods, machinery, and essential drugs not produced locally; 5 percent duty on imported raw materials; 10 percent duty on intermediate goods; 20 percent duty on finished goods; and 50 percent duty on goods in the industries that the government seeks to protect. The 50-percent tariff would cover many items currently subject to import bans. Items deemed to be necessities such as anti-retroviral drugs for the treatment of patients with HIV/AIDS will now be imported duty free. This duty-free status will be reviewed after one year to assess its impact on the Nigerian economy and its stakeholders. The recent reforms are an effort to harmonize the trade environment in the sub-region while at the same time improving Nigeria's own trade and investment environment.

Frequent policy changes and inconsistent duty collection make importing difficult and expensive and occasionally create severe bottlenecks for commercial activities. This problem is aggravated by Nigeria's dependence on imported raw materials and finished goods, which affects both foreign and domestic manufacturers. Many importers resort to under-valuing and smuggling to avoid paying full tariffs.

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Non-Tariff Trade Barriers

The United States continues to have serious concerns about the Nigerian government's use of non-tariff barriers to trade. Bans on the importation of a variety of items – sorghum, millet, wheat flour, cassava, frozen meat and poultry products, biscuits, bottled water, fruit juice in retail packs, beer, mosquito repellent coils, most textile and apparel products, used clothing, and cars more than eight years old – continued into 2005. Products added to the list of banned items in 2005 include maize, cocoa butter, disinfectants and germicides, diaries, greeting cards, calendars, and facial tissues. Items removed from the list in 2005 include certain textile products (such as nylon tire cord, conveyor belts, trimmings and linings, gloves for industrial use, elastic bands, mosquito nets, motifs), chocolates, white cement, linseed oils, castor oils, hydrogenated vegetable fats used as industrial raw materials, all raw materials for the manufacture of soap and detergents, safety shoes used in the oil industry, sports shoes, stadium chairs and fittings, accessories used in furniture making, and prefabricated buildings. Overall, the government has reduced the number of items on its import prohibition list and has stated its intention to rescind all import bans by January 2007, but new import bans, such as an announced ban on rice imports starting in 2006, are inconsistent with the government's stated intentions.

Customs Barriers

Nigerian port practices continue to present major obstacles to trade. Importers face long clearance procedures, high berthing and unloading costs, erratic application of customs regulations, and corruption. Customs exemptions granted to U.S. firms as a concession for setting up operations in Nigeria have not always been honored. In December 2005, the government released import guidelines for the implementation of a physical destination inspection regime. Under the destination inspection scheme, all imports will be inspected on arrival into Nigeria. These guidelines will be implemented by the Destination Inspection Service Providers, which is a team comprised of the Customs Service and three firms that provide scanning services.

STANDARDS, TESTING, LABELING, AND CERTIFICATION

Rules concerning sanitary and phytosanitary standards, testing, and labeling are well defined, but bureaucratic hurdles slow the import-approval process. Regardless of origin, all food, drug, cosmetic, and pesticide imports must be accompanied by certificates of analysis from manufacturers and appropriate national authorities, and specified animal products, plants, seeds, and soils must be accompanied by proper inspection certificates. U.S. exporters may obtain these certificates from the U.S. Department of Agriculture and other relevant federal or state agencies. By law, items entering Nigeria must be labeled exclusively in the metric system. The Nigerian Customs Service is charged with preventing the entry of products with dual or multiple markings, but such items are often found in Nigerian markets.

FOREIGN TRADE BARRIERS

High tariffs and uneven application of import and labeling regulations make importing high-value perishable products into Nigeria difficult. Disputes between Nigerian agencies over the interpretation of regulations often cause delays and frequent changes in customs guidelines slow the movement of goods through Nigerian ports. These factors can contribute to product deterioration and may translate into significant losses for perishable-goods importers.

The National Agency for Food and Drug Administration and Control (NAFDAC) is charged with protecting Nigerian consumers from fraudulent or unhealthful products. The agency recently targeted the illicit importation of counterfeit and expired pharmaceuticals for special attention, particularly imports from East and South Asia. NAFDAC's severely limited capacity for carrying out inspections and testing contributes to what some have characterized as an occasionally heavy-handed or arbitrary approach to regulatory enforcement, and the agency has occasionally challenged legitimate food imports.

U.S. products do not appear to be subject to extraordinary or discriminatory restrictions or regulations.

GOVERNMENT PROCUREMENT

The Obasanjo administration has made modest progress on its pledge to practice open and competitive bidding and contracting for government procurement. Procurement and contracting guidelines are implemented by a "due-process" office in the Budget Monitoring and Price Intelligence Unit. "Due process" certification aims at ensuring that the procurement process for public projects adheres to international standards for competitive bidding. The unit acts as a clearing house for government contracts and procurement and monitors the implementation of projects to ensure compliance with contract terms and budgetary restrictions. Procurement above 50 million naira (about \$385,000) is subject to "due process" review.

Foreign companies incorporated in Nigeria receive national treatment and government tenders are published in local newspapers. U.S. companies have won government contracts in several sectors. Unfortunately, many companies that have won contracts have subsequently had difficulty getting them funded, usually as a result of delays in the national budget process, and some companies that won contracts for which funds were allocated have had trouble getting paid. Nigeria is not a signatory to the WTO Agreement on Government Procurement.

EXPORT PROMOTION

The Nigerian Export Promotion Council and the Nigerian Export-Import Bank administer export incentive programs that include tax concessions, export development funds, capital assets depreciation allowances, and foreign currency retention programs. Funding constraints limit the effectiveness of these programs. In 2005, the government of Nigeria (GON) rescinded all export subsidies, because it claims that the Common External Tariff (CET) it implemented in October 2005 automatically favors manufacturers through its lower tariffs on capital goods and raw materials.

FOREIGN TRADE BARRIERS

The Nigerian Export Processing Zone Authority (NEPZA) is responsible for attracting investment in export-oriented industries. Of the five zones established under NEPZA, only the Calabar and Bonny Island (Onne) export-processing zones are operational, with some difficulties reported. The Calabar export-processing zone also functions as a free trade zone. NEPZA rules dictate that at least 75 percent of production in the zones be exported, but lower export levels are tolerated.

INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

Nigeria is a member of the World Intellectual Property Organization (WIPO), a party to the Universal Copyright Convention (UCC), the Berne Convention, and the Paris Convention for the Protection of Industrial Property, and has signed the WIPO Copyright Treaty and the WIPO Performances and Phonograms Treaty. Legislation pending in the National Assembly is intended to establish a legal framework for an IPR system compliant with WTO rules.

The government's lack of institutional capacity to address IPR issues is a major constraint to enforcement. Relevant Nigerian institutions suffer from low morale, poor training, and limited resources. Fraudulent alteration of IPR documentation is common. Despite Nigeria's active participation in the conventions cited above, its reasonably comprehensive IPR laws, and growing interest among Nigerians in seeing their intellectual property protected, piracy is rampant in Nigeria. Counterfeit auto parts, pharmaceuticals, business and entertainment software, music and video recordings, and other consumer goods are sold openly throughout the country, and intellectual property infringers from other countries appear increasingly to be using Nigeria as a base for the production of pirated goods. In 2004, U.S. industry reported a growth of optical disk manufacturing plants, some of which may be contributing to the production of pirated optical disk products. Additionally, book piracy remains a problem.

Patent and trademark enforcement remains weak, and judicial procedures are slow and subject to corruption. Nonetheless, recent government efforts to curtail IPR abuse have yielded results. The Federal High Court of Enugu, Nigeria, issued an interim injunction on November 23, 2004 against several firms infringing a Honeywell International trademark for spark plugs. The court warned all distributors, dealers, and retailers in Nigeria that the unauthorized use of Honeywell's "Autolite" trademark is illegal and constitutes an offense punishable by fine or imprisonment.

Nigeria's broadcast regulations do not permit rebroadcast or excerpting of foreign programs unless the station has an affiliate relationship with a foreign broadcaster. This regulation is generally respected, but some cable providers illegally transmit foreign programs. The National Broadcasting Commission monitors the industry and is responsible for punishing infractions.

Almost no foreign feature films have been legally distributed in the country in the last two decades. Widespread pirating of foreign and domestic videotapes discourages the entry of licensed distributors. In 2004, the Nigerian Copyright Commission launched an anti-piracy initiative named "Strategy Against Piracy" (STRAP). The Nigerian police force, working closely with the Nigerian Copyright Commission, has raided enterprises producing and selling pirated software and videos, and a number of high-profile charges have been filed against IPR violators. Unfortunately, most raids appear to target small rather than large and well-connected pirates, and

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very few cases involving copyright, patent, or trademark infringement have been successfully prosecuted.

SERVICES BARRIERS

Foreign participation in the services sector is generally not restricted. Regulations provide for 100 percent foreign access in many service sectors, including banking, insurance, telecommunications, and securities. Central Bank of Nigeria directives stipulates minimum levels of paid-up capital. At least three foreign banks operate in Nigeria and several Nigerian banks have foreign shareholders.

Professional societies in engineering, accounting, medicine, and law define minimum professional requirements. Nigeria imposes quotas on expatriate employment based on the issued capital of firms. Quotas are especially strict in the oil and gas sector and may apply to both production and service companies. Oil and gas companies must hire Nigerian workers unless they can demonstrate that particular positions require expertise not found in the local workforce. Positions in finance and human resources are almost exclusively reserved for Nigerians; certain geoscience and management positions may be filled by expatriates with the approval of the National Petroleum Investment and Management Services (NAPIMS) agency. Each oil company must negotiate its expatriate worker allotment with NAPIMS. Significant delays in the approval of this allotment, and in subsequent approval of visas for expatriate personnel, present serious management challenges to the energy industry's efforts to acquire the necessary personnel and maintain their legal immigration status in Nigeria.

NAPIM's approval is required for all procurement in the energy sector above \$500,000. Approval processes are slow and can significantly escalate the time and cost required for a given project, as well as providing opportunities for corruption and favoritism.

INVESTMENT BARRIERS

Under the Nigerian Investment Promotion Commission (NIPC) Decree of 1995, Nigeria allows 100-percent foreign ownership of firms outside the petroleum sector. Investment in the petroleum sector is limited to existing joint ventures or production-sharing agreements. Foreign investors may buy shares of any Nigerian firm except firms on a "negative list" (such as manufacturers of firearms, ammunition, and military and paramilitary apparel). Foreign investors must register with the NIPC after incorporation under the Companies and Allied Matters Decree of 1990. The decree prohibits nationalization or expropriation of a foreign enterprise, except when necessary to protect the national interest. Despite efforts to improve the country's investment climate, disincentives to investing in Nigeria continue to plague foreign entrepreneurs. Potential investors must contend with poor infrastructure, complex tax administration procedures, confusing land ownership laws, arbitrary application of regulations, corruption, and extensive crime. The sanctity of contracts is often violated, and Nigeria's court system for settling commercial disputes is weak and sometimes biased.

Foreign oil companies are under significant pressure to increase procurement from indigenous firms. NAPIMS set a target of 40 percent local content for oil-related projects by 2005 and 60

FOREIGN TRADE BARRIERS

percent by 2010. Oil companies and NAPIMS appear to be working together cooperatively to meet these goals, but the extent of and mechanisms for enforcement of local content regulations remain unclear. In many cases, sufficiently trained personnel and physical infrastructure do not currently exist to meet the government's local content targets. The Nigerian National Petroleum Corporation (NNPC) is working toward identifying and certifying indigenous firms with specific skill sets through the Joint Qualification System (JQS). Although many indigenous firms possess adequate technical expertise, managerial and financial capabilities are often lacking.

OTHER BARRIERS

The Nigerian government has increased its efforts to eliminate financial crimes such as money laundering and advance-fee fraud (or "419 fraud," named after the relevant section of the Nigerian Criminal Code). With the encouragement and cooperation of U.S. law enforcement agencies, the Nigerian government is now prosecuting more "419" perpetrators. But fraud, theft, and extortion remain rampant.

International monitoring groups routinely rank Nigeria among the most corrupt countries in the world. While sales of U.S. goods and services to public-and private-sector enterprises are not restricted, some U.S. suppliers believe they lose sales when they refuse to engage in illicit or corrupt behavior. Other U.S. exporters say Nigerian businessmen and officials understand that U.S. firms must adhere to the U.S. Foreign Corrupt Practices Act, and they believe that the law's restrictions help minimize their exposure to corruption.

NORWAY

TRADE SUMMARY

The U.S. goods trade deficit with Norway was \$4.9 billion in 2005, about the same as in 2004. U.S. goods exports in 2005 were \$1.9 billion, up 20.2 percent from the previous year. Corresponding U.S. imports from Norway were \$6.8 billion, up 4.6 percent. Norway is currently the 48th largest export market for U.S. goods.

U.S. exports of private commercial services (i.e., excluding military and government) to Norway were \$1.7 billion in 2004 (latest data available), and U.S. imports were \$2.0 billion. Sales of services in Norway by majority U.S.-owned affiliates were \$2.7 billion in 2003 (latest data available), while sales of services in the United States by majority Norway-owned firms were \$936 million.

The stock of U.S. foreign direct investment (FDI) in Norway in 2004 was \$9.1 billion, up from \$7.7 billion in 2003. U.S. FDI in Norway is concentrated largely in the mining, and manufacturing sectors.

IMPORT POLICIES

Industrial Goods

Norway, along with Switzerland, Iceland and Liechtenstein, is a member of the European Free Trade Association (EFTA). EFTA members, with the exception of Switzerland, participate in the European Union (EU) single market through the European Economic Area (EEA) accord. Norway grants preferential tariff rates to EEA members. As an EEA signatory, Norway assumes most of the rights and obligations of EU member states. The principal exception is in the agricultural sector, which the EEA accord does not cover.

Although Norway maintains a liberal trade and investment regime with respect to industrial products, its agricultural sector remains highly protected. Some of Norway's trade restrictions are more severe than those of the EU, such as non-tariff barriers related to approval for agricultural products derived from biotechnology. As a general matter, Norway has implemented or is in the process of implementing most EU trade policies and regulations. Therefore, U.S. exports to Norway face many of the same trade and investment barriers that limit U.S. access to the EU, such as the ban on hormone-treated meat products. As a non-EU member, Norway's ability to influence EU decisions is limited.

Norway's market, except for agricultural products and processed foods, is generally transparent and open. Norway has continued on a unilateral basis to dismantle import tariffs on industrial products. The average most favored nation (MFN) tariff on non-agricultural products has fallen from 2.3 percent in 2000 to 0.9 percent in 2004. About 94 percent of industrial tariff lines are currently duty free.

FOREIGN TRADE BARRIERS

STANDARDS, TESTING, LABELING AND CERTIFICATION

On July 30, 2005, the Government of Norway notified the WTO Technical Barriers to Trade committee about a draft regulation that was under consideration in the Norwegian government related to brominated flame retardants. The draft regulation proposes to ban as of July 1, 2006 products that consist of, or contain, decabromodiphenyl ether (“decaBDE”) in concentrations higher than 0.1 percent. The flame retardant decaBDE is manufactured in the United States and used in electronics and textiles to increase their resistance to fire.

Many of Norway’s standards are harmonized with the EU. With the exception of telecommunications equipment, few technical standards exist. However, there are stringent regulations for chemicals and foodstuffs. No country of origin labeling is required.

Agricultural Goods

Though it accounts only for about one percent of Gross Domestic Product (GDP), Norway maintains strict protections for agriculture that shelter the sector from global competition. As justification for these protective policies, Norway emphasizes the importance of “non-trade concerns,” which include food security, environmental protection, rural employment, and the maintenance of human settlement in sparsely populated areas.

One of Norway’s leading concerns in the WTO Doha Development Round is the preservation of its highly-subsidized and protected agricultural sector. The August 2005 Parliamentary elections brought the agrarian Center Party to power as part of a center-left coalition. With a Center Party official appointed as Minister of Agriculture and Food, Norway is expected to more aggressively oppose opening its agricultural sector to outside competition.

Tariffs

Norway bound its tariffs for agricultural commodities in 1995 as part of its commitments in the WTO. Tariffication of agricultural non-tariff barriers as a result of the Uruguay Round led to the replacement of quotas with high *ad valorem* product tariffs. Although Norway is only 50 percent self-sufficient in agricultural production, it maintains a protective system that assures domestic producers – farmers and the food processing industry – have little competition until all domestic production has been consumed. Tariff rates on agricultural products currently average about 38 percent – in comparison to less than one percent for non-agricultural products – and can range as high as several hundred percent.

Domestic agricultural shortages and price surges have been offset by temporary tariff reductions. Lack of predictability in tariff adjustments and insufficient advance notifications – generally only 2-5 days before implementation – favor nearby European suppliers and make imports from the United States, especially of fruit, vegetables and other perishable horticultural products, very difficult. For a number of processed food products, tariffs are applied based on their recipes, requiring the Norwegian importer to provide a detailed disclosure of product contents. Many exporters to the Norwegian market refuse to give all requested details and their products are, as a result, subjected to maximum tariffs.

FOREIGN TRADE BARRIERS

Tariff-Rate Quotas

Norwegian tariff-rate quotas are divided into two categories – minimum access quotas and Generalized System of Preferences (GSP) quotas. Tariff-rate quotas exist for grains and a number of horticultural products. In July 2001, Norway also implemented auction quotas for grain and other carbohydrate feed. All quotas are traded at auctions held by the Norwegian Agricultural Authority, a Ministry of Agriculture agency that controls all agricultural imports.

Interest in the quotas among Norwegian importers is limited, except for grain, despite the substantial reductions in duties for some products. Compared with domestic consumption and production, the quotas are very small. Most of the interest in Norway's quota auction comes from smaller importers who use their quotas for niche products or from large farmer-owned companies to block competition to their own domestically produced products.

Auction participation is inexpensive, and those who secure a quota are not required to actually import. Although about 98 percent of the quotas each year are sold on these auctions, only 30 percent to 40 percent of the quotas auctioned are usually filled through imports. There is no system to reallocate unused import quotas, hindering foreign exporters seeking access to the Norwegian market for these products.

Raw Material Price Compensation

Though Norway uses high import tariffs to protect domestic commodities from foreign competition, the situation is more complex for certain processed goods. Although the EEA does not generally apply to agricultural products, it includes provisions on raw material price compensation that are meant to increase trade in processed food. Norway has a special agreement with the EU within the EEA framework that grants some EU processed food products a preferential duty. In 2003, the agreement extended coverage to bread and baked goods, breakfast cereals, chocolate and sweets, ice cream, pasta, pizza, soups, and sauces. This scheme disadvantages the competitiveness of U.S. exporters in the Norwegian market for the covered processed foods.

Norway also maintains a price reduction scheme that includes subsidies for using certain domestically produced raw materials in processed foods. Products for which such subsidies are paid include chocolate, sweets and ice cream (for milk and glucose), and pizza (for cheese and meat). The purpose of the system is to help compensate the domestic food processing industry for high domestic raw material costs.

EU-Based Regulations

In addition to its own requirements related to the import of food products, Norway has generally implemented EU regulations since 1999. Some EU regulations that Norway has adopted inhibit trade, such as EU regulations on veterinary control of animals and animal products requiring that meat products entering the country come from an EU-approved plant and be accompanied by the necessary certificates. The importer in Norway must be registered and notify authorities in

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advance of the arrival of any shipment (twenty-four hours in advance for plants and thirty days in advance for animals). Except for fish products, shipments must enter through either Oslo harbor or Oslo airport. Twenty entrance locations exist for fish products. Norway also implements EU regulations that bar imports of meat from animals treated with growth hormones.

Biotechnology

Norway's strict limitations on imports of agricultural biotechnology products have had a particularly adverse impact on U.S. producers. Before 1996, when the limitations took effect, U.S. exporters usually supplied 60 percent to 80 percent of the Norwegian soybean market. As a result of the limitations, the entire market has been lost. Norwegian soybean imports in 2004 were 374,898 tons, valued at \$121 million, all of which was sourced from Brazil.

Over the last year, Norway has gradually adopted the EU's biotechnology policies with regard to allowable content and labeling of genetically modified materials in foodstuffs, marking the culmination of an administrative review process initiated earlier this decade. However, adopting EU standards has not necessarily eased entry for genetically modified agricultural products, as Norway still maintains a separate and independent domestic approval process that has kept practically all genetically modified foodstuffs, even many of those approved in the EU, off the local market.

Under the authority of Norway's 1993 Gene Technology Act, the government maintains its own review board and may ban the import of agricultural biotechnology products based on several criteria, including ethical issues, sustainable development, and social justification. The Review Board performs independent studies on biotechnology products and does not always accept EU findings. Before approval of an agricultural biotechnology product – even if the product does not require labeling – a health risk assessment must be conducted according to Norwegian guidelines for assessments of novel foods.

Norway has implemented EU Directive 90/220 on the deliberate release into the environment of agricultural biotechnology products. Also, Norway generally uses a more expansive interpretation of the possible “unintended effects” of bioengineering than does the EU. To date, Norway has only approved four agricultural biotechnology products for import: one type of tobacco plant – grown only in France – and three types of dried, cut carnations grown in greenhouses. Norway has rejected fourteen biotechnology products approved for use in the EU.

In October 2004, Norway slightly relaxed its “zero tolerance” policies on agricultural biotechnology products. Norwegian environmental and food safety authorities raised the limit for the “unintentional” presence of material derived from biotechnology in foodstuffs from zero to 0.9 percent, in line with EU standards. Though the change paved the way for U.S. “identity preserved” agricultural products (with inadvertent content of 0.9 percent or less) to return to the Norwegian market, no U.S. exports of major identity preserved crops – soybeans, corn or wheat – have occurred since this change took effect.

The Norwegian Food Law of 1997 governs the labeling of agricultural products derived from biotechnology. On September 15, 2005 Norway's Food Safety Authority (NFSA) adopted new

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rules for labeling agricultural products derived from biotechnology that bring Norway's treatment of such goods into line with EU standards. The previous system required labeling whenever more than 2 percent of *any ingredient* was derived from biotechnology. Under the new, more reasonable system, labeling is required whenever 0.9 percent of an *entire product* contains genetically modified materials. The revised labeling requirement applies to food, feed, additives, and aromas.

Taxes and Fees

Norway's internal tax system on agricultural products, which includes various inspection and control levies and taxes, is complex and difficult for potential exporters to navigate. For example, a special inspection fee imposed on U.S. wheat from autumn 2000 until February 2004 rendered U.S. wheat noncompetitive in the Norwegian market. The special fee, which was directed at wheat and rye imports from countries affected by fungal diseases, substantially raised the cost of importing U.S. wheat into Norway. U.S. wheat exporters were practically eliminated from the local market after years of supplying food wheat to Norway. Although the NFSA lifted the fee in February 2004, American wheat exporters have yet to return to the market.

Limited Competition

The spirits and wine retail market in Norway is controlled by the government monopoly Vinmonopolet. There are 190 Vinmonopolet stores throughout Norway. Spirits and wine sales through ordinary retail stores are not allowed. An approved importer/agent and distributor are required in order to enter the market. Gaining approvals to include new wines and other alcoholic beverages on Vinmonopolet's retail list is cumbersome, limiting the variety of U.S. wines available to Norwegian consumers. Vinmonopolet's reputation was badly damaged over the last year after allegations surfaced in January 2005 that some managers and employees had improperly accepted gifts and other favors from Norway's leading wine importer in exchange for favored treatment for the company's wine offerings.

GOVERNMENT PROCUREMENT

Norway is a signatory to the WTO Government Procurement Agreement (GPA). Norway's government procurement procedures are non-discriminatory and based on open, competitive bidding for procurement above certain threshold values. A similar set of national rules applies to public contract tenders below these thresholds. Exceptions for defense procurement leave a "gray area" for items such as rescue helicopters that can also be used in military operations. Although disputes may be settled by the European Surveillance Authority (ESA) or by the courts, the process can be unduly lengthy.

INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

Internet piracy and cable/satellite decoder and smart card piracy have risen in Norway. Broadband internet is standard; making peer-to-peer downloads of music and video easy and common. Encoding groups that release early copies of new motion pictures on the internet are problematic. Television and cable companies are active in combating decoder and smart card

FOREIGN TRADE BARRIERS

piracy and satellite operators recently introduced conditional access technologies that have mitigated the problem. Private organizations like the Motion Picture Association are attempting to raise public awareness of internet and video piracy, for example by running anti-pirating advertisements in movie theaters. Norwegian authorities have not undertaken any serious public relations efforts to combat internet or other piracy of copyrighted property.

In June 2005, Norway enacted legislation based on the EU's 2001 Copyright Directive that combats internet piracy and addresses some gaps in Norway's intellectual property rights protections. The legislation bans unauthorized peer-to-peer file sharing and requires that creative works can only be downloaded from the internet with the artist's prior approval. The legislation also grants legal protection to technological protection measures designed to prevent unauthorized use of a creative work. The law bars the intentional circumvention of such systems in most circumstances.

However, an exception is made for "private use." Norway thus expressly allows circumvention of copy protection and other technical measures for private use of copyrighted materials except computer software. This measure allows music CD owners, for example, to legally breach protection measures in order to transfer copyrighted music. Although not expressly stated in the law, the legislative history of this provision suggests that "private use" also includes providing free copies to family and friends.

In compensation, Norway budgeted NOK 32.5 million (\$5 million) in 2005 for payments to affected music and motion picture rights holders. Norway plans to make these payments annually from future government budgets. The funds will be paid only to artists in the EU and EFTA countries, though copyrighted American products undoubtedly comprise a high percentage of downloaded material. The EFTA Surveillance Authority is reviewing whether Norway has correctly implemented the EU Copyright Directive.

Norway made no substantial progress last year in addressing the lack of an express ban on imports of counterfeit or pirated goods. A trademark or copyright holder must obtain a court order and have the case referred to the police before customs authorities will take action to stop entries of pirated goods. However, Norway's strict privacy laws bar customs authorities from informing rights holders when questionable shipments arrive at the border, rendering the remedy practically moot. Although counterfeit and pirated goods are not commonly available domestically, counterfeiters and intellectual property pirates use Norway as a "gateway" to third countries – importing illicit goods, paying applicable import duties, and reshipping the goods to EU nations. For example, significant numbers of pirated DVDs from Russia and the Far East – some reports suggest as many as 80,000 in larger shipments – are believed to have transited Norway for consumption in the EU.

Enforcement of IPR protections is inconsistent. Norwegian police and judicial authorities are generally committed in principle to taking action against piracy and intellectual property right infringement, to the extent authorized by Norwegian law, and have successfully prosecuted a number of high-profile cases in the last year. However, the authorities lack the capability and resources to handle complaints about IPR violations effectively. Police authorities are aware of such problems as the "gateway" gap and have been working to address them, but with little

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result. Given limited resources, Norwegian law enforcement authorities have placed more priority on areas like computer crime than traditional IPR violations. Local business representatives indicate that complaints about copyright infringement, for example, usually either go unaddressed or are given low priority.

SERVICES BARRIERS

Financial Sector

Current regulations require that the Norwegian Financial Supervisory Authority grant permission for ownership levels in local financial institutions that exceed certain thresholds. The Authority assesses the acquisitions to ensure that prospective buyers are financially stable and the acquisition does not unduly limit competition. The Authority applies national treatment to non-bank foreign financial groups and institutions, but applies nationality restrictions to bank ownership. At least half the members of the board and half the members of the corporate assembly of a financial institution must be nationals and permanent residents of Norway or another EEA nation. On January 1, 2005, Norway removed the ceiling on foreign equity in a Norwegian financial institution, provided the Authority has granted a concession. Norway grants branches of U.S. and other foreign financial institutions the same treatment as domestic institutions.

Telecommunications Sector

In 1998, Norway began to liberalize the former monopoly of telecommunications services (Telenor) in Norway. Telenor was partially privatized in December 2000, leaving the government with a stake of 78 percent. Since that time, the government's share has declined to about 54 percent, though Norway's new center-left government has indicated it will suspend further privatization of state-controlled companies.

Telenor remains the dominant operator in the Norwegian Telecom market. In 2005, the Norwegian Post and Telecommunications Authority (NPTA), in line with the EU's telecommunications regulatory framework, declared that Telenor had significant market power in a number of segments in the telecommunications sector including: leased lines; call origination; transit services; wholesale unbundled access to metallic loops and sub-loops for the purpose of providing broadband and voice services; wholesale broadband access; and wholesale transmission services for national radio, local television, and national television on analogue terrestrial networks. New regulatory obligations have been imposed on Telenor by the NPTA in order to facilitate competitors' entry into and further access to these markets.

The introduction of Voice-over Internet Protocol (VoIP) telephone services has further encouraged competition among telecommunications operators in Norway. The NPTA released an outline of regulation on VoIP services in April 2005.

Equipment that has not been tested and certified under the EEA's common technical regulations must be type-approved by the Norwegian telecommunications authority. The Norwegian government maintains that that this takes about six weeks under normal procedures. In the past,

FOREIGN TRADE BARRIERS

U.S. companies have reported that such approval is slow and costly for companies offering new products.

INVESTMENT BARRIERS

Norway welcomes foreign investment as a matter of policy and grants national treatment to foreign investors, except in the following sectors: financial services, mining, hydropower, and property acquisition.

Foreign companies are required to obtain concessions for the right to own or use various kinds of real property, including forests, mines, tilled land, and waterfalls. However, foreign companies need not seek concessions to rent real estate, provided that the rental contract is made for a period not exceeding ten years.

In the offshore petroleum sector, Norwegian authorities encourage the use of Norwegian goods and services. The Norwegian share of the total supply of goods and services in this sector has remained high, approximately 50 percent, over the last decade. Norway's petroleum concession process still operates on a discretionary basis, with the government awarding licenses based on subjective factors rather than competitive bidding. Though the Norwegian government had in the past shown a strong preference for Norwegian petroleum companies in awarding the most promising oil and gas exploration and development blocks, foreign companies report no discrimination in recent licensing rounds. Norway has implemented EU directives requiring equal treatment of EEA oil and gas companies.

Foreign and domestic investors are barred by law from investing in industries monopolized by the government, which includes postal services, railways, and the domestic production and retail sale of alcohol. The government rarely allows foreign investment in hydropower production, and such investments, if approved, are limited to 20 percent equity participation. Norway has fully opened the electricity distribution system to foreign participation.

State Ownership and Control of Commercial Enterprises

The government continues to play a strong role in the Norwegian economy through its ownership or control of many of the country's leading commercial firms. The public sector accounts for nearly sixty percent of Norway's Gross Domestic Product and approximately 100 enterprises are either fully or partly owned by the central government. Central or local authorities own approximately 35 percent of the companies listed on the Oslo Stock Exchange, and approximately 42 percent of the stock exchange's capitalization at the end of 2004 was in government hands.

An April 2002 government "White Paper" called for reducing and improving State ownership in the economy. Norway took steps over the last several years to implement that policy, partially privatizing some of the country's leading firms, e.g. Statoil, Norsk Hydro, Telenor and others. However, the new government has announced that it will halt further privatization of state-controlled companies.

FOREIGN TRADE BARRIERS

OTHER SECTORAL POLICIES

Pharmaceuticals

Foreign pharmaceutical firms continue to experience difficulties in the Norwegian market. Until 1992, Norway limited patent protection for pharmaceuticals to the manufacturing process for a drug's active ingredient. Although Norway introduced product patents for pharmaceuticals in 1992, the previous system has left a difficult legacy for pharmaceutical companies as competitors that claim to use non-patented processes have recently entered the market. Several U.S. pharmaceutical companies brought actions in Norwegian courts in 2005 alleging infringement by these new entrants. Norwegian Health Ministry officials have been considering, but not yet acted upon, proposals to amend the public health care system's drug reimbursement regulations to bar pharmacies from substituting generics for branded drugs that have process patents.

Transparency on pricing, reimbursement decisions, and recommendations is lacking. U.S. pharmaceutical products often face lengthy delays in securing approval for their products' inclusion in the state health care reimbursement scheme. Reimbursement and approval decisions are complex and political, with Parliament making final decisions as part of its budget process.

The Norwegian Medicines Agency (NMA) added another potential hurdle to reimbursement approvals in 2005 by denying a U.S. pharmaceutical manufacturer's reimbursement application for lack of documentary proof – which would have taken several years to develop – that the costs of the drug in question compared reasonably with its treatment value and the costs of alternative treatments. The NMA's procedures for reviewing reimbursement applications neither require such cost-benefit data nor make them a factor in reimbursement decisions. The drug at issue is reimbursed in all EU countries except Denmark, and no other EU country requested such data as a condition of approving reimbursement. Requiring manufacturers to perform multi-year cost-benefit studies of medically approved pharmaceuticals as a condition of reimbursement will result in significant additional costs and delays in bringing new drugs to the Norwegian market.

U.S. pharmaceutical manufacturers cite Norway's total prohibition of supplying product information to consumers – ranging from advertising to scientific data – as a barrier to market entry and expansion. Consumers are not fully informed about pharmaceutical innovations, dampening demand for new products and sometimes delaying consumer access to the latest medicines.

The Norwegian Association of Pharmaceutical Manufacturers, which includes U.S. pharmaceutical firms, has complained about Norway's inadequate implementation of EU directives on transparency of measures regulating medicinal products for human use. Although Norway complies with the letter of EU requirements that reimbursement applications be acted on within 180 days, Norwegian authorities often reject applications as the period expires, giving them an unlimited amount of time to consider applications once appealed.

OMAN

TRADE SUMMARY

The U.S. goods trade balance with Oman went from a deficit of \$88 million in 2004 to a goods trade surplus of \$38 million in 2005. U.S. goods exports in 2005 were \$593 million, up 79.7 percent from the previous year. Corresponding U.S. imports from Oman were \$555 million, up 32.8 percent. Oman is currently the 75th largest export market for U.S. goods.

The stock of U.S. foreign direct investment (FDI) in Oman 2004 was \$438 million, up from \$358 million in 2003.

After consultations with Congress, the United States began Free Trade Agreement (FTA) negotiations with Oman in March 2005. On October 3, 2005, the two sides announced the conclusion of the negotiations. On January 19, 2006, U.S. Trade Representative Rob Portman and Omani Minister of Commerce and Industry Maqbool bin Ali Sultan signed the agreement.

IMPORT POLICIES

Tariffs

As a member of the Gulf Cooperation Council (GCC), Oman applies the GCC common external tariff of five percent to most products, with a limited number of GCC-approved country-specific exceptions. Oman's exceptions to the common external tariff include 100 percent tariff rates on pork and alcohol products, 100 percent on cigarettes, a 25 percent duty on edible oils sold in retail packaging, as well as protective duties on a limited number of products such as dried lemons, bananas, dates, and ghee.

Upon entry into force of the U.S.-Oman FTA, 100 percent of bilateral trade in industrial and consumer products, with the exception of certain textile and apparel products, will become duty-free. In addition, Oman will provide immediate duty-free access on virtually all products in their tariff schedule and will phase out tariffs on the remaining handful of products within ten years. On agricultural products, Oman will provide immediate duty-free access for U.S. agricultural products in 87 percent of agricultural tariff lines. Oman will phase out tariffs on the remaining products within ten years.

Import Licensing

In Oman, companies that import goods must be registered with the Ministry of Commerce and Industry. Importation of certain classes of goods, such as alcohol, livestock, poultry and their respective products, firearms, narcotics and explosives, requires a special license. Media imports are subject to censorship.

FOREIGN TRADE BARRIERS

Documentation Requirements

Except for food products, an authentication procedure is not required if the importing company has an existing agency agreement with a U.S. exporter. In 1996, Oman began the process of simplifying customs clearance documentation to expedite the flow of goods and promote its ports and airports. Only Omani nationals and companies of WTO members that are registered as importers are permitted to submit documents to clear shipments through customs.

Customs Valuation

Oman implemented the Customs Valuation Agreement when it joined the WTO in 2000, and is working to further enhance its customs valuation system.

STANDARDS, TESTING, LABELING AND CERTIFICATION

Oman is working to revise its shelf-life requirements for shelf-stable foods and implementing CODEX standards. In its accession to the WTO, Oman committed to eliminate mandatory shelf-life standards for shelf-stable foods, establish regulations and procedures in line with international norms for highly perishable refrigerated food products, and replace remaining shelf-life requirements with a science-based regulatory framework. In 2000, Oman announced by Royal Decree its intention to adopt internationally recognized standards developed by Codex Alimentarius for the labeling of prepackaged food.

GOVERNMENT PROCUREMENT

Oman provides a 10 percent price preference to tenders that contain a high content of local goods or services, including direct employment of Omanis. The government considers the quality of a product or service and support, as well as cost, in evaluating bids. For most major tenders, Oman typically invites bids from firms either already registered in Oman or pre-selected by project consultants. To increase transparency in the tendering process, Oman advertises tenders in the local press, international periodicals, and on the Tender Board's website. Also, bidders are now requested to be present at the opening of bids, and interested parties may view the process on the Tender Board's website. In the past, bidders' costs have sometimes increased dramatically when award decisions were delayed, sometimes for years, or when bidding was reopened with modified specifications and, typically, short deadlines. Offsets are not standard requirements in defense procurement and have not been associated with any defense-related transactions involving U.S. companies.

When the U.S.-Oman FTA enters into force, Oman will be required to conduct procurement covered by the FTA in a fair, transparent, and non-discriminatory manner. As part of its WTO accession, Oman committed to begin negotiations to join the WTO Agreement on Government Procurement.

INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

The U.S.-Oman FTA commits Oman to provide and enforce world-class IPR protection. Prior to entry into force, Oman will draft additional legislation to comply with these obligations. Under its FTA obligations, Oman has committed to provide increased IPR protection for copyrights, trademarks, geographical indications, and patents. Oman will also improve enforcement and protection of undisclosed test data from unfair commercial use.

As part of its WTO accession, Oman adopted derogations to the GCC patent law to comply with its obligations under the TRIPS Agreement. In 2000, Oman amended its copyright protection law, and in 1999 enacted decrees banning the local sale of pirated videocassettes, sound recordings, and computer software. Enforcement of the copyright protection decree by the Ministry of Heritage and Culture, the Ministry of Commerce and Industry, and the Royal Oman Police has been largely effective, as once plentiful pirated video and audiotapes and computer software have largely disappeared from local vendors' shelves. Nonetheless, under-the-counter sales of unauthorized software and DVDs persist in various locations, and authorities continue to grapple with effective enforcement measures against such sales. Forty Omani companies have signed the Business Software Alliance (BSA) Code of Ethics since October 2003. The Code of Ethics declares that the signatories would neither commit nor tolerate the manufacture, use, or distribution of unlicensed software and would supply only licensed software to customers. According to local satellite television representatives, the Ministry of Commerce and Industry conducts periodic raids on unlicensed distributors of pirated satellite signals in response to industry complaints.

SERVICES BARRIERS

Agent and Distributor Rules

Since 1993, Oman has permitted an importer to bring in goods without paying a commission to a registered agent, if the goods are imported through an Omani port or airport. However, it is difficult for a foreign firm to sell directly to the government without an Omani agent identifying and bidding on tender opportunities. In addition, termination of an agency agreement can be difficult, as a supplier may not unilaterally terminate an agency agreement without justifiable cause. Since September 1996, Oman has registered non-exclusive agency agreements. Most recently, Oman has attempted to address unemployment through local-hire requirements, limiting distribution from food wholesale centers, and restricting small grocery food retail sales to businesses owned and operated by Omani nationals.

Insurance

As part of its WTO commitments, Oman is allowing foreign ownership of up to 100 percent in most insurance sectors, except for brokerage companies, which are restricted to a 70 percent limit.

FOREIGN TRADE BARRIERS

Banking

Omani laws permit the operation of foreign banks. Although Oman barred entry of new non-GCC banks in the past on the grounds of excess capacity in the sector, it has recently licensed the State Bank of India to commence operations. Oman does not permit representative offices or offshore banking.

INVESTMENT BARRIERS

The U.S.-Oman FTA establishes a secure, predictable legal framework for U.S. investors operating in Oman. Among other things, Oman will have to provide U.S. investors in Oman most-favored-nation treatment and national treatment, the right to make financial transfers freely and without delay, international law standards for expropriation and compensation cases, and access to international arbitration. All forms of investment will be protected under the Agreement, including enterprises, debt, concessions, contracts, and intellectual property. As a result, U.S. investors in almost all circumstances will be able to establish, acquire, and operate investments in Oman on an equal footing with Omani investors and with investors of other countries. The FTA also prohibits the imposition of certain restrictions on U.S. investors, such as requirements to buy Omani rather than U.S. inputs for goods manufactured in Oman.

PAKISTAN

TRADE SUMMARY

The U.S. goods trade deficit with Pakistan was \$2.0 billion in 2005, an increase of \$945 million from \$1.1 billion in 2004. U.S. goods exports in 2005 were \$1.2 billion, down 31.2 percent from the previous year. Corresponding U.S. imports from Pakistan were \$3.3 billion, up 13.2 percent. Pakistan is currently the 57th largest export market for U.S. goods.

The stock of U.S. foreign direct investment (FDI) in Pakistan in 2004 was \$991 million, up from \$790 million in 2003.

IMPORT POLICIES

Since 1998, Pakistan has progressively and substantially reduced tariffs and liberalized imports. This effort culminated in June 2002 with the establishment of four maximum import tariff bands of 5 percent, 10 percent, 20 percent, and 25 percent. Generally, Pakistan's applied tariffs are below WTO-bound commitments, and the weighted average applied tariff is currently 15.2 percent, down from 56 percent in 1994. The tariff on most consumer goods was reduced to 25 percent, for most intermediate goods to 10 percent, and for most raw materials to 5 percent.

In November 2000, Pakistan reached an agreement with the WTO Balance of Payments Committee to phase out quantitative restrictions on textile imports and to remove all textile products from its "negative list." All textile products can now be imported into Pakistan, although the tariff on certain synthetic fibers (scheduled to expire in 2008) remains relatively high.

Pakistan's trade policy in 2005 continued to ban the import of 30 items, mostly on religious, environmental, security, and health grounds. Effective July 1, 2005, Pakistan further reduced duties on imported automobiles to between 50 percent and 75 percent from the previous range of 75 percent to 150 percent. The government exempted all domestically produced pharmaceutical related inputs from its General Sales Tax (GST), a value-added tax (VAT), through a Statutory Regulatory Order issued in April 2002. Imported pharmaceutical inputs subject to a 10 percent customs duty are also exempt from payment of GST. This includes most, but not all, imported pharmaceutical inputs. In FY2005, the Pakistani government further reduced duties on instant print film and instant print cameras to 5 percent from the prior 30 percent to 200 percent range in order to eliminate the incentive to smuggle.

The Government of Pakistan reserves the right to grant sector-specific duty exemptions, concessions, and protections under Statutory Regulatory Orders (SROs). In recent years, the use of SROs has decreased. SROs and other trade policy and regulatory documents are published on the Central Board of Revenue's website, www.cbr.gov.pk.

FOREIGN TRADE BARRIERS

In January 2000, the Pakistani government began implementing a transactional valuation system, pursuant to which 99 percent of import valuation is based on invoice value, in accordance with the WTO's Customs Valuation Agreement. Currently, about 90 percent of imports are assessed duties pursuant to the transactional valuation system. A number of traders in food and nonfood consumer products, however, report experiencing irregularities and deviations in the application of that system.

A U.S. freight forwarding company reported in 2005 that Pakistan imposed a new SRO requiring that the commercial invoice and the packing list must be included within a container. This practice is difficult in situations when shipments originate from a location that is different from where the invoice and packing list are created; when, for security, invoices are created after the shipment departs; or when several companies are involved.

STANDARDS, TESTING, LABELING, AND CERTIFICATION

The Pakistan Standards and Quality Control Authority (PSQCA) is the national standards body. As of June 30, 2005, the end of Pakistani Fiscal Year 2005, PSQCA had established over 21,000 standards (including 15,500 ISO standards) for agriculture, food, chemicals, civil and mechanical engineering, electronics, weights and measures, and textile products. However, no new standards were approved in 2005.

Testing facilities for agricultural goods are inadequate and standards are inconsistently applied, which U.S. industry contends has resulted in occasional discrimination against U.S. farm products. Generally, however, U.S. exporters have not reported problems due to the restrictive application of sanitary, phytosanitary, or environmental standards. Pakistan accepts most U.S. standards.

The Government of Pakistan approved biosafety guidelines and rules in April 2005, but the action plan to implement these guidelines is still pending with the government. At present Pakistan has permitted the import of biotech soybeans. The delay in the implementation of biosafety guidelines, however, has impeded the introduction of other U.S. biotechnology products that could significantly boost Pakistan's agricultural productivity, rural incomes, and overall GDP.

GOVERNMENT PROCUREMENT

Pakistan is not a member of the WTO Government Procurement Agreement. Government contracts are often awarded through publicly issued tender notices or are issued to registered suppliers. The government established the Public Procurement Regulatory Authority in May 2002, in order to strengthen procurement practices. International tender notices now are publicly advertised and sole source contracting using company-specific qualifications has been eliminated. There are no "buy national" policies.

FOREIGN TRADE BARRIERS

Political influence on procurement decisions, charges of official corruption, and long delays in bureaucratic decision-making have been common in the past. Investors have reported instances when the government used the lowest bid as a basis for further negotiations, rather than accepting the lowest bid under its tender rules. The Pakistani government does not invite tenders from private-sector companies for the transportation of crude oil and requires all transport of crude oil to be conducted by the state-owned Pakistan National Shipping Corporation.

EXPORT SUBSIDIES

Pakistan actively promotes the export of Pakistani goods with measures such as tariff concessions on imported inputs and income and sales tax concessions. Subsidies in FY2005 were confined mostly to wheat and totaled roughly \$21.8 million, according to government sources. The government also provides freight subsidies to some products and these subsidies totaled close to \$23.5 million in FY2005. Pakistan established its first Export Processing Zone (EPZ) in Karachi in 1989, with special fiscal and institutional incentives available to encourage the establishment of exclusively export-oriented industries. The government subsequently established additional EPZs in Risalpur, Gujranwala, Sialkot in Punjab Province, and Saindak and Duddar in Balochistan Province. Principal government incentives for EPZ investors include an exemption from all federal, provincial, and municipal taxes for production dedicated to exports; exemption from all taxes and duties on equipment, machinery, and materials (including components, spare parts and packing material); indefinite loss carryforward; and access to Export Processing Zone Authority "One Window" services, including facilitated issuance of import permits and export authorizations.

INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

The Government of Pakistan has taken noticeable steps to improve copyright enforcement in 2005, especially for optical discs. Nevertheless, Pakistan does not provide adequate protection of all intellectual property. Book piracy, weak trademark enforcement, lack of data protection for proprietary pharmaceutical and agricultural chemical test data, and problems with Pakistan's pharmaceutical patent protection, remain as serious barriers to trade and investment. The U.S. Government placed Pakistan on the Special 301 "Watch List" from 1989 to 2003 due to widespread piracy, and continuing IPR violations prompted the U.S. Government to place Pakistan on the Special 301 Priority Watch List in 2004 and 2005. In early 2005, Pakistan was among the world's leading producers of pirated optical discs and other copyrighted material, but took significant steps to shut down pirate optical disc production and exports of pirate optical discs later in the year. The Government of Pakistan has identified intellectual property protection as a key area for its "second generation" economic reforms. Pakistan has enacted five major new laws relating to patents, copyrights, trademarks, industrial designs and layout designs for integrated circuits in the past few years, but their impact has been limited by weaknesses in the legislation and/or enforcement. In 2005, measures were implemented that, if sustained, could lead to improvement in several longstanding IP problem areas.

FOREIGN TRADE BARRIERS

In August 2005, in response to longstanding domestic and international criticism of Pakistan's lack of a functioning central IPR regulatory and enforcement authority, as well as the need to implement its WTO TRIPS obligations, the Pakistani President created the Intellectual Property Rights Organization of Pakistan (IPO). IPO, an autonomous body under the administrative control of the Government of Pakistan's Cabinet Division, consolidates into one government body authority over trademarks, patents, and copyrights – areas that were previously handled by offices in the three separate ministries. IPO will initiate and monitor the enforcement and protection of intellectual property rights through law enforcement agencies, in addition to dealing with other IPR related issues. While IPO's establishment represents an important milestone, its success in the coming year will be gauged by whether it leads to measurable results in terms of increased public awareness of intellectual property rights, stepped up enforcement, and prompt action to address specific legislative and policy weaknesses.

In April 2005, in an effort to improve the protection of intellectual property within Pakistan, the Government of Pakistan transferred inter-agency responsibility for the enforcement of intellectual property laws to the Federal Investigation Agency (FIA). FIA staff has received specialized training in intellectual property enforcement and technologies, which has enabled the agency to expand enforcement operations to target manufacturers of pirated goods. Key challenges ahead will be to expanding manpower and training at the FIA, including the possible establishment of a dedicated IP enforcement unit.

Pakistan is a party to the Berne Convention for the Protection of Literary and Artistic Works, and is a member of the World Intellectual Property Organization (WIPO). On July 22, 2004, Pakistan acceded to the Paris Convention for the protection of industrial property. Pakistan has not yet ratified the WIPO Copyright Treaty nor the WIPO Performance and Phonograms Treaty. A draft law concerning plant breeders' rights has not progressed because of a dispute over federal and provincial jurisdiction for the past two years.

Patents

Pakistan enacted a patent law in 2000 that protects both process patents and product patents in accordance with its WTO obligations. Under this law, both the patent-owner and licensees can file suit against those who infringe. Unfortunately, the 2002 Patent Ordinance weakened the 2000 Patent Law by eliminating use patents, restricting patent filings to single chemical entities, limiting protection for derivatives, and introducing barriers to patenting biotechnology-based inventions. This generated great concern among U.S. pharmaceutical firms seeking to sell patented drugs in Pakistan. Pakistan fails to protect against unfair commercial use of test or other data, a requirement under the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS). In addition, the Pakistani government has authorized the sale of pharmaceuticals without requiring checks confirming that another firm does not hold an active patent on the compound. Although courts have issued injunction orders against firms licensed by the Ministry of Health that sell drugs in violation of patent holder rights, such orders are not consistently enforced. Patent theft is exacerbated by the fact that it often takes one or two years to register drugs in Pakistan. During this registration process, the government also sets prices - often at levels that do not reflect the cost of developing the product.

Trademarks

Pakistan developed its Trademarks Ordinance in 2000, which provides for the registration and better protection of trademarks and for the prevention of the use of fraudulent marks. The ordinance has been enforced since April 2004 with the enactment of implementing rules. The government has eliminated the requirement that pharmaceutical firms label the generic name on all products with at least equal prominence as that of the brand name. Trademark infringement remains widespread.

Copyrights

According to the International Intellectual Property Association, copyright piracy rates in 2005 in Pakistan remained at 100 percent for records and music and 83 percent for business software (no figures were available for motion pictures, entertainment software, or published books). CD and DVD losses were dropped from \$70 million in 2004 to \$25 million in 2005, a noticeable decrease. Pakistan was a major exporter of pirated optical discs before its recent enforcement efforts.

Pakistan carried out a meaningful increase in enforcement activity against pirated optical discs in 2005. In May, Pakistan's Federal Investigation Agency (FIA) raided and closed six major illegal disc plants outside of Karachi. Additional raids on other production facilities continued throughout the year. These cases are pending before Pakistani courts. These raids corresponded to anecdotal reports of fewer pirated copyright goods available in the markets of Pakistan. Book piracy and business software end-user piracy still remain serious problems.

SERVICES BARRIERS

Pakistan generally permits foreign investment in services, subject to certain provisions including a minimum initial capital investment of \$150,000 (investment requirements are higher in financial services – see below). Recent changes in the government's investment policy permit foreign investors to hold up to a 100 percent equity stake and allow 100 percent repatriation of profits. These 2004 changes reduced the \$300,000 minimum initial capital investment requirement in the services sector, eliminated the requirement that foreign investors accumulate 40 percent local equity within five years of initial investment, and eliminated the cap on repatriation of profits at a maximum of 60 percent of total equity or profits.

Investment policy also allows foreign investors in services and other non-manufacturing sectors (including international food franchises) to remit royalties and technical fees, subject to certain conditions. In information technology services, including software development, foreign investors are not subject to the requirements for minimum initial investment.

FOREIGN TRADE BARRIERS

Telecommunications

In July 2003, the Pakistani government announced a telecommunications sector deregulation policy in order to comply with its WTO commitments and encourage growth in the sector. Implementation of this policy has ended the exclusive right of the Pakistan Telecommunication Company Limited (PTCL) to provide basic telephone services, and the government has issued 13 licenses to long distance telephone companies (10 of which have commenced operations), 72 licenses to local loop regional telephone companies (three of which are operating) and 92 licenses to wireless local loop companies (four of which are operating).

In early 2005, as part of its privatization program, the Government of Pakistan invited international bids on a 26 percent stake, along with management control, in PTCL. Etisalat, a UAE-based company, was named the winning bidder in July 2005. Despite the privatization of PTCL, the ability of telecom companies to operate in Pakistan will depend on access to PTCL infrastructure. Pakistan currently allows the cross border provision of packet-switched data and Internet services. Roughly 70 private firms, including foreign invested companies, provide Internet services, and the government has issued licenses to 55 more companies. At present, the government does not issue exclusive licenses for voice-over-internet providers (VoIP), but long distance telephone license holders can also provide VoIP services.

Competition among service providers is already allowed in cellular telephony. The Government of Pakistan permits 100 percent foreign equity in most telecommunications services, including electronic information services, pre-paid telephone services, paging services, and voice mail services.

Limitation on Foreign Films

The Government of Pakistan prohibits the importation of films that are deemed inconsistent with local religious and cultural standards. Films from neighboring India are routinely denied entry via cable transmission or video/digital media, but are widely available in pirated form.

Banking and Insurance

Pakistan improved its financial services commitments in the WTO Financial Services Agreement in December 1997. These commitments grant the right to establish new banks as well as grandfathering acquired rights of established foreign banks and foreign securities firms. The State Bank of Pakistan (SBP), Pakistan's central bank, has changed its branch licensing policy and has eliminated restrictions on the number of branches for foreign banks. Currently, foreign banks, like local banks, have to submit an annual branch expansion plan to the SBP for approval. The SBP approves new branch openings based on the bank's net worth, adequacy of its capital structure, future earning prospects, credit disciplines, and the needs of the local population. Foreign brokers, like their Pakistani counterparts, must register with the Securities and Exchange Commission of Pakistan. Over the past several years, Pakistan has privatized the majority of its commercial banks (most of which had previously been nationalized).

As of January 2006, 80 percent of the commercial banking sector is now privately owned, and the Government of Pakistan only retains an ownership stake in the National Bank of Pakistan, the nation's largest commercial bank.

The government has opened the insurance market as one of its financial sector reforms. Foreign investors are allowed to hold up to a 51 percent equity share of companies operating in the life and general insurance sectors. Foreign investors are also required to bring in a minimum of \$2 million in foreign capital and raise an equal amount of equity in the local market. There are no restrictions on the repatriation of profits, and capital investment made in this sector can be repatriated with the permission of the SBP. Pakistan does not regulate insurance premiums. The government issued a new insurance law in 2000 that raised capital adequacy standards and enhanced policyholder protections.

The government permits only the parastatal National Insurance Company to underwrite and insure public sector firms. Private sector firms must meet their reinsurance needs within the country. If domestic insurance companies cannot meet their reinsurance needs only then these companies can seek outside reinsurance facilities. Market domination in the insurance sector may pose a significant barrier to entry. The state-owned State Life Insurance Company holds over 76 percent of the life insurance market, although that number has been declining over the past several years. Five major domestically-owned companies account for 78 percent of the general insurance (property, casualty, and health) market.

Other Services

Foreign professionals can provide legal and engineering consultancy services with 100 percent equity participation. This reflects a change made in 2004 that eliminated the prior requirement that Pakistanis hold 40 percent local equity for five years and reduced the minimal capital requirement for investment in these services from \$300,000 to \$150,000. A legal consultant need not be licensed to practice law in Pakistan. Foreign lawyers, however, may not appear in court or otherwise formally litigate cases unless licensed, even if they work with local lawyers. The Islamabad-based Pakistan Bar Council licenses attorneys in Pakistan, and no *de jure* prohibition exists against the admission of foreign lawyers into the bar. Similarly, foreign doctors must, like their local counterparts, register with the Pakistan Medical and Dental Council, and foreign engineers must register with the Pakistan Engineering Council, in order to practice their respective professions in Pakistan.

INVESTMENT BARRIERS

Foreign investors are free to establish and own business enterprises in all sectors of the economy, with the exception of five restricted areas: arms and munitions, high explosives, currency/mint operations, radioactive substances, and new non-industrial alcohol plants. While foreign ownership in agricultural investments cannot exceed 60 percent, there are no ownership limits in other sectors of the economy. There is no minimum investment requirement for manufacturing, a \$150,000 minimum foreign investment requirement in non-financial services, and a minimum investment requirement of \$300,000 in agriculture, infrastructure projects, and social services (such as education and health).

FOREIGN TRADE BARRIERS

The government's investment policy promises full repatriation of capital, capital gains, dividends, and profits with the approval of the State Bank of Pakistan. No requirements exist for technology transfer. The law provides for expropriations only upon adequate compensation, and it prohibits changes in benefits and incentives for the purpose of disadvantaging foreign investors.

The Government of Pakistan has eliminated most, but not all, of the local content requirements that it reported to the WTO in 1995 under the Agreement on Trade-Related Investment Measures (TRIMS). In 1999, Pakistan's "deletion" program (mandating the use of domestic inputs) encompassed 106 items. As of December 2005, 16 items (all in the auto and motorcycle industries) remain. For these 16 items, Pakistan has petitioned for a three-year extension on its original deadline of December 31, 2003, to eliminate all deletions. At the end of 2005, the United States and other WTO Members were still considering this request. There are reports, however, that the Government of Pakistan is working on a plan to phase out the deletion program in its automobile sector, as many believe it is now serving as an impediment to new investment in that sector.

Although Pakistan has enacted a Monopolies and Restrictive Trade Practices Ordinance, and established a Monopoly Control Authority, regulatory oversight suffers from resource constraints. Moreover, state-owned firms are exempt from the provisions of this law. Thus, in the Pakistani market, where state-owned firms dominate several sectors, competition policy remains incomplete. The state-owned Water and Power Development Authority (WAPDA) retains control of power transmission and distribution throughout much of the country outside Karachi and continues to be highly subsidized. The privatization in 2005 of some major state-owned organizations, including Karachi Electric Supply Corporation (KESC) and Pakistan Telecommunication Company (PTCL), has reduced the state's role in power and telecommunications. The state, however, continues to hold equity stakes in important players in the oil and gas, civil aviation, power and steel sectors. In 2006, the Government of Pakistan plans to privatize Pakistan Steel (Pakistan's major steel producer), Sui Southern Gas Company (Pakistan's largest gas company), Pakistan State Oil (PSO) (Pakistan's largest gasoline retailer), and Oil and Gas Development Company (Pakistan's largest energy exploration company). In an effort to create market competition in former monopoly sectors, the Government of Pakistan has already issued licenses to long distance and local telephone operators, as well as to cellular and wireless local loop operators, ending PTCL's monopolies, and has licensed three private airlines to compete with state-owned Pakistan International Airlines. In retail food sales, the government has used pricing in its several hundred Utility Stores chain to create price competition in essential foodstuffs such as flour, rice and pulses. Market leaders in the cement and sugar industries are alleged to have formed cartels.

The United States and Pakistan have initiated negotiations on a Bilateral Investment Treaty (BIT), which would provide significant protections for U.S. investors in Pakistan. Three rounds of BIT negotiations were held in 2005, and meaningful progress was made on the basic text of an agreement in early 2006.

FOREIGN TRADE BARRIERS

ELECTRONIC COMMERCE

There are no trade restrictions, duties, or taxes on electronic commerce in Pakistan. Electronic commerce is, however, not well developed in Pakistan. In 2002, the Pakistani government enacted an Electronic Transactions Ordinance that adopted international standards and provided for the establishment of a certification authority. In 2005, one certification authority began functioning (as outlined in the ordinance) in the private sector. The Government of Pakistan is also planning to establish a certification authority in the public sector to meet governmental needs. The government blocks certain websites that contain content which it deems as conflicting with Pakistani religious and cultural norms.

OTHER BARRIERS

Businesses operating in Pakistan have repeatedly called for strengthening law and order. Corruption and a weak judicial system remain recurrent and substantial disincentives to investment. Pakistani laws targeting corruption include the 1947 Prevention of Corruption Act, the 1973 Efficiency and Discipline Rules, and most recently the 1999 National Accountability (NAB) Ordinance. Previously, the NAB, the Federal Investigation Agency (FIA), and Provincial Anti-Corruption Departments shared official responsibility for combating corruption.

In October 2002, Pakistan's cabinet approved a National Anti-Corruption Strategy (NACS) that identified areas of pervasive corruption and recommended time-bound measures and reforms to combat corruption. The NACS also named the NAB as the sole anticorruption agency at the federal level.

Contract enforcement is difficult in Pakistan. A long-standing investment dispute between a major U.S. multinational company and a local partner raised concerns about the sanctity of international arbitration awards under contracts between private parties. In June 2005, the Lahore Civil Court ruled in favor of the U.S. multinational company, upholding the original arbitration settlement. The local partner has exercised its right to file an appeal in the Lahore High Court; the appeal is still pending. In 2004, Pakistan's Cabinet approved Pakistan's joining the 1958 New York Convention on Recognition and Enforcement of Arbitral Awards. Pakistan's parliament, however, has not yet enacted legislation putting it into force.

Pakistan's ranking in the Transparency International's Corruption Perceptions Index dropped from 29th out of 145 countries in 2004, to 144th out of 158 countries listed in 2005. Pakistan scored 2.1 points on the Corruption Perception Index in 2005.

FOREIGN TRADE BARRIERS

PANAMA

TRADE SUMMARY

The U.S. goods trade surplus with Panama was \$1.8 billion in 2005, an increase of \$322 million from \$1.5 billion in 2004. U.S. goods exports in 2005 were \$2.2 billion, up 18.2 percent from the previous year. Corresponding U.S. imports from Panama were \$327 million, up 3.5 percent. Panama is currently the 45th largest export market for U.S. goods.

The stock of U.S. foreign direct investment (FDI) in Panama in 2004 was \$5.9 billion, up from \$5.5 billion in 2003. U.S. FDI in Panama is concentrated largely in the finance and wholesale sectors.

IMPORT POLICIES

Free Trade Negotiations

In April 2004, the United States and Panama began negotiating a free trade agreement (FTA). Negotiations proceeded through nine rounds, the most recent of which concluded in January 2006. U.S. and Panamanian negotiators continue to discuss ways forward to successfully conclude an FTA. A bilateral FTA with Panama would be a natural extension of an already largely open trade and investment relationship. Panama is unique in Latin America in that it is predominantly a services-based economy, as services represent about 80 percent of Panama's GDP. Following passage of the U.S. FTA with Central America and the Dominican Republic (CAFTA-DR), a bilateral FTA with Panama could further boost momentum for lowering trade and investment barriers throughout the region.

Tariffs

Following its accession to the World Trade Organization (WTO) in 1997, Panama opened its markets considerably and its applied tariffs ranked among the lowest in Latin America, averaging just 8 percent. In September 1999, however, Panama raised selected agricultural tariffs, some of which reached the maximum amount allowed under Panama's WTO commitments. For example, Panama retains tariffs of 273 percent for chicken, 63 percent to 159 percent for dairy products, 83 percent for tomatoes and over-quota potatoes, 74 percent for pork, 55 percent for rice, 20 percent on sparkling wine and other fermented beverages, and 40 percent on still wines. In addition, Panama charges a 10 percent tax on wine products. Panama also increased the tariff on frozen french fries from 15 percent to 20 percent. Through the ongoing FTA negotiations, the United States is seeking substantial new market access for U.S. exporters.

FOREIGN TRADE BARRIERS

Non-Tariff Measures

In addition to tariffs, all imports into Panama are subject to a 5 percent transfer (or ITBM) tax levied on the CIF value and other handling charges. Pharmaceuticals, foods, and school supplies are exempt from the transfer tax. Currently, Panama does not require import licenses on manufactured goods entering the country, provided the importing entity holds a commercial or industrial license to operate in Panama.

STANDARDS, TESTING, LABELING, AND CERTIFICATION

With certain exceptions, Panama's application of standards and certification requirements generally conform to WTO standards. However, restrictions have been applied at times, apparently in order to protect local producers. Of particular concern has been the lack of procedural transparency by relevant Panamanian authorities in deciding whether to issue phytosanitary permits.

Panama requires that Panamanian health and agriculture officials certify individual U.S. processing plants as a precondition for the import of poultry, pork, dairy, and beef products. U.S. exporters have assisted Panamanian officials in inspecting U.S. plants and there have been no instances of a failed inspection by a U.S. plant. Inspections, however, are often delayed due to budgetary constraints and the lack of personnel in the responsible Panamanian ministries. As such, it is the United States' priority to obtain Panamanian recognition of the U.S. meat inspection system in place of the current plant-by-plant approach. This effort is a primary focus of the ongoing FTA negotiations.

In December 2003, following detection of the first case of bovine spongiform encephalopathy (BSE), or "Mad Cow" disease in the United States, the Panamanian Agriculture Ministry banned the importation of U.S. beef. The ban remained in place until March 2005, despite U.S. assurances that BSE-infected beef never entered the human food supply. Shortly after the United States discovered a second BSE case, the Agriculture Ministry reinstated the ban in May 2005. Following questionable reporting requirements imposed on the U.S. Department of Agriculture and problematic delays, the Agriculture Ministry lifted the ban in October 2005. The Agriculture Ministry acted slowly to resume issuance of import permits for U.S. beef. Before the ban, Panama imported an estimated 12,000 pounds (5,400 kilograms) of U.S. beef annually.

Panama's import licensing process is often arbitrary and non-transparent, constituting a major impediment for U.S. exporters. For example, Panamanian importers of U.S. processed potatoes have had difficulties obtaining import permits in 2003 and 2004. In one instance, arguing that U.S. processed potatoes compete directly with domestic fresh potatoes, the Panamanian government refused to issue import permits for frozen french fries, disrupting the extensive quick service restaurant industry within the country.

While importers of non-agricultural products must register them with the Ministry of Commerce and Industry before distribution or sale in Panama, procedures for registration are usually straightforward and evenly applied.

FOREIGN TRADE BARRIERS

There is no comprehensive labeling or testing requirement for imports, except for food and pharmaceutical products. U.S. industry is seeking a commitment from the Panamanian government to provide explicit recognition of Bourbon and Tennessee Whiskey as a trademark.

When the United States launched FTA negotiations in 2004, it simultaneously initiated a working group on SPS barriers to agricultural trade to meet in parallel with the negotiations and to work on resolution of SPS issues even after the negotiations conclude.

GOVERNMENT PROCUREMENT

Panama's government procurement regime is governed by Law 56 and managed by the Ministry of Economy and Finance (MEF). The law provides for a transparent bidding process for government contracts, but allows for exceptions, such as for procurements relating to national defense. The Panamanian government has generally handled bids in a transparent manner, although occasionally U.S. companies have complained of mishandling of certain procedures.

While Panama committed to become a party to the WTO Agreement on Government Procurement (GPA) at the time of its WTO accession, its efforts to accede to the GPA have stalled. Although the Panama Canal Authority (PCA) has generally followed transparent and fair bidding processes, the United States was disappointed by the Government of Panama's exclusion of the PCA from its GPA accession offer. The U.S. government is currently addressing the issue of the coverage of the PCA in the bilateral FTA negotiations to help ensure a strong government procurement package that would give U.S. businesses fair opportunities to bid on Panama Canal procurements, including a planned expansion of the Panama Canal, assuming Panamanian voters ultimately approve the future referendum on Canal expansion and modernization.

EXPORT SUBSIDIES

Panamanian law allows any company to import raw materials or semi-processed goods at a duty of three percent for domestic consumption or processing, or duty free for export production, except for sensitive agricultural products such as rice, dairy, pork, and tomato products. Companies not already receiving benefits under the Special Incentives Law of 1986 were allowed a tax deduction of up to 10 percent of their profits from export operations through 2005.

Due to its WTO obligations, Panama revised its export subsidy policies in 1997-98. The government originally had stated its intention to phase out its Tax Credit Certificate (CAT), which was given to firms producing certain non-traditional exports, by the end of 2001. During the WTO Ministerial Conference in November 2001, however, the Government of Panama asked for and received an extension for the use of CATs. The WTO extended this waiver until December 2006, allowing exporters to receive CATs equal to 15 percent of the export's national value added.

FOREIGN TRADE BARRIERS

The certificates are transferable and may be used to pay tax obligations to the government, or they can be sold in secondary markets at a discount. The government has, however, become stricter in defining national value added, in an attempt to reduce the amount of credit claimed by exporters.

In addition, a number of export industries, such as shrimp farming and tourism, are exempt from paying certain types of taxes and import duties. The Government of Panama established this policy to attract foreign investment, especially in economically depressed regions, such as the city of Colon. Companies that profit from these exemptions are not eligible to receive CATs for their exports.

A new domestic subsidy called the Certificate to Foment Industry (CFI), designed to replace the CATs when they end, was enacted by the former Moscoso administration in February 2004. Although the previous government had maintained that the CFI would be consistent with Panama's WTO obligations, the Torrijos administration repealed the measure after entering office in September 2004.

Other Export-Related Items

The Tourism Law of 1994 (Law 8) allows a deduction from taxable income of 50 percent of any amount invested by Panamanian citizens in tourism development.

Law 25 of 1996 provides for the development of export processing zones (EPZ's) as part of an effort to broaden the Panamanian manufacturing sector while promoting investment, particularly in relation to former U.S. military bases. Companies operating in these zones may import inputs duty-free if products assembled in the zones are to be exported. The government also provides other tax incentives to EPZ companies.

INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

Intellectual property policy and practice in Panama is the responsibility of an "Inter-institutional" Committee. This committee consists of representatives from six government agencies and operates under the leadership of the Vice-Minister of Foreign Trade. It coordinates enforcement actions and develops strategies to improve compliance with the law. The creation of specialized prosecutors for intellectual property-related cases has strengthened the protection and enforcement of intellectual property rights (IPR) in Panama. Given Panama's role as a transshipment point, however, the industry is concerned Panama will become susceptible to trading in pirated and counterfeit goods.

Strengthening and improving Panama's overall regime for the protection and enforcement of intellectual property rights in a broad range of areas is an important objective of the ongoing FTA negotiations.

Patents

Panama's 1996 Industrial Property Law provides a term of 20 years of patent protection from the date of filing. Pharmaceutical patents, however, are granted for only 15 years and can be renewed for an additional ten years if the patent owner licenses a national company (minimum of 30 percent Panamanian ownership) to exploit the patent. The United States' position is that discrimination against pharmaceutical patents is inconsistent with Panama's TRIPS obligations, and the U.S. is working with Panama to remedy this.

Copyrights

Though Panama's 1994 copyright law modernized copyright protection and its 2004 update created a special Copyright Office with anti-piracy enforcement powers, piracy remains a significant problem.

The government of Panama is a signatory to the WIPO Copyright Treaty and the WIPO Performances and Phonographs Treaty, but the Copyright Office has been slow to draft and implement further improvements to the Copyright Law. Nevertheless, the office has proposed to enhance border measures and establish new punishable offenses, such as for Internet-based copyright violations.

Though U.S. industry welcomes both the effective police and legal action, which have significantly reduced the rate of VHS piracy, internet piracy is quickly emerging as a problem in Panama. Both hard goods sales and films in theatrical release are often downloaded, reproduced on optical discs, and then distributed by street vendors. U.S. industry is concerned that Panama has the potential to become a regional transshipment point for pirated optical discs in the region. Despite ongoing investigations to detect laboratory facilities, the legal framework guiding internet use in the country remains incomplete. The United States is working with Panama through the current FTA negotiations to establish a legal regime to combat piracy of audiovisual products over the Internet, including notice and take down provisions and clearly defined Internet Service Provider (ISP) liabilities and copy protection measures.

Trademarks

Law 35 provides trademark protection, simplifies the process of registering trademarks and allows for renewal of a trademark for ten-year periods. The law's most important feature is the granting of *ex-officio* authority to government agencies to conduct investigations and to seize materials suspected of being counterfeited. Decrees 123 of November 1996 and Decree 79 of August 1997 specify the procedures to be followed by Customs and Colon Free Zone (CFZ) officials in conducting investigations and confiscating merchandise. In 1997, the Customs Directorate created a special office for IPR enforcement, followed by a similar office created by the CFZ in 1998. The Trademark Registration Office has undertaken significant modernization with a searchable computerized database of registered trademarks that is open to the public.

INVESTMENT BARRIERS

Panama maintains a largely open investment regime and is receptive to foreign investment. Over the years the country has bolstered its reputation as an international trading, banking, maritime, and services center.

Under the constitution, however, retail activity is reserved to Panamanians—an issue that the U.S. government seeks to address within the context of FTA negotiations. On a variety of investment issues, the Panamanian government has been, until recently, often unresponsive to concerns raised by U.S. investors. For example, a few firms that are closely regulated by, or hold concessions from the Government of Panama, in the past encountered a lack of cooperation from certain officials and abrupt changes related to terms of various concessions or contracts. In 2003, the Government of Panama addressed these problems constructively by re-opening discussion with the U.S. Government via the “Ad Hoc Investment Commission” (comprised of officials from the U.S. Embassy and Panama’s Ministry of Commerce), which had been used successfully in the past to resolve concerns of U.S. investors. This advanced the resolution of a number of investment disputes and helped open the way for the start of bilateral FTA negotiations.

The U.S.-Panama Bilateral Investment Treaty (BIT) entered into force in 1991 (with additional amendments in 2001). With some exceptions, the BIT ensures that U.S. investors receive fair, equitable and non-discriminatory treatment and that Parties abide by international law standards such as for expropriation and compensation and free transfers. Conclusion of a bilateral FTA would suspend the availability of both investor-state and state-state dispute settlement under the BIT and replace it with investor-state and state-state dispute settlement under the FTA.

A 1998 investment law aims to enhance new investment in Panama by guaranteeing that investors will have no restrictions on capital and dividend repatriation, foreign exchange use, and disposal of production inside a limited number of sectors in the economy. For a period of ten years, investors will not suffer any deterioration of the conditions prevailing at the time the investment was made.

ELECTRONIC COMMERCE

In mid-2001, Panama became the first country in Central America to adopt a law specific to electronic commerce. The law was a collaborative effort between the public and private sectors, resulting from several months of detailed discussions and broad consultations. Panama's electronic commerce law has several important features: it gives legal force to any transaction or contract completed electronically; it creates the National Directorate of Electronic Commerce to oversee the enforcement of the law; and it defines certification organizations and establishes a voluntary registration regime. In addition, in August 2004, partial regulations to the 2001 law were issued to facilitate the registration of certification organizations. The law is expected to have a favorable impact on many sectors of Panama's services dominated economy, particularly the maritime sector.

FOREIGN TRADE BARRIERS

OTHER BARRIERS

Panama's judicial system can pose a problem for investors due to poorly trained personnel, huge case backlogs and a lack of independence from political influence. Amid persistent allegations of corruption in the government, particularly in the judiciary, the Torrijos Administration has committed itself to combating corruption as part of its overall agenda of institutional reform.

PARAGUAY

TRADE SUMMARY

The U.S. goods trade surplus with Paraguay was \$844 million in 2005, an increase of \$280 million from \$564 million in 2004. U.S. goods exports in 2005 were \$896 million, up 43.8 percent from the previous year. Corresponding U.S. imports from Paraguay were \$51 million, down 12.5 percent. Paraguay is currently the 67th largest export market for U.S. goods.

The stock of U.S. foreign direct investment (FDI) in Paraguay in 2004 was not available, \$115 million in 2003.

IMPORT POLICIES

Tariffs

Paraguay is a member of MERCOSUR, a customs union comprising Argentina, Brazil, Paraguay, and Uruguay. Full Common External Tariff (CET) product coverage is scheduled for implementation in 2006. CET tariffs range from zero percent to 35 percent *ad valorem*, with a limited number of country-specific exceptions. Currently, Paraguay maintains 399 exceptions to the CET. A temporary CET surcharge applied to most imports since 1997 was abolished by Paraguay on January 1, 2004. Paraguay's average applied tariff rate was 14.5 percent in 2004.

Customs Procedures

For exports to Paraguay, a Paraguayan consulate in the country of export must certify specific documentation, such as the commercial receipt, certificate of origin, and cargo manifest. If there is no Paraguayan consulate in the country of export, the documents can be certified in the nearest country with a consulate or in the border consulate office in the country from which the exports enter Paraguay (in the case of ground or river shipments). Multiple changes in procedures make it difficult for exporters to ensure they are following the most current procedures, which can delay shipments and lead to unexpected costs. The burden of compliance is most often borne by importers. Some of the changes implemented in 2005 result from the January 2005 adoption of a new customs code, and the government's stated intention is to streamline import procedures.

Customs Valuation

On September 21, 2004, Paraguay notified the World Trade Organization (WTO) of its legislation and checklist for implementing the WTO Agreement on Customs Valuation.

GOVERNMENT PROCUREMENT

The Duarte government's highly successful implementation of the Law of Public Contracting, which came into force in July 2003, has been an important reform. While there continues to be some concern about collusion and attempts by contracting agencies to favor preferred bidders, the new Directorate General of Public Contracting has greatly increased transparency and has become a legitimate arbiter of disputed awards. Since March 3, 2004, all public contracting in Paraguay with a value over 20 daily minimum wages (about \$140) must be publicized on the website of the Director General of Public Contracting, which is <http://www.contratacionesparaguay.gov.py>. The Law of Public Contracting applies to the central government as well as to state and local entities. The contracting office screens tenders to identify and eliminate preferential specifications in an effort to avoid issuing tenders biased in favor of a particular bidder. All tender documents are made available electronically and, once contracts are awarded, the information on the winner and the final price is made publicly available on the website. Complaints are channeled through the Directorate rather than being submitted directly to the contracting entity. Most of the complaints that have been submitted so far have been adjudicated in favor of bidders. Foreign firms may bid on tenders deemed "international," which accounted for about 60 percent of total tenders in 2004. Foreign firms may also bid on "national" tenders through a local representative. Paraguay is not a member of the WTO Agreement on Government Procurement.

INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

The Duarte Administration has been particularly active and focused in its fight against piracy, counterfeiting and contraband, declaring the fight a national priority. However, serious concerns over the lack of effective border enforcement remain, because Paraguay continues to be a transshipment point for pirated and counterfeit goods to Brazil and other neighboring markets. In 2004, the International Intellectual Property Association (IIPA) reported that losses in Paraguay due to piracy of copyrighted material, such as movies, music, books, and entertainment and business software, totaled \$137.3 million.

In January 1998, the United States Trade Representative (USTR) identified Paraguay as a Priority Foreign Country under the Special 301 provisions of the Trade Act of 1974, and in February 1998, the United States initiated a Section 301 investigation of Paraguay's acts, policies and practices regarding intellectual property. Paraguay is currently subject to Section 306 monitoring of its Memorandum of Understanding (MOU) with the United States on the protection of intellectual property, which allowed the United States to remove Paraguay from its Priority Foreign Country status and to terminate the Section 301 investigation.

FOREIGN TRADE BARRIERS

In the 1998 MOU, the Paraguayan government committed to implement institutional and legal reforms and to strengthen intellectual property rights enforcement and prosecution. In addition, Paraguay agreed to ensure that its government ministries use only authorized software.

The Paraguayan government has made significant effort to implement the MOU and has met regularly with U.S. government officials to review and discuss the progress achieved in addressing IPR-related concerns. The United States will continue to work closely with Paraguay to address remaining IPR-related concerns, particularly with regard to increasing the penalties for IPR infringement as called for in the MOU, strengthening border and other enforcement measures to combat piracy and counterfeiting activities, as well as providing information and assistance to Paraguay on its MOU obligations concerning geographical indications.

OTHER BARRIERS

Law 194/93 establishes the legal framework governing relationships between foreign companies and their Paraguayan representatives. Modeled after Puerto Rico's Dealers Act, this law requires that foreign companies prove just cause in a Paraguayan court to terminate, modify or fail to renew contracts with Paraguayan distributors. Severe penalties and high fines may result if the court determines that the foreign company ended the relationship with its distributor without just cause, which often leads to expensive out-of-court settlements. In several cases, however, the courts have upheld rights of foreign companies to terminate representation agreements after just cause was established, mainly on the basis of lack of sales performance by local representatives. This law may discourage U.S. investment through fear of potential lawsuits.

For virtually all textile and apparel products and footwear, Paraguay requires that in addition to the name of the manufacturer, the name and fiscal number of the importer also be included on the label. Industry reports that such information is difficult, if not impossible to know during the construction process when permanent labels are attached. Re-labeling of products upon entry to meet these requirements results in additional costs and delays. Additionally, in 2000, Paraguay promulgated Decree 7084/00, which explicitly prohibits the importation of used clothing. Previously, used clothing could be imported with a certification notarized in the place of origin showing that the used clothing had been sanitized.

Privatization

Paraguay has an uneven record on privatization. Political pressures have impeded the process as large state-run companies most attractive to foreign buyers (such as telecommunications, water/sewage, and electrical companies) that employ thousands of potential voters and are outlets for political patronage. An effort to privatize the telecommunications company failed in 2002, due to intense political pressure and amid allegations of mishandling. In May 2004 and again in May 2005, efforts by some in Congress to revive the privatization process were thwarted, in part by a public outcry.

As part of its Stand-By Arrangement with the International Monetary Fund, the government committed to undertake independent audits of state-owned firms and to develop business plans for them with the aim of eventually increasing private sector involvement in the management and ownership of the companies. Progress on the audits has been slow and emphasis now appears to be on devising ways to increase private sector participation without outright privatization, such as management contracts.

PERU

TRADE SUMMARY

The U.S. goods trade deficit with Peru was \$2.8 billion in 2005, an increase of \$1.2 billion from \$1.6 billion in 2004. U.S. goods exports in 2005 were \$2.3 billion, up 9.0 percent from the previous year. Corresponding U.S. imports from Peru were \$5.1 billion, up 38.3 percent. Peru is currently the 43rd largest export market for U.S. goods.

The stock of U.S. foreign direct investment (FDI) in Peru in 2004 was \$3.9 billion, up from \$3.7 billion in 2003. U.S. FDI in Peru is concentrated largely in the mining sector.

FREE TRADE NEGOTIATIONS

In May 2004, the United States initiated free trade negotiations with Colombia, Ecuador, and Peru. To date, the United States has concluded free trade agreements with Peru and Colombia. Negotiations with Ecuador will resume in late March 2006. Bolivia has participated as an observer and could become part of the agreement at a later stage. The United States has significant economic ties to the region. Total two-way goods trade with the Andean countries of Peru, Colombia, and Ecuador was approximately \$24 billion in 2004. The stock of U.S. foreign direct investment in these countries in 2004 was \$7.7 billion.

IMPORT POLICIES

Tariffs

Peru applies tariffs to virtually all goods exported from the United States, although the Government of Peru has consistently lowered tariff rates since the early 1990s. Peru's average applied rate is approximately 10 percent. Currently, most imported goods are subject to tariff rates of four percent, 12 percent, or 20 percent. The government also maintains a five percent "temporary" tariff surcharge on agricultural goods to protect local production and domestic investment in the sector.

Certain sensitive agricultural products, including corn, rice, sugar and powdered milk, are subject to a Peru-specific "price band," or variable levy, which fluctuates to ensure that the import prices of such products equal a predetermined minimum import price. This levy is the difference between the minimum import price and an international reference price plus an adjustment for insurance, freight and other factors.

FOREIGN TRADE BARRIERS

Once the free trade agreement between the U.S. and Peru enters into effect, 80 percent of U.S. exports of industrial goods will become duty-free immediately, with the remaining tariffs phased out over 10 years. More than two-thirds of current U.S. farm exports will become duty-free immediately, with most of the remaining tariffs phased out over 15 years, and the remainder in 17 years. Additionally, Peru will eliminate barriers to trade for U.S. agricultural products, while providing reasonable adjustment periods and safeguards for producers of import sensitive agricultural products.

Non-Tariff Measures

The Government of Peru has eliminated almost all non-tariff barriers, including subsidies, import licensing requirements, import prohibitions and quantitative restrictions. However, the following imports are banned: used clothing and shoes (except as charitable donations, which are subject to the 19 percent VAT), used tires, remanufactured goods, cars over five years old and heavy trucks (weighing three tons or more) over eight years old. Used cars and trucks that are granted import permits must pay a 45 percent excise tax – compared to 20 percent for a new car – unless they are refurbished in an industrial center in the south of the country upon entry, in which case they are exempted entirely from the excise tax. The free trade agreement between the U.S. and Peru will remove the import ban on remanufactured goods.

For textile and apparel products and footwear, Peru requires that in addition to the name of the manufacturer, the label must also include the name and address of the importer or distributor. Industry reports that such information is difficult if not impossible to know during the construction process when permanent labels are attached. Re-labeling of products upon entry to meet these requirements results in additional costs and delays.

SENASA, the Peruvian plant and animal health agency, imposes several significant trade barriers (which include bans, import requirements and sanitary permits) on agricultural products, including poultry, live animals and animal genetic material. Among the affected products are:

--Poultry Products: The Peruvian government lifted its ban on U.S. poultry products in July 2004. Currently, U.S. poultry and poultry products are allowed except from the states of California, Connecticut, Rhode Island, Pennsylvania, Texas, Delaware, New Jersey and Maryland due to Avian Influenza. Additionally, in October 2004 SENASA revised its import requirements, which brought imports from the U.S. to a halt. Currently Food Safety Inspection Service (FSIS) is working with SENASA to implement a list of requirements acceptable to both countries.

--Beef and beef products: SENASA enacted a ban on U.S. beef products in March 2004, due to Bovine Spongiform Encephalopathy (BSE).

--Pork: In November 2004, SENASA revised its import requirements, effectively stopping trade. Since then FSIS has been working with SENASA to agree on a set of requirements that would satisfy both parties.

--Paddy Rice: Peru has a ban on paddy rice imports from the United States. SENASA is

FOREIGN TRADE BARRIERS

currently conducting a Pest Risk Assessment that, if successful, will result in lifting the ban. SENASA has not indicated when it will make a final decision.

In the context of the free trade negotiations, Peru agreed to accept imports of beef and poultry products from the United States, when accompanied by an Export Certificate of Wholesomeness, no later than March 1, 2006. Peru also undertook to apply to imports of U.S. rice standards no less favorable than those applied to domestically produced rice and confirmed that it had eliminated certain decrees to the contrary.

The United States and Peru have also worked to resolve sanitary and phytosanitary (SPS) barriers to agricultural trade, including: fully complying with the WTO regarding imports of beef and poultry products, recognizing the U.S. meat inspection system as equivalent to Peru's, modifying Peru's import permit requirements for the import of pork and poultry and agreeing to apply fair standards for Peru's import of rice. Under the free trade agreement, an SPS Committee will be established to expedite resolution of technical issues.

GOVERNMENT PROCUREMENT

In 2002, in an effort to support national companies, Peru began adding 20 percent (on its rating scale of 100) to bids by Peruvian firms on government procurement contracts. U.S. pharmaceutical and medical equipment firms have raised concerns about this practice with regard to bidding on Health Ministry purchases. U.S. firms contend that the 20-point margin is excessive, giving unfair advantage to Peruvian competitors that would otherwise lose these bids on cost or technical grounds. In 2001, Peru began reserving certain procurements for domestic firms. In November 2004, the Peruvian government eliminated this distinction for the majority of products, applying it only to construction works. Peru is not a signatory to the WTO Agreement on Government Procurement. The free trade agreement between the U.S. and Peru will provide for fair, non-discriminatory, and transparent opportunities for U.S. companies to bid on Peruvian government procurement contracts.

INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

Peru is a member of the World Intellectual Property Organization (WIPO). It is also a member of the Paris Convention, Berne Convention, Rome Convention, Geneva Phonograms Convention, Brussels Satellites Convention, Universal Copyright Convention, the WIPO Copyright Treaty (WCT), and the WIPO Performances and Phonograms Treaty (WPPT). Peru remains on the U.S. Trade Representative's Special 301 Watch List. Concerns remain about the adequacy of IPR law enforcement, particularly with respect to the relatively weak penalties imposed on IPR violators by the criminal justice courts. Although the Peruvian government recently increased the minimum penalty for piracy to a four-year sentence, there have yet to be any convictions under the new law.

The provisions agreed to in the IPR chapter of the free trade agreement between the U.S. and Peru should improve protection and strengthen enforcement of IPR in Peru.

FOREIGN TRADE BARRIERS

Copyrights

Peru's 1996 Copyright Law is generally in line with international standards. Peru joined the WCT in July 2001 and the WPPT in February 2002. Although most of the provisions of these two WIPO treaties are included in Peru's 1996 Copyright Law, officials at Indecopi (the IPR administrative agency) have acknowledged the need for additional legislation in order to clarify the rights of artists and producers. The National Association of Music Publishers continues to criticize Indecopi's enforcement, claiming that its members are not receiving the royalties due to them.

In July 2004, the Peruvian government published a Supreme Decree establishing the Law of Artists, Interpreters, and Music to protect the interests and rights of those involved in the creative arts, including performers and producers of musical recordings and motion pictures, from acts of piracy. The decree stated that blank optical media was being used for "private copies" and piracy of media and software, violating copyright laws. Under the law, the Peruvian Artists Association will apply a levy on all blank optical discs, to be paid by the manufacturers of blank recording media. All imports of blank optical discs since November 2004 are subject to the levy. Imported blank CDs are subject to a \$0.25 fee per unit, with imported blank DVDs subject to a \$1.20 levy per unit. These fees represent between 200 percent and 300 percent of product cost. Indecopi, the Lima Chamber of Commerce and several companies are working with the Peruvian Artists Association to lower the levy to a more reasonable rate.

Patents and Trademarks

Peru's 1996 Industrial Property Rights Law provides the framework for patent protection. In 1997, based on an agreement reached with the U.S. Government, Peru addressed several inconsistencies with the WTO TRIPS Agreement provisions on patent protection and most-favored nation treatment for patents.

However, the U.S. pharmaceutical and agrochemical industries continue to have concerns about Peru's protection of confidential test data. Peruvian government health authorities are approving the commercialization of new drugs that are bioequivalent of already approved drugs, without appropriate protection for the innovative drugs. In the free trade agreement between the U.S. and Peru, Peru agreed to provide adequate protection for innovative drugs. Therefore, entry into force of this agreement should rectify this situation.

Enforcement

Despite Peruvian government efforts to increase enforcement, including increased raids on large-scale distributors and users of pirated material, piracy remains widespread. The International Intellectual Property Alliance estimates that piracy levels in Peru for recorded music was 98 percent in 2004-2005 with damage to U.S. industry estimated at \$100 million, while motion picture piracy accounts for 60 percent of the market, for a loss of an estimated \$5.5 million. Indecopi estimates that software piracy levels remained the same in 2005, at 56 percent.

SERVICES BARRIERS

Under the services chapter of the free trade agreement between the U.S. and Peru, Peru will assume commitments to provide non-discriminatory treatment and market access in almost all services sectors. The chapter also commits Peru to increased regulatory transparency and to free transfers associated with the supply of a service.

The financial services chapter also provides secure access and nondiscriminatory treatment across most banking, insurance and securities sectors, and improves U.S. companies' ability to provide portfolio advice and certain kinds of insurance on a cross border basis.

In the WTO negotiations on basic telecommunications services, concluded in March 1997, Peru made commitments on all basic telecommunications services, with full market access and national treatment to be provided as of June 1999. Peru is continuing the process of developing a competitive telecommunications market and lowered its interconnection rates for most types of telephones in 2001. Termination rates for calls to mobile networks, however, remain among of the highest in the world. OSIPTEL, Peru's telecommunications regulator, is working to establish its model to lower mobile termination rates. This model, according to the OSIPTEL timeframe, should lower these rates over a period of 4 years, from its current levels of roughly \$0.21 to approximately \$0.11, depending on the carrier. Suppliers claim that unconstrained pricing by the dominant supplier has created significant barriers to competition in the wireless sector. Continued oversight and review of these rates by OSIPTEL will be important to achieving progress in addressing concerns raised by suppliers.

INVESTMENT BARRIERS

National treatment for foreign investors is guaranteed under Peru's 1993 constitution. There are no limitations on the repatriation of capital or profits. Domestic arbitration is available for disputes between foreign investors and the Government of Peru. Several U.S. companies have chosen to pursue claims through arbitration, with mixed results. Under the investment chapter of the free trade agreement between the U.S. and Peru, Peru will assume obligations relating to national treatment and most favored nation (MFN) treatment, the right of U.S. investors to make financial transfers freely and without delay, international law standards for expropriation and compensation, and access to binding international arbitration.

Peruvian law restricts majority ownership of broadcast media to Peruvian citizens. Foreigners are also restricted from owning land or investing in natural resources within 50 kilometers of a border, but they can operate within those areas with special authorization. National air and water transportation are restricted to domestic operators. New licensing for passenger transportation within Peru is suspended for both nationals and foreign suppliers.

Under current law, foreign employees may not comprise more than 20 percent of the total number of employees of a local company (whether owned by foreign or Peruvian persons) or more than 30 percent of the total company payroll. Under the free trade agreement between the U.S. and Peru, Peru has agreed not to apply most of these nationality-based hiring requirements to U.S. professionals and specialty personnel.

FOREIGN TRADE BARRIERS

Several U.S. firms complain that executive branch ministries, regulatory agencies, the tax agency, and the judiciary lack the resources, expertise, and impartiality necessary to carry out their respective mandates. Peru's weak judicial branch is a particular problem. Commercial disputes that end up in Peruvian courts are often delayed and can yield results that are not foreseeable based on a review of relevant precedents. The tax agency has also created additional investment and trade barriers through its reinterpretation of rules and its imposition of disproportionate fines. The Toledo Administration has tried to address institutional weaknesses in the executive branch and has offered plans for judicial reform. In July 2005, the Supreme Court issued an edict stating that final binding arbitration awards cannot be disputed in the judiciary. The U.S. Government has worked with the Government of Peru both before and in parallel with the free trade negotiations to ensure a fair resolution of U.S. investor disputes, consistent with Peruvian law. Several of those disputes have been resolved, while others remain pending.

ELECTRONIC COMMERCE

The Peruvian government is moving to put in place legislation that will facilitate electronic commerce. It has already passed laws giving legal status to digital signatures, creating a framework for electronic contracts and making it illegal to tamper with, destroy or interfere with computer systems or data. The free trade agreement between the U.S. and Peru includes rules prohibiting duties on and discrimination against digital products, such as computer programs, videos, images, and sound recordings, based on where they are made or the nationality of the firms or persons making them.

PHILIPPINES

TRADE SUMMARY

The U.S. goods trade deficit with Philippines was \$2.4 billion in 2005, and increase of \$306 million from \$2.0 billion in 2004. U.S. goods exports in 2005 were \$6.9 billion, down 2.7 percent from the previous year. Corresponding U.S. imports from Philippines were \$9.2 billion, up 1.2 percent. Philippines is currently the 25th largest export market for U.S. goods.

U.S. exports of private commercial services (i.e., excluding military and government) to Philippines were \$1.5 billion in 2004 (latest data available), and U.S. imports were \$1.7 billion. Sales of services in Philippines by majority U.S.-owned affiliates were not available in 2003 (\$1.2 billion in 2001), while sales of services in the United States by majority Philippines-owned firms were \$18 million in 2003 (latest data available).

The stock of U.S. foreign direct investment (FDI) in Philippines in 2004 was \$6.3 billion, up from \$5.8 billion in 2003. U.S. FDI in Philippines is concentrated largely in the manufacturing, utilities, and finance sectors.

The United States and the Philippines concluded a bilateral Trade and Investment Framework Agreement (TIFA) in 1989. In recent years, the United States and the Philippines have held regular meetings under the TIFA. The United States has used the TIFA to discuss and seek resolution of many issues that might otherwise inhibit bilateral trade and investment. The United States-Philippines TIFA is a component in the Enterprise for ASEAN Initiative (EAI), which was launched by President Bush in October 2002.

IMPORT POLICIES

Tariffs

In January 2003, the Philippine government announced a reversal in tariff policy and indicated that it would undertake a comprehensive review of all tariff lines. The Tariff Commission issued recommendations for increased tariffs in several sectors and a slowdown of its tariff reduction plans in others. While the increased tariffs, which took effect in 2004, remain below the WTO bound rates, they represent a reversal of the hard fought reforms of successive previous Philippine administrations during the 1990s. Simple average tariffs fell from 9.7 percent in 1999 to 5.8 percent in 2003, but increased to 7.4 percent in 2004.

Previous progress on tariff liberalization took shape through a series of reform programs beginning in 1995. Normal trade relations' (NTR) / most favored nation (MFN) tariff rates on all goods (except sensitive agricultural products) were to be gradually reduced to the following target rates: 3 percent for raw materials and 10 percent for finished products by January 2003, and a uniform 5 percent tariff rate for all remaining products by January 2004.

FOREIGN TRADE BARRIERS

Executive Orders 241 and 264, signed by Philippines President Gloria Arroyo in October and December 2003, respectively, raised tariff rates on more than 1,000 product lines and maintained 2002 rate levels for an even greater number of product lines. Affected products include industrial goods produced domestically, such as chemical fertilizers, cement and consumer products including apparel and footwear. The orders raised rates on these products from the previous rates of between 3 percent and 10 percent to between 5 percent and 20 percent. The Philippine government is currently reviewing the tariff program and expects to complete the review by early 2006. In regards to the classification of products within tariff codes, at least one major U.S. company has reported inconsistency by the Bureau of Customs in the application of tariff classifications.

The Common Effective Preferential Tariff (CEPT) Agreement for the ASEAN Free Trade Area (AFTA) requires that tariff rates among ASEAN members on a broad range of products be reduced to between zero percent and 5 percent or below, while quantitative restrictions and other non-tariff barriers are to be eliminated. ASEAN members agreed on a firm timetable leading up to the full realization of AFTA by the end of 2003. President Arroyo signed an executive order on January 9, 2003, which temporarily suspended the AFTA tariff reduction schedule on petrochemical resins and certain plastic products. As permitted under AFTA, Singapore sought and won compensation from the Philippines for failing to lower Philippine petrochemical tariffs. The Philippines has reduced duties to 5 percent or below on 99 percent of all tariff lines under the AFTA-CEPT. Moreover, as a result of the November 2004 ASEAN Summit, members agreed to implement the ASEAN Sectoral Integration Protocols, which legally bind them to undertake accelerated integration measures in 11 priority sectors. These sectors account for 50 percent of 2003 intra-ASEAN trade and include electronics, E-ASEAN (electronic commerce/usage/connectivity among ASEAN countries), health care, wood-based products, automotives, rubber-based products, textiles and apparel, agri-based products, fisheries, air travel, and tourism. The Philippines is spearheading the formulation of the Electronics Road Map and committed to fast-track tariff elimination of more than 1,000 electronics and ICT products.

Automobile Sector Tariffs

On April 17, 2001, the Arroyo Administration issued an order lowering the tariff on automotive vehicle components from 10 percent to 3 percent under the Philippine government's Motor Vehicle Development Program (MVDP), a program designed to rationalize the auto industry and transform the Philippines into a regional hub for automotive production. To promote local assembly under the program, imports of finished automobiles (completely built-up units) and motorcycles have been subject to the highest duty rate applied to non-agricultural products. Under the MVDP, completely-knocked down (CKD) kits can be imported at preferential tariff rates if they promote efficiency in the domestic industry, increase value-added, create jobs, and transfer technology. The tariff rate on CKD is between 1 percent and 3 percent.

In April 2005, President Arroyo issued Executive Orders 418 and 419 increasing the tariff rates on certain types of automobiles. Executive Order 418 imposed a specific duty of 500,000 pesos (approximately \$9,800) on top of the *ad valorem* duty on used vehicles. However, the high tariff imposed on the importation of used vehicles has yet to be implemented since a temporary restraining order was initiated shortly after the passing of EO 418. EO 419 increased from 30 percent to 35 percent the duties on high engine displacement vehicles under a stated pretext as an energy conservation and environmental measure. Under AFTA-CEPT, the tariffs on automobile components will be at 3 percent and 5 percent on passenger cars.

Excise Tax on Automotive Vehicles

In August 2003, the Philippine Congress passed legislation changing the automotive excise tax structure from one based on engine displacement to a system based on vehicle value. The old system generally discouraged imported vehicles with large engine displacement, including those from the United States. The August 2003 law covers most types of imported and locally manufactured vehicles, except for some trucks defined as motor vehicles designed for cargo and buses, which are classified by their tonnage. Vehicles that had been tax-exempt under the “10-seater rule”, which applied to vehicles containing at least 10 seats including Asian utility vehicles (AUVs), are now taxed under the new system.

Under the revised excise tax scheme, vehicles are divided into four brackets based on their price: (1) for vehicles with a manufacturer’s price of 600,000 pesos and below, the tax is 2 percent; (2) for those priced over 0.6 million to 1.1 million pesos, the tax is 12,000 pesos plus 20 percent of the amount in excess of 600,000 pesos; (3) for those priced over 1.1 million to 2.1 million pesos, the tax is 112,000 pesos plus 40 percent of the amount in excess of 1.1 million pesos; and (4) for those over 2.1 million pesos, the tax is 512,000 pesos plus 60 percent of the amount in excess of 2.1 million pesos.

Safeguards

The Safeguard Measures Act, enacted in 2000, authorizes the Secretary of Trade and Industry or the Secretary of Agriculture to raise a tariff or, in the case of an agricultural good, impose a quantitative restriction, to protect a domestic industry from an import surge. The U.S. Government has expressed reservations concerning the Philippine safeguards legislation, noting in particular that the five days afforded to foreign industry to comment on proposed safeguards is not a reasonable period of time as provided for in the WTO Agreement on Safeguards. The U.S. Government has requested that the Philippines lengthen the statutorily mandated period. The Philippine government indicated that it would increase the comment period to 30 days, but this change has not been implemented.

In November 2001, the Philippine government put in place a safeguard to protect local cement producers from imports. The Secretary of Trade and Industry imposed the safeguard duty despite the finding of the interagency Tariff Commission's that there was no merit to the cement producers’ case. This decision was brought to the Philippine Supreme Court and in July 2004, the Court ruled that the safeguard duty was illegal.

FOREIGN TRADE BARRIERS

The Department of Trade and Industry appealed the case. The Philippine government has also established safeguard duties on imported ceramic floors and wall tiles, float glass, figured glass and glass mirrors.

Agriculture Tariffs and Import Licensing

The average nominal tariffs on agricultural products (covering HS Codes 01 to 24) remained at 11.3 percent in 2005. High tariffs are still maintained on sensitive agricultural products, including grains, livestock, poultry and meat products, sugar, frozen and processed potatoes, onions, coffee, and fresh citrus, including oranges, lemons, and grapefruit.

In 2002, the Philippines issued several executive orders that provided for tariff reductions for most agricultural products through 2004. However, in January 2003, the Philippines reversed this policy by issuing Executive Order 164, which set tariff rates for most agricultural products at their generally higher 2002 levels with the exception of pork, poultry, processed meats, corn, coffee and vegetables. Executive Order 264, issued in 2003, raised tariff rates on some product lines. These rates have been extended to an even greater number of food and agricultural products including those for which the United States has a substantial market share.

The U.S. Government continues to closely monitor the operation of the Philippines TRQ system and the allocation and distribution of import licenses. In particular, the U.S. government is monitoring the Philippine government's application of its Veterinary Quarantine Clearance (VQC) certificates for meat and poultry imports, as well as its import permit system for fresh vegetables.

In response to pressure from domestic meat and poultry producers to limit imports as well as to crack down on illegal importation of meat and poultry into the country, the Philippine Department of Agriculture (DA) maintains a VQC import-licensing scheme for imported meat and poultry, although its name connotes an SPS monitoring mechanism. The amended meat import regulation under the Administrative Order (AO) 26 series of 2005 (AO26) reiterates the need for an accredited importer to obtain a Veterinary Quarantine Clearance (VQC) certificate prior to the importation of meat and meat products. A VQC will now be valid for 60 days from the date of issuance, within which the meat or meat products are to be shipped from the country of origin, and may no longer be extended beyond that. The regulation still requires a one-time use of a VQC, meaning that each VQC must be surrendered upon arrival of a shipment of a covered product. When the quantity allowed on a VQC is insufficient to cover the amount in a container, the importer must supply an additional VQC to cover the difference. Any remaining tonnage from that second VQC is subsequently forfeited rather than the importer being given credit for the unused tonnage. This practice creates the appearance of discretionary licensing and fosters imprecision in statistical tracking of import volumes. Although the U.S. Government has registered its concern with the Government of the Republic of the Philippines (GRP) regarding the VQC process and has requested that its application be made more flexible, transparent and WTO consistent, the AO26 still contains the same inflexibilities.

The Philippine Fisheries Code permits importation of fresh, chilled, or frozen fish and fish products only when certified as necessary by the Secretary of Agriculture and upon issuance of an import permit by the Department of Agriculture. The Secretary issues a certificate of necessity when he deems import is essential for achieving food security and the import will not cause serious injury or threat of injury to a domestic industry that produces like or directly competitive products. This process appears to be a discretionary application of import licensing.

Excise Tax on Distilled Spirits and Tobacco Products

President Arroyo signed legislation in December 2004 that raised the taxes on alcohol and tobacco products starting in 2005. The law maintained the preferential treatment the Philippines gives to distilled spirits produced from indigenous raw materials in its excise tax regime, which is a tiered tax structure based on net retail price. This tax regime continues to impede access to the Philippine market for U.S. exports of higher-value distilled spirits and is a primary reason why U.S. exports to this potentially significant market remain quite small.

The December 2004 legislation increased the excise tax by 30 percent for distilled spirits produced from indigenous sources, raising the tax from 8.96 pesos to 11.65 pesos on every liter of distilled spirits made from raw materials such as coconut palm, cane, and certain root crops. It also increased the excise tax by 50 percent on distilled spirits made from other materials (which would apply to most imports) from a range of 84 pesos to 336 pesos per 750 ml bottle to a range of 126 pesos to 504 pesos per bottle. The legislation also increased the excise tax on fermented liquor by 20 percent. Wines with an alcohol content of 14 percent or less by volume are assessed an excise tax of 17.47 pesos per liter, while wines with an alcoholic content greater than 14 percent but less than 25 percent alcohol content by volume are charged an excise tax of 34.94 pesos per bottle. Fortified wines (containing greater than 25 percent alcohol content) are taxed as distilled spirits. Depending on the net retail price per bottle, an excise tax ranging from 145.60 pesos to 436.80 pesos per liter is assessed on bottles of sparkling wine and champagne. The legislation increases these rates on alcohol products by 8 percent every two years until 2011.

The Philippines also maintains a multi-tiered excise tax system based on retail prices for cigarettes, which will increase every other year until 2011. Low-priced machine-packed cigarettes with a retail price below 5 pesos per pack and hand-rolled cigarettes were assessed a tax of 2 pesos in 2005, rising to 2.72 pesos in 2011. Medium-priced machine-packed cigarettes with a net retail price between 5 pesos and 6.50 pesos per pack were assessed a tax of 6.35 pesos in 2005, rising to 7.16 pesos in 2011. High-priced cigarettes with net retail prices above 6.50 pesos up to 10 pesos per pack were charged a tax of 10.35 pesos in 2005, rising to 12 pesos in 2011. Premium cigarettes with net retail prices above 10 pesos per pack were charged a tax of 25 pesos in 2005, rising to 28.3 pesos in 2011. The legislation assessed an *ad valorem* tax of 10 percent on cigars with a net retail price of 500 pesos or lower and, for cigars with a net retail price above 500 pesos, a tax of 50 pesos plus 15 percent of the net retail price in excess of 500 pesos.

The legislation that President Arroyo signed into law in December 2004 also provides that alcohol and cigarette brands being sold in the domestic market as of October 1996 be classified according to their net retail prices for excise tax purposes; and brands introduced between January 1997 and December 2003 be classified according to their net retail prices as of end-2003. This provision effectively provides existing brands/players with preferential excise tax treatment relative to new brands/entrants.

U.S. firms have noted that the Documentary Stamp Tax presents a related national treatment issue with respect to cigarettes. Although the National Internal Revenue Code requires that tax stamps be affixed to all cigarettes sold in the Philippines, this is only effectively enforced on imported cigarettes. Because of lax enforcement, domestically produced cigarettes are often shipped to outlets without the stamps and without paying the connected taxes.

Quantitative Restrictions

The National Food Authority (NFA), a state trading enterprise, controls rice imports and administers an import quota. It imports any shortfall in rice production under the import quota. The 2005 minimum access volume (quota) for rice was set at 238,000 metric tons. Both in and out of quota tariffs are 50 percent, although this tariff is waived when the NFA contracts for these imports. Rice import demand is expected to continue growing in the Philippines due to persistent shortfalls in local production and a high population growth rate (2.4 percent annually). Due to import restrictions, rice is illegally imported into the country on a regular basis from various rice-producing countries in the region.

Among sensitive agricultural products, 15 items (at the four-digit HS level and covering some 60 tariff lines) are subject to a minimum access volume (MAV) administered through tariff-rate quotas (TRQs). The Philippines' 10-year minimum access commitments under the Uruguay Round expired in June 2005. Final-year TRQ commitments are being maintained until such time when the products are liberalized or new commitments are negotiated under the Doha Development Agenda. For rice, a commodity for which the GRP receives special treatment under Annex 5 of the Uruguay Round Agricultural Agreement, the GRP petitioned WTO members for an extension until 2012. In return for various agricultural concessions, nine countries (Thailand, Pakistan, Egypt, China, Argentina, the United States, Canada, India and Australia) have provisionally accepted the GRP's extension. Several products with significant market potential for the United States are subject to TRQs. These include: corn, with an in-quota tariff rate of 35 percent and an out-of-quota tariff rate of 50 percent for 2004/2005; poultry meat, with an equalized in-quota and out-of-quota tariff rate of 40 percent; and pork, with an in-quota rate of 30 percent and out-of-quota rate of 40 percent.

Other Import Restrictions

The Philippines maintains import restrictions on a number of goods. These restrictions are intended to safeguard public health, morals, national security, and to meet international treaty obligations regulating certain products. Imports may only be allowed after securing clearance and permits from appropriate government agencies. Among the restricted products are dangerous drugs, chemicals, penicillin and its derivatives, color reproduction machines, used vehicles and tires.

Customs Barriers

The Philippine government has made progress during the last several years toward bringing its customs regime into compliance with its WTO obligations, but corruption and other irregularities remain commonplace. The Philippine laws R.A. 8181 (1996) and R.A. 9135 (2001), with supporting regulations, provide the legal context for the Philippines' implementation of the WTO Agreement on Customs Valuation. The Philippines discontinued use of Home Consumption Value and adopted transaction value for the purpose of calculating *ad valorem* rates of duty. Supporting regulations also provided the Bureau of Customs with the authority to create a post-entry audit unit, a risk management unit and a border control unit charged with IPR enforcement.

The 2001 law eliminated private sector involvement in the valuation process. It also clarified that reference values may be used as a risk management tool, but not as a substitute for valuation. The U.S. Government remains concerned, however, about reports of continued private sector involvement in the valuation process, particularly in the activities of the Import Specialist Team, which has the authority to review all green lane entries for possible valuation-related offenses. The Philippine government has made improvements to the valuation system, but periodic procedural irregularities continue to occur, including requests by Customs officials for the payment of unrecorded facilitation fees. The U.S. Government has raised this issue during bilateral trade discussions during the past several years and will continue to closely monitor the situation.

Currently, all importers or their agents must file import declarations with the Bureau of Customs (BOC), which the BOC then processes through its Automated Customs Operating System (ACOS). ACOS uses its selectivity system to classify shipments as low-risk (green lane), moderate-risk (yellow lane) or high-risk (red lane). All shipments channeled through the yellow lane require a documentary review, while red lane shipments require both documentary review and physical inspection at the port. Green lane shipments are not subject to any documentary or inspection requirements. In early 2002, the BOC also announced the addition of a "Super Green Lane" (SGL) facility for importers acknowledged as the lowest risk. The import transactions of Super Green Lane importers are not covered by the selectivity system and thus are exempt from documentary and physical examination. Because of low throughput during the implementation, which was launched in December 2003, the BOC lowered the cost to companies of accessing the facility. By the end of 2004, 86 firms were using these facilities.

Despite these improvements, the U.S. Government continues to have concerns about inconsistent application of customs rules and procedures, undue and costly processing delays, and corruption. The United States has regularly urged the Philippine government to improve the administration of its customs regime. Customs administration could be strengthened by improving classification of entries and providing precise descriptions of imported articles to reduce discretionary authority of customs officials. During bilateral trade discussions in 2003, the Philippines reviewed the progress on administrative reforms, including efforts to reduce average clearance time for goods passing through Customs and ongoing internal efforts to eliminate corruption. Reform and modernization within the Bureau of Customs is being supported through technical assistance by USAID and several other donor organizations.

STANDARDS, TESTING, LABELING AND CERTIFICATION

Industrial Goods

Local inspection for compliance with mandatory Philippine national standards is required for 91 products, including automotive and motorcycle batteries, cosmetics, medical equipment, lighting fixtures, fire extinguishers, electrical wires and cables, cement, pneumatic tires, sanitary wares, and household appliances. For goods not subject to such standards, U.S. manufacturers' self-certification of conformity is accepted. Labeling is mandatory for textile fabrics, ready-made garments, household and institutional linens, and garment accessories. Mis-labeling, misrepresentation, or misbranding may subject an entire shipment, rather than just the offending goods, to seizure and disposal. The "Generic Act" of 1988 aims to encourage the use of generic drugs by requiring that the generic name of a particular pharmaceutical appear above its brand name on all packaging.

Agricultural Goods

The Philippine Department of Agriculture (DA) established plant health regulations in 1995 that allow the import of U.S. apples, grapes, oranges, potatoes, onions, and garlic, provided these products, when necessary, undergo a specified cold treatment to control targeted pests. Importation of Florida grapefruit, oranges, and tangerines into the Philippines is permitted under a March 2000 protocol between the Philippines and the United States. Similarly, under a July 2004 protocol, importation of cherries from the United States is permitted.

In January 2004, the DA issued Memorandum Order No. 33 (MO 33), which provided new requirements for beef and beef products imported from the United States. This was in response to the detection of Bovine Spongiform Encephalopathy (BSE) in a single imported dairy cow in the State of Washington in December 2003. Only beef and beef products derived from cattle 30 months of age or less are allowed entry into the country. Other specified requirements include: only deboned and deglanded muscle cuts of beef from healthy and ambulatory cattle devoid of nerves and any specified risk materials (SRMs) will be allowed entry. Moreover, the production or slaughter date of the cattle must be provided on the packaging label.

GOVERNMENT PROCUREMENT

Although the Philippines is not a signatory to the WTO Government Procurement Agreement (GPA), the Philippine government has taken some steps to reform its procurement process. In January 2003, President Arroyo signed the Government Procurement Reform Act to consolidate numerous procurement laws and issuances and to standardize guidelines, procedures, and forms across Philippine government agencies, government-controlled corporations, and local government units. Among others, the law simplified pre-qualification procedures, introduced more objective non-discretionary criteria in the selection process; and established an electronic procurement system to serve as the single portal for government procurement activities. The Government Procurement Reform Act also calls for public monitoring of the procurement process to promote greater transparency and competition, enhance the flow of information, and lessen discretion among agencies.

Nevertheless, the Government Procurement Reform Act's Implementing Rules and Regulations (IRRs) for locally funded government projects/contracts continue to favor purchases from Filipinos and or Filipino-controlled companies. As a general rule, goods and supplies for locally-funded projects must be purchased from enterprises that are at least 60 percent Filipino-owned; infrastructure services from enterprises with at least 75 percent Filipino interest; and consulting services from at least 60 percent Filipino-controlled entities. For infrastructure projects, the law also provides that, for the next five years from the effective date of the law, contractors whose head office is located in the province where the project will take place have the right to match the lowest offer by a non-province based bidder.

The Philippine government, in consultation with foreign donors, has yet to issue IRRs covering procurement for projects/contracts involving foreign financing and/or assistance, reportedly because of strong pressure to favor local suppliers (which would contradict donor procurement policies). The Official Development Assistance (ODA) Act (Republic Act 8182, as amended in February 1998 by Republic Act 8555) remains in force and waives the preference for local suppliers for projects/contracts involving ODA. Foreign donors have been able to implement their procurement regulations under the provisions of the ODA Act. The Build Operate Transfer Law (Republic Act 6957 of July 1990, as amended in May 1994 by Republic Act 7718) allows proponents of Build-Operate-Transfer (BOT) projects to engage the services of Filipino and/or foreign firms for the construction of BOT infrastructure projects.

In February 2004, President Arroyo issued Executive Order 278, which provides preferential treatment for Filipino consultants in public sector infrastructure projects. The Executive Order stipulates that, as much as possible, the government should fund consultancy services for its infrastructure projects with local funds, and using local resources and expertise. When Filipino capability is determined to be insufficient, Filipino consultants may hire or work with foreign consultants, but should be the lead consultants. Where foreign funding is indispensable, foreign consultants must enter into joint ventures with Filipinos. Foreign donors have so far been able to comply with their respective procurement guidelines without violating Executive Order 278. However, because an executive order has the force of law, the specter of problems arising in the future remains. In addition to concerns about discriminatory treatment against foreign firms, U.S. companies continue to raise concerns about corruption in government procurement.

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The Philippine government issued Executive Order 120 in August 1993 mandating a counter trade requirement for procurements by government agencies and government-owned or controlled corporations that entail the payment of at least \$1 million in foreign currency. Implementing regulations set the level of counter trade obligations at a minimum of 50 percent of the import price and set penalties for nonperformance of counter trade obligations.

EXPORT SUBSIDIES

Enterprises and exporters engaged in activities under the Philippine government's Investment Priorities Plan may register with the Board of Investments (BOI) for fiscal incentives, including four- to six-year income tax holidays, a tax deduction equivalent to 50 percent of the wages of direct-hire workers, and tax and duty exemptions for the importation of breeding stock and genetic materials. BOI-registered firms that locate in less developed areas may be eligible to claim a tax deduction of up to 100 percent of outlays for infrastructure works and 100 percent of incremental labor expenses. As a general rule, an enterprise should be at least 60 percent foreign-owned and, if export-oriented, export at least 50 percent of production to qualify for BOI incentives. Enterprises with less than 40 percent Filipino equity may qualify provided they engage in projects listed as “pioneer” under the IPP or they export at least 70 percent of production. Firms in government-administered export processing zones, free trade zones, and other special industrial estates registered with the Philippine Economic Zone Authority (PEZA) enjoy similar incentives, as well as tax and duty-free imports of capital equipment and raw materials, and exemption from customs inspection. In lieu of national and local taxes, PEZA-registered firms are subject to a 5 percent tax on gross income. Firms that earn at least 50 percent of their income from exports may register with BOI or PEZA for certain tax credits under the Philippines’ Export Development Act, including a tax credit on incremental annual export revenue.

Automotive Export Subsidies

To further promote the local assembly and export of vehicles from the Philippines, President Arroyo signed Executive Order 156 in October 2003. The export incentives program allows any auto manufacturer that exports finished vehicles from the Philippines to receive a benefit equivalent to \$400 per vehicle. This benefit will be provided in the form of a reduced tariff rate on finished vehicles the manufacturer imports into the Philippines. The reduced tariff rates are: MFN rates of 30 percent and 20 percent will be reduced to 10 percent and the ASEAN Common External Preferential Tariff (CEPT) rate of 5 percent will become 1 percent for imports from the other ASEAN countries. This export incentive will be equivalent to \$400 per unit exported for year one to two of the program, \$300 for year three, and phased down to \$100 by year five.

INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

In February 2006, the United States lowered the Philippines from the Special 301 “Priority Watch List” to the “Watch List,” after having been on the “Priority Watch List” for the previous five consecutive years. Key government officials, including President Arroyo, are pledging continued momentum and increased effort on IPR initiatives. Although there has been a general improvement in the IPR protection regime, the U.S. Government continues to have serious

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concerns about intellectual property rights (IPR) protection in the Philippines. Significant problems remain in ensuring the consistent and effective protection of intellectual property rights. U.S. distributors report high levels of pirated optical discs as well as widespread unauthorized transmissions of motion pictures and other programming on cable television systems. Counterfeit goods such as brand name and designer clothing, handbags, cigarettes, and other consumer goods are widely available. Optical media piracy, including piracy of DVDs and CD-Rs, also continues to be a problem. Although, some improvement is visible in select shopping malls, it is unclear whether this represents a long-term trend. The Philippines has made progress in combating optical media piracy through passage of the Optical Media Act in 2004 and stepped-up enforcement by the Optical Media Board, but the government has failed to improve the prosecution and conviction of IPR violators to create a credible deterrent. Print piracy and end-user piracy of business and entertainment software also are serious problems. The United States has encouraged the Philippines to further improve and sustain enforcement efforts, and to take steps to enhance judicial capacity.

Intellectual Property Laws

The 1997 Intellectual Property Code provides the basic legal framework for IPR protection in the Philippines. The 2000 Electronic Commerce Act extends this framework to the Internet. However, the Code contains ambiguous provisions relating to the rights of copyright owners over broadcast, rebroadcast, cable retransmission, or satellite retransmission of their works, and burdensome restrictions affecting contracts to license software and other technology.

The Philippine government has taken several positive steps in recent years to address legislative deficiencies in its IPR regime. In 2001, the Philippines enacted a new law to protect layout designs (topographies) of integrated circuits. In January 2002, the Philippine Supreme Court adopted rules establishing *ex parte* seizure authority in civil cases of IPR infringement (i.e., “seizure without notice to the suspected infringer”).

In June 2002, President Arroyo approved legislation designed to comply with TRIPS Article 27.3(b) requirements on the protection of the exclusive rights of breeders with respect to their new plant varieties. However, U.S. seed company representatives have expressed concern about the vagueness of key provisions of the law, particularly relating to rules that could affect their operations and a provision exempting local farmers from licensing requirements.

In November 2005, the Senate was considering legislation to reduce patent protection for pharmaceutical products. If passed, this legislation would weaken important patent protection provisions in the Intellectual Property Code.

In addition to adhering to the WTO TRIPS Agreement, the Philippines is a party to the Paris Convention, the Berne Convention, the Budapest Treaty, the Patent Cooperation Treaty, and the Rome Convention. The Philippines, as a member of WIPO, ratified the WIPO Performances and Phonograms Treaty and the WIPO Copyright Treaty in March 2002.

The treaties took effect in October 2002. However, the Philippine government has not yet enacted necessary amendments to its copyright law that would fully implement the requirements of these WIPO treaties into domestic law. The U.S. Government continues to urge the Philippines to enact this needed legislation.

President Arroyo signed into law the Optical Media Act (OMA) on February 10, 2004. The OMA is intended to regulate the import, export and production of optical disks, including tools and materials involved in their manufacture. In addition, the OMA created the Optical Media Board (OMB) as a replacement for the Videogram Regulatory Board. On February 1, 2005, the Congressional Oversight Committee approved implementing regulations for the Optical Media Act. Full implementation and enforcement of this law and regulations, including prosecution of IPR violators, will be critical to strengthening the Philippines IPR regime.

IPR Enforcement

The United States continues to have serious concerns regarding the lack of consistent, effective and sustained IPR enforcement in the Philippines. U.S. industry estimated the annual losses due to copyright piracy in the Philippines in 2004 at \$139 million. U.S. distributors report high levels of piracy of optical disks of films and musical works, computer games, and business software, as well as widespread unauthorized transmissions of motion pictures and other programming on cable television systems. Trademark infringement in a variety of product lines is also widespread, with counterfeit or pirated merchandise openly available in both legitimate and illegitimate venues.

During bilateral discussions in 2004 and 2005, the U.S. Government encouraged swift action and full funding support for IPR enforcement efforts and judicial capacity building. Furthermore, the U.S. Government continues to encourage the closure of malls and other outlets where pirated optical discs are the primary products being offered. The U.S. Government also urged the Philippines to adopt laws that would extend further IPR protection to the Internet by accommodating electronic commerce and outlawing online piracy, and take further steps to combat piracy of textbooks and other printed materials. The U.S. Government continues to provide technical assistance and training to strengthen capacity within Philippine agencies responsible for the protection of intellectual property.

Serious problems continue to hamper the effective operation of agencies tasked with IPR enforcement. Many enforcement agencies suffer from a lack of resources because IPR issues remain a relatively low priority. Enforcement efforts such as raids and seizures have increased in frequency over the past year, yet have only had a minor deterrent effect due to ineffective post-raid enforcement. Lack of effective interagency coordination also has had a negative impact on enforcement efforts. The Intellectual Property Code of the Philippines stipulates that the Intellectual Property Office (IPO) has jurisdiction to resolve disputes concerning alleged infringement and licensing. Since February 2005, the IPO has implemented a more robust leadership role on enforcement issues in the Philippines; and in February 2006, was granted oversight authority over law enforcement efforts. Components of the IPO's strategy include a greater emphasis on interagency coordination, enforcement campaigns in partnership with private industry, and sustained outreach efforts to inform the public on IPR issues.

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However, the IPO's enforcement coordination efforts are still in the early stages, and the agency should focus more vigorously on reinforcing links among the agencies with responsibilities in this area, including the Department of Justice, the National Bureau of Investigation, the OMB, the Bureau of Customs (BOC), and the National Telecommunications Commission (NTC).

The Philippine government has taken some administrative steps intended to strengthen enforcement. A customs administrative order in September 2002 strengthened the ability of the BOC to prohibit the importation of pirated products, and created an Intellectual Property Unit within the BOC. The order requires the BOC to maintain an IPR registry where property holders may record their rights and other information to facilitate enforcement. Nonetheless, U.S. industry continues to cite the absence of effective border enforcement as a significant concern.

A recent encouraging development, however, regarding IPR protection and enforcement in the Philippines is a new assertiveness emanating from the OMB. Since February 2005, the OMB has moved towards full operational capability in its efforts to combat domestic production of pirated optical media. The OMB has conducted 13 raids of optical media production lines since February and has seized large quantities of production equipment and finished product. Yet the legal system in the Philippines continues to undermine the best enforcement efforts and courts often release suspects picked up in OMB raids and drop their cases on questionable technical grounds.

The Philippines created specialized Intellectual Property Courts in 1995, but in practice those courts were not exclusive to IPR cases and thus lacked technical expertise. These courts remained subject to backlogs and delays. In June 2003, the Supreme Court issued a resolution transferring all intellectual property cases to the newly designated Special Commercial Courts, effectively revoking the previously existing 34 special IPR courts. The Special Commercial Courts handle cases formerly adjudicated by the Securities and Exchange Commission, in addition to cases involving IPR issues. It is unclear whether the judges have sufficient time or adequate technical knowledge of IPR issues to be effective. Moreover, IPR crimes are not considered serious and take lower precedence in criminal court proceedings. In late 2005, the Supreme Court created a Task Force on Intellectual Property Rights, which identifies three judges and a team of prosecutors who will focus on IPR cases and receive specialized training. These judges will handle other commercial and criminal cases such as money laundering, but are expected primarily to handle IPR cases. If appealed, IPR cases would still go through the current appellate system, which permits numerous interlocutory appeals and can result in long delays.

In October 2003, a new law increased the compensation of judges, with the long-run objective of recruiting more judges to fill up court vacancies. The Department of Justice has also created a task force on intellectual property piracy, with 28 state prosecutors tasked to handle the preliminary investigation of IPR complaints filed with the task force.

There have been very few successful cases of prosecution and imprisonment. Some companies have invested significant resources in investigations and litigation, but many cases remain unresolved as long as a decade after the initial complaint.

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The Philippines has failed to establish punitive sanctions sufficient enough to serve as a deterrent to IPR violators. For example, the nominal damages awarded by the Philippine courts in most IPR cases add little to the cost of doing business for IPR pirates, with no risk of imprisonment.

SERVICES BARRIERS

Basic Telecommunications

The Philippine Constitution defines telecommunication services as a public utility and therefore limits foreign ownership to 40 percent. This restricts market entry, especially in more capital-intensive applications, such as broadband, where foreign firms are reluctant to invest without majority control. In addition, foreigners are restricted from serving as executives or managers and the number of foreign directors in telecommunication companies must be proportionate to its aggregate share of foreign capital. Foreign equity in the private radio communication network is limited to 20 percent. Operation of cable TV and other forms of broadcasting and media are constitutionally reserved for Filipinos.

An August 2005 ruling of the National Telecommunications Commission (NTC) determined that Voice Internet Protocol (VIP) is a value added service and therefore did not require a legislative franchise to operate. The NTC is currently drafting the guidelines for VOIP operators who are already thriving in this newly competitive business.

During the WTO negotiations on basic telecommunications services, the Philippine government made commitments on most basic telecommunications services and adopted some pro-competitive regulatory principles contained in the WTO Reference Paper. It did not provide market access or national treatment for satellite services (which remain subject to discriminatory rules) and did not allow resale of private leased lines. The Philippine government is now over six years late in ratifying the Fourth Protocol to the WTO General Agreement on Trade in Services (GATS) embodying its proposed obligations under the WTO Basic Telecommunications Agreement, despite regular U.S. urging.

Financial Services

The Philippines also has yet to ratify the Fifth Protocol to GATS, embodying its obligations under the WTO Financial Services Agreement.

Insurance

Although current practice permits up to 100 percent foreign ownership in the insurance sector, the Philippines only committed in the GATS to a maximum of 51 percent equity participation and grandfathered existing insurers with more than 51 percent foreign equity. Under current regulations, minimum capitalization requirements increase with the degree of foreign equity. As a general rule, only the state-owned Government Service Insurance System may provide coverage for government-funded projects. Administrative Order 141, issued in August 1994, also required proponents and implementers of Build-Operate-Transfer projects and privatized government corporations to secure their insurance and bonding requirements from the GSIS at

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least to the extent of the government's interests. Private insurance firms, both domestic and foreign, regard this as a significant trade barrier. Current regulations require all insurance/professional reinsurance companies operating in the Philippines to cede to the industry-owned National Reinsurance Corporation of the Philippines at least 10 percent of outward reinsurance placements.

Banking

Pursuant to 1994 legislation, 10 foreign banks were permitted to open full service branches in the Philippines or to own up to 60 percent of a new or existing local subsidiary. Foreign branch banks are limited to six branches each. Four foreign-owned banks that had been operating in the Philippines prior to 1948 were each allowed to operate up to six additional branches. The Philippines only committed to foreign ownership at a 51 percent level in its 1997 WTO financial services offer and included a reciprocity test for authorization to establish a commercial presence. The General Banking Law of 2000 (signed in May 2000 to succeed the 1948 General Banking Act) created a seven-year window during which foreign banks may own up to 100 percent of one locally incorporated commercial or thrift bank (up from the previous 60 percent foreign equity ceiling). Such investments can be made only in existing banks since the Bangko Sentral ng Pilipinas (BSP, the central bank) imposed a moratorium on the issuance of new bank licenses in September 1999 to encourage consolidation in the banking system. Current regulations mandate that majority Filipino-owned domestic banks should, at all times, control at least 70 percent of total banking system assets. Rural banking remains completely closed to foreigners.

Pre-1997 legislation exempted banks' Foreign Currency Deposit Units (FCDUs) as well as Offshore Banking Units (OBUs) from certain non-income taxes (i.e., gross receipts tax, documentary stamp tax, and branch profit remittance tax). In 1997, a Comprehensive Tax Reform Program (CTRP) was signed into law to broaden the tax base. The final version of the CTRP, due to faulty drafting, inadvertently withdrew these tax exemptions by leaving out the phrase "exempt from all taxes." Last year, the Bureau of Internal Revenue (BIR) started to assess current and back taxes on FCDUs/OBUs. Even though one bank has paid the taxes assessed by the BIR for the timeframe 1998-2004, other members of the Bankers Association of the Philippines are still pursuing a blanket removal of these taxes. Legislators have indicated that there was no intention to rescind the exemptions in the CTRP.

Securities and Other Financial Services

Membership in the Philippine Stock Exchange is open to foreign-controlled stock brokerages that are incorporated under Philippine law. Foreign equity in securities underwriting companies is limited to 60 percent. Securities underwriting companies not established under Philippine law may underwrite Philippine issues for foreign markets, but not for the domestic market. Although there are no foreign ownership restrictions governing acquisition of shares of mutual funds, current law restricts membership on a board of directors to Philippine citizens. The Philippines took an MFN exemption on foreign equity participation in securities firms, stating that Philippine regulators would approve applications for foreign equity only if Philippine companies enjoy similar rights in the foreign investor's country of origin.

Advertising

The Philippine Constitution limits foreign ownership of advertising agencies to 30 percent. All executive and managing officers of advertising agencies must be Philippine citizens.

Public Utilities

The Philippine Constitution specifically limits the operation of certain utilities (water and sewage, electricity transmission and distribution, telecommunications, public transport) to firms with at least 60 percent ownership by Philippine citizens. All executive and managing officers of such enterprises must be Philippine citizens. These limitations also apply to the operation of public utilities under Build-Operate-Transfer and similar arrangements.

The June 2001 Electric Power Industry Reform Act provides for the privatization of the generation and transmission assets of the National Power Corporation. Transmission and distribution require a public utility franchise under the Act, which would be subject to a 40 percent foreign ownership ceiling (1986 Constitution). After a series of failed biddings, the government decided to privatize the national transmission grid, known as Transco, by awarding a 25 year concession, renewable for another 25 years. The government will seek a congressional franchise after the concession is awarded. Though stated to be a top priority, only five small hydroelectric generating stations and one large coal-fired power plant had been sold, which represent a mere 12 percent of total generating assets. The privatization and restructuring of the sector is considered critical to attracting additional foreign investment.

Practice of Professions

As a general rule, the Philippine Constitution reserves the practice of licensed professions (e.g., law, medicine, nursing, accountancy, and engineering, architecture, and customs brokerage services) to Philippine citizens.

Shipping

Under the Philippine's cabotage laws, foreign-flagged vessels cannot engage in the carriage of domestic trade cargoes. In specific cases, Philippine-registered ships engaged in international trade may be issued a special permit to temporarily engage in domestic trade services. These permits can only be issued if: there is no existing Philippine-flagged vessel operating on the proposed route; there is no suitable local vessel available; the vessel is contracted by private or public utilities; and it involves tourist passenger vessels, when the itinerary includes calls at domestic ports. Government cargo is reserved to Philippine-flagged vessels, though exemptions are permitted if these vessels are unavailable at reasonable freight rates. Only Filipino nationals or locally incorporated entities authorized to engage in overseas shipping and with a maximum of 40 percent foreign equity may register a vessel. Philippine-registered vessels must be completely manned by Filipino crews except as supernumerary for up to six months.

Express Delivery Services

Foreign air express couriers and airfreight forwarding firms must either contract with a 100 percent Philippine-owned business to provide local delivery services, or establish a domestic company with a minimum of 60 percent Philippine-owned equity. U.S. companies currently operate hub operations in the Philippines, made possible by partial open skies provisions.

In 2003, the U.S. Government attempted to negotiate amendments to the bilateral aviation agreement with the Philippine government, seeking enhanced passenger rights and cargo seventh freedom rights. Seventh-freedom cargo rights would enable U.S. and Philippine operators to carry cargo between two countries without having to pass through their home country. Talks ended in July 2003 when the Philippine delegation claimed that seventh-freedom rights were unconstitutional. In December 2003, however, President Arroyo signed an executive order permitting cargo seventh-freedom rights for the two international airports located within the Clark and Subic economic zones for carriers of any country. The Civil Aeronautics Board adopted the Implementing Rules and Regulations on April 4, 2005, granting unrestricted flight frequency, aircraft configuration, and non-cabotage traffic rights for carriers who petition for a waiver. Non-cabotage rights would allow any flight schedule except flying between two points within the Philippines for foreign carriers.

INVESTMENT BARRIERS

The 1991 Foreign Investment Act contains two "negative lists", collectively called the "Foreign Investment Negative List" (FINL), enumerating areas where foreign investment is restricted. The Foreign Investment Act requires the government to update and publish the FINL every two-years. The most recent FINL was released in November 2004.

List A restricts foreign investment in certain sectors by mandate of the Constitution and specific laws. For example, enterprises engaged in retail trade (with paid-up capital of less than \$2.5 million, or less than \$250,000 for retailers of luxury goods), mass media, small-scale mining, private security, cock fighting, utilization of certain marine resources, and manufacture of firecrackers and pyrotechnic devices are reserved for Filipino citizens.

FOREIGN TRADE BARRIERS

Up to 25 percent foreign ownership is allowed for enterprises engaged in employee recruitment and for public works construction and repair, with the exception of build-operate-transfer and foreign-funded or foreign-assisted projects, (that is, projects that benefit from foreign aid, for which there is no upper limit on foreign ownership). Foreign ownership of 30 percent is allowed for advertising agencies, while 40 percent foreign participation is allowed in natural resource extraction (although the President may authorize 100 percent foreign ownership for large-scale projects), educational institutions, public utilities, commercial deep sea fishing, certain government procurement contracts, ownership of condominium units, and rice and corn production and processing. Full foreign participation is allowed for retail trade enterprises: (1) with paid-up capital of \$2.5 million or more, provided that investments for establishing each store is not less than \$830,000; or (2) specializing in high end or luxury products, provided that the paid-up capital per store is not less than \$250,000. Financing companies and investment houses are limited to 60 percent foreign ownership.

List B restricts foreign ownership (generally to 40 percent) for reasons of national security, defense, public health, safety, and morals. Sectors covered include explosives, firearms, military hardware, massage clinics, and gaming activities. This list also addresses local small- and medium-sized firms by restricting foreign ownership to no more than 40 percent in non-export firms capitalized at less than \$200,000.

In addition to the restrictions noted in lists "A" and "B", firms with more than 40 percent foreign equity that qualify for BOI incentives must divest to the 40 percent level within 30 years from registration date or within such longer period determined by the BOI. Foreign-controlled companies that export 100 percent of production are exempt from this divestment requirement. As a general policy, the Philippine Department of Labor and Employment allows the employment of foreigners, provided there are no qualified Philippine citizens who can fill the position. BOI-registered companies may employ foreign nationals in supervisory, technical or advisory positions for five years from registration, extendable for limited periods at the discretion of the BOI. The positions of elective officers of majority foreign-owned enterprises (i.e., president, general manager, and treasurer or their equivalents) are not subject to this limitation.

The Philippine Constitution also bans foreigners from owning land in the Philippines. The 1994 Investors' Lease Act allows foreign companies investing in the Philippines to lease land for 50 years, renewable once for another 25 years, for a maximum 75 years. Deeds are difficult to establish, poorly reported and poorly regulated. The deeds and property infrastructure is full of ambiguities, which makes it difficult to establish clear ownership and the court system is not known to settle cases in a timely manner. Land ownership issues such as these need to be clarified for domestic landowners before foreign land ownership can become viable.

Trade Related Investment Measures (TRIMS)

The BOI-imposed, industry-wide local content requirements under its Motor Vehicle Development Program were eliminated in July 2003. In 1995, pursuant to the WTO TRIMS Agreement, the Philippines notified the WTO of its maintenance of local content and foreign

FOREIGN TRADE BARRIERS

exchange balancing requirements to promote investment. Proper notification allowed the Philippines to maintain such measures for a five-year transitional period, ending January 1, 2000. In October 1999, the Philippines requested a five-year extension for the measures in the motor vehicle sector. After extensive consultations on this issue with the United States, the Philippines agreed in November 2001 that it would discontinue the exchange balancing requirements immediately and remove all local content requirements in the motor vehicle sector by July 1, 2003, following the implementation of a phase-out program begun in January 2002. The final phase out of the local content and foreign exchange requirements was completed by July 1, 2003. The U.S. Government is continuing to closely monitor Philippine implementation of this WTO commitment.

Under a 1987 executive order, the soap and detergent industry is required to use a minimum of 60 percent of locally produced raw materials that do not endanger the environment. The law is intended to require soap and detergent manufacturers to use coconut-based surface-active agents (soft surfactants) of Philippine origin. In 1999, the Philippine Department of Justice determined that this executive order conflicts with the Philippines' obligations under the WTO TRIMS Agreement and since then, while not repealed, the order has not been enforced. Moreover, a 1990 law (Republic Act 8970) prohibits manufacture, importation, distribution, and sale of laundry and industrial detergents containing hard surfactants. Only natural oleo chemicals, including those derived from coconut, palm, palm kernel, sunflower, and rapeseed oils are allowed.

The United States continues to monitor the Philippines' compliance with other TRIMS requirements. Regulations governing the provision of BOI-administered incentives impose a higher export performance requirement for foreign owned enterprises (70 percent of production should be exported) than for Philippine-owned companies (50 percent). A 1984 measure, which requires mining firms to prioritize the sale of copper concentrates to the then government-controlled Philippine Associated Smelting and Refining Company (PASAR), has yet to be repealed despite PASAR's privatization in 1998. In addition, there appear to be unwritten "trade balancing" requirements for firms applying for approval of ventures under the ASEAN Industrial Cooperation scheme. Under a 1982 executive order (EO 776), the Bureau of Foods and Drugs requires pharmaceutical firms to purchase semi-synthetic antibiotics from a specific local company, except when these firms can show that the landed cost of imports are at least 20 percent cheaper.

TRIMS and Retail Trade

Legislation passed by the Philippine Congress in February 2000 requires that foreign retailers, for 10 years after the bill's enactment, source at least 30 percent (for retail enterprises capitalized at no less than \$2.5 million) or 10 percent (for retail enterprises specializing in luxury goods) of their inventory, by value, in the Philippines. In addition, prospective investors in the retail sector face a reciprocity requirement. The Retail Trade Act states that only nationals from, or juridical entities formed or incorporated in countries that allow the entry of Filipino retailers, shall be allowed to engage in retail trade in the Philippines.

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Public Utilities

The Philippine government's most important privatization effort, the June 2001 Electric Power Industry Reform Act, provided that the National Power Corporation (NPC) should privatize at least 70 percent of its generating assets located in Luzon and Visayas within three years. Privatization stalled and no asset has been privatized since December 2004 when five small hydroelectric and one large coal-fired power plant were sold. The bidding for a 225 MW Bataan thermal and a 600 MW Calaca coal-fired power plant is currently ongoing. Seventy-five percent of the funds used to acquire NPC assets must be inwardly remitted and registered with the BSP. However, foreign participation may be restricted pursuant to a constitutional provision regarding utilization of certain natural resources (such as water and geothermal resources) and power generation as well as provisions requiring a minimum of 60 percent Filipino ownership to obtain water rights for hydropower generation under the implementing rules of the 1976 Water Code of the Philippines.

Licensing of Technology

The Philippine government defines technology transfer arrangements as: (1) contracts involving the transfer of systematic knowledge for the manufacture of a product; (2) the application of a process, or rendering of a service including management contracts; and, (3) the transfer, assignment, or licensing of all forms of intellectual property rights, including computer software (except for software developed for the mass market). The Intellectual Property Office requires that all technology transfer arrangements comply with provisions outlined in R.A. 8293, including the prohibition of the use of certain clauses in such arrangements. The scope of these provisions is extremely broad and serves to obstruct the normal contracting process between unrelated parties or as part of intra-company business.

Mining

The Philippine Supreme Court, in a decision issued in December 2004, reversed its January 2004 ruling that declared key provisions of the Mining Act of 1995 unconstitutional and prohibited majority foreign-owned firms from mining in the Philippines. The reversal opens the sector to direct foreign investment. As such, mineral exploration and processing licenses are open to full foreign equity participation for large projects valued at over \$50 million; small and medium-scale mining is reserved for Filipinos. The country's unexploited mineral wealth is estimated as \$840 billion. The Philippines has some of the richest deposits of metallic and non-metallic minerals in the world (e.g., copper and gold). Mining output is currently about \$500 million per year. There are nine million hectares where mineral deposits may be found, although the government has issued permits for only 1.4 percent of those lands. Significant barriers to investment remain, such as unresolved disputes regarding land claims and a paucity of progress in implementing key regulatory and administrative reforms.

Other Investment Issues

The Supreme Court recently decided to disallow the Clark Special Economic Zone fiscal incentives provided under the Bases Conversion Development Act, although the underlying court case has been appealed. Over 350 investors, including 10 U.S. firms, maintain investments at Clark. The unforeseen taxes, including retroactive taxation, may lead to investor withdrawals from Clark and discourage new investment.

ANTICOMPETITIVE PRACTICES

The Philippine Constitution provides the government with authority to regulate or prohibit monopolies, and it also bans combinations of entities in restraint of trade and unfair competition. However, there is no comprehensive competition law to implement this constitutional provision. Instead, there are a number of laws dealing with competition, including the 1930 Revised Penal Code, the 1961 Act to Prohibit Monopolies and Combinations in Restraint of Trade, 1949 Civil Code, the 1980 Corporation Code, the 1991 Price Act, and the 1932 Consumer Act. However, enforcement agencies do not effectively enforce these laws, as they do not have the resources or capability to challenge entrenched economic and political interests.

ELECTRONIC COMMERCE

The Electronic Commerce Law, signed in June 2000, provides that business transactions through an automated electronic system such as the Internet are functionally and legally equivalent to a written document protected under existing laws on commerce. Business-to-business transactions include domestic and international exchange of information, arrangements, and contracts for procurement, payments, supply management, transportation, and facility operations. An Internet service provider (ISP) generally is not criminally liable for unlawful activities conducted using its services if the ISP does not directly commit any infringement or other unlawful activities, or does not cause another party to commit any unlawful act. The law includes provisions to penalize, among other offenses, hacking or cracking (unauthorized access into or interference in a communications system) and piracy (or the unauthorized reproduction, distribution, importation, use, removal, alteration, and downloading, or broadcasting of copyrighted works including legally protected sound recordings). Electronic transactions are not currently subject to any tax measures. However, a reciprocity clause specifies that all benefits, privileges, and advantages established under the act will be enjoyed only by parties whose country of origin grants the same benefits and privileges or advantages to Philippine citizens.

OTHER BARRIERS

Corruption is pervasive and a longstanding problem in the Philippines. During discussions under our bilateral TIFA, the United States has conveyed to the Philippines its views on specific cases where corruption appears to be a factor and urged the Philippines to tackle the problem of corruption as a means of improving the country's investment climate. The Philippines' score in Transparency International's annual Corruption Perceptions Index survey has averaged 2.5 to 2.6 (out of a best score of 10) since 2002, down from 3.6 in 1999. The Philippine Revised Penal

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Code, the Anti-Graft and Corrupt Practices Act, and the Code of Ethical Conduct for public officials are intended to combat corruption and related anticompetitive business practices. The Office of the Ombudsman investigates cases of alleged graft and corruption involving public officials. The Sandiganbayan (anti-graft court) prosecutes and adjudicates cases filed by the Ombudsman. In addition, a Presidential Commission Against Graft and Corruption is tasked with prosecuting corruption cases linked to the former Marcos regime.

Soliciting or accepting and offering or giving a bribe are criminal offenses, punishable by imprisonment of between six and 15 years, a fine, and/or disqualification from public office or business dealings with the government. As with many other laws, however, enforcement of anti-corruption laws has been inconsistent. The Philippine government launched an initiative to strengthen public and private governance, including anticorruption efforts, in cooperation with bilateral and multilateral aid donors in May 2000. To date, results of this initiative have been limited.

The government seems to have reinvigorated its anti-corruption drive. The Office of the Ombudsman has reported improved conviction rates. In December 2003, the President issued an executive order creating an anti-corruption watchdog - the Revenue Integrity Protection Service (RIPS) - in the Department of Finance that has worked closely with the Ombudsman to help curb corruption in revenue collection agencies. President Arroyo has articulated her desire to strengthen the Office of the Ombudsman to become as efficient as Hong Kong's Independent Commission Against Corruption. Achieving that goal will require strong political will and significantly greater financial and human resources than currently dedicated to the effort. In November 2004, the Philippines became eligible for the Millennium Challenge Account Threshold Program. In August 2005, the country's concept proposal for the Threshold Program addressing corruption in revenue administration was approved for the development of an approximately \$20 million Threshold Country Plan (TCP).

Both foreign and domestic investors express concern over the propensity of Philippine courts and regulators to stray beyond matters of legal interpretation into policymaking functions and about the lack of transparency in these decision-making processes. In addition, there are many reports that courts influenced by bribery improperly issue temporary restraining orders impeding the conduct of legitimate commerce. Investors also have raised concerns that regulators rarely have any background in economics, business, or a competitive economic system, which enables entrenched interests to manipulate the legal system and regulatory process - whether by bribery or through exploiting the lack of expertise among regulators - to protect market positions.

QATAR

TRADE SUMMARY

The U.S. goods trade surplus with Qatar was \$538 million in 2005, an increase of \$471 million from \$67 million in 2004. U.S. goods exports in 2005 were \$986 million, up \$117 percent from the previous year. Corresponding U.S. imports from Qatar were \$448 million, up 16 percent. Qatar is currently the 65th largest export market for U.S. goods.

The stock of U.S. foreign direct investment (FDI) in Qatar in 2004 was \$4.4 billion, up from \$3.2 billion in 2003.

The United States and Qatar signed a Trade and Investment Framework Agreement (TIFA) in March 2004, providing a forum to address U.S. concerns.

IMPORT POLICIES

Tariffs

As a member of the Gulf Cooperation Council (GCC), Qatar applies the GCC common external tariff of five percent for most products, with a limited number of country-specific exceptions. Qatar's exceptions to the common external tariff include duty exemptions for basic food products such as wheat, flour, rice, feed grains, and powdered milk. The tariff on alcoholic beverages and tobacco products is 100 percent. Qatar also has a 20 percent tariff on iron bars and rods, non-alloy hot-rolled steel, and 12 millimeter steel bars. Projects funded by the Qatar Industrial Development Bank (QIDB) can be granted a customs duty waiver for the import of machinery, raw materials, and other industrial inputs. Qatar is not a signatory to the WTO Information Technology Agreement.

Import Licensing

Qatar requires importers to have a license for most products, and only issues import licenses to Qatari nationals. Only authorized local agents are allowed to import goods produced by the foreign firms they represent in the local market. However, this requirement may be waived if the local agent fails to provide the necessary spare parts and backup services for the product. The importation and distribution of alcohol is the exclusive right of the Qatar Distribution Company (QDC). Pork and pork derivatives may not be imported.

Documentation Requirements

In Qatar, a letter of credit is the most common instrument for controlling exports and imports. When a letter of credit is opened, the supplier is required to provide a certificate of origin. The Qatari embassy, consulate, or chamber of commerce should notarize the certificate of origin in the United States.

FOREIGN TRADE BARRIERS

To clear goods from customs zones at ports or land boundaries in Qatar, importers must submit a variety of documents, including a bill of lading, certificate of origin, *pro forma* invoice, and an import license.

All imported beef and poultry products require a health certificate from the United States and a halal slaughter certificate issued by an approved Islamic center in the United States. The Qatari embassy, consulate, or chamber of commerce in the United States must legalize all shipping documents.

STANDARDS, TESTING, LABELING AND CERTIFICATION

In October 2002, Qatar established a General Authority for Standards and Specification. However, most Qatari standards are derived from standards developed by the GCC. The Ministry of Public Health provides input on standards related to public health issues. Qatar enforces government-mandated shelf-life standards for about seventy-five food products, and although never officially endorsed, requires importers to comply with shelf-life standards defined in Gulf Standard 150/1993, Part II. Food products must arrive at the destination with at least half the shelf-life remaining and shelf-life validity of all foodstuffs should not be less than six months at the time of entry of the products into Qatar. All foodstuffs are examined at government central laboratories before they are distributed to consumers.

Qatar still imposes a ban on imports of U.S. beef in response to the discovery of Bovine Spongiform Encephalopathy (BSE) in a single dairy cow in Washington State. In February 2004, Qatar also banned imports of U.S. poultry due to the discovery of low pathogenic avian influenza in a flock of chickens in Delaware and high pathogenic avian influenza in a flock of chickens in Texas. In May 2004, Qatar modified the import ban against U.S. poultry to exclude all fresh poultry from Delaware and Texas.

GOVERNMENT PROCUREMENT

Qatar gives preferential treatment to contractors that include high local content in bids for government tenders. As a rule, Qatar requires that suppliers be 51 percent Qatari-owned or that foreign firms have a local agent when submitting tenders, though in practice certain exceptions exist. Qatar gives a 10 percent price preference to local firms and a five percent price preference to GCC firms in all government procurement. Qatar is not a signatory to the WTO Agreement on Government Procurement.

INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

Qatar was removed from the Special 301 “Watch List” in 2003 in recognition of the passage of the 2002 Copyright Law and its improved, sustained enforcement actions against copyright infringement. The new copyright law provides a series of important changes to Qatar’s legal framework, addressing many of the deficiencies and improving the degree of consistency with the WTO TRIPS Agreement. The copyright law also requires that an “Office for the Protection of Copyright and Neighboring Rights” be established under the Ministry of Economy and Trade. However, the law does not provide explicitly for national treatment or coverage of unpublished

FOREIGN TRADE BARRIERS

works, does not criminalize end-user piracy, and does not clearly treat computer programs as literary works. In 2003, Qatar authorized government officials responsible for IPR enforcement to independently conduct raids and seize pirated material without Ministry of Interior officials, and the Copyright Office continues to prosecute resellers of unlicensed video and software. These efforts have significantly helped reduce piracy in Qatar over the last several years.

In September 2003, the government of Qatar and Microsoft signed a three-year software licensing agreement that covers all Qatari government ministries and agencies. Qatar joined the WIPO Copyright Treaty and Performances and Phonograms Treaty in April 2005, and is drafting the necessary implementing legislation and regulations.

Qatar uses the GCC patent law with derogations as needed to comply with its obligations under the TRIPS Agreement. It also established a joint committee between the Ministry of Economy and Commerce and the Ministry of Public Health to coordinate their efforts and ensure that only patented products or authorized copies of pharmaceutical products are registered for sale.

Qatar provides protection for trademarks registered with the Office of Commercial Registration. In June 2002, Qatar promulgated Law No. 9 for Trademarks and Geographic Indications. However, the implementing regulations for the law have yet to be issued.

SERVICES BARRIERS

Agent and Distributor Rules

The vast majority of foreign firms operating in Qatar are required to engage local agents. Only firms granted 100 percent foreign-ownership by the government in five sectors – agriculture, industry, tourism, education, and health – are excluded from the local agent requirement. Qatari laws state that only Qatari nationals can act as local agents, distributors, or sponsors. The 2002 Commercial Agents Law grants agents and distributors exclusive rights to import, market, and distribute particular goods and services. The Commercial Agents Law allows individuals other than exclusive agents to import products provided they pay up to five percent commission to the registered agent/distributor. In practice, some Qatari ministries may waive the local agent requirement for foreign companies that have contracts directly with the government of Qatar.

Banking

In 2004, Law No. 31/2004 amended the Organization of Foreign Capital Investment Law to allow foreign investment in the banking sector with approval by decree from the Cabinet of Ministers. Qatari regulations for local and foreign bank practices are the same, with new licenses available through the Qatar Central Bank application process. In 2003, the Qatar Central Bank allowed foreign banks to establish representational offices and the existing foreign banks in Qatar to open new branches through a case-by-case waiver by Emiri Decree.

FOREIGN TRADE BARRIERS

Insurance

In 2004, Law No. 31 amended the Organization of Foreign Capital Investment Law to allow foreign investment in the insurance sector with approval by decree from the Cabinet of Ministers. Foreign insurance companies wishing to operate in Qatar are subject to the same laws that apply to foreign firms in all other sectors.

Telecommunications

The Organization of Foreign Capital Investment Law (Law No. 13/2000) prohibits foreign investment in the telecommunications sector, but foreign nationals are allowed to buy a limited quantity of stock in Qatar Telecommunications (Q-Tel) Company, which is majority-owned (55 percent) by the government of Qatar. Q-Tel has a license to operate as the monopoly telecommunications provider in Qatar until 2013.

INVESTMENT BARRIERS

The Organization of Foreign Capital Investment Law (Law No. 13/2000) allows foreign investors to own up to 100 percent of projects in the agriculture, tourism, education, industry, health and energy sectors with approval by the government. Foreign equity is limited to 49 percent in other sectors. Although the law does not allow foreign investment in the banking and insurance sectors, in 2004 Qatar amended the law to allow foreign investment in these sectors with approval by decree from the Cabinet of Ministers. The investment law permits foreign investors to lease land for up to 50 years, renewable with government approval. Qatar passed a law in 2004 allowing foreigners to own some residential property in select projects of the Pearl of the Gulf Real Estate Development Project.

OTHER BARRIERS

Corporate Tax Policies

Qatar levies corporate income taxes on foreign firms at rates from 5 percent to 35 percent of net profits, including profits from majority-owned Qatari joint ventures exceeding 100,000 Qatari riyals (US \$30,000). All Qatari owned firms and joint ventures are exempt from corporate income taxes. Under Law No. 13 of 2002, the Ministry of Finance may grant a tax holiday of up to ten years for new foreign investments in key sectors. Other foreign companies may be granted tax exemptions on a case-by-case basis by Emiri Decree.

FOREIGN TRADE BARRIERS

ROMANIA

TRADE SUMMARY

The U.S. goods trade deficit with Romania was \$576 million in 2005, an increase of \$248 million from \$328 million in 2004. U.S. goods exports in 2005 were \$632 million, up 20.3 percent from the previous year. Corresponding U.S. imports from Romania were \$1.2 billion, up 41.6 percent. Romania is currently the 73rd largest export market for U.S. goods.

The stock of U.S. foreign direct investment (FDI) in Romania in 2004 was \$542 million, up from \$401 million in 2003.

IMPORT POLICIES

Tariffs

Romania's trade policies are shaped primarily by its World Trade Organization (WTO) commitments and by its efforts to join the European Union (EU). Romania has a preferential trade agreement with the EU (the "Europe Agreement"), and free trade agreements with its Central European neighbors and the European Free Trade Area (EFTA) countries. Romania provides duty-free access to its market for nearly all products imported from the EU but maintains higher levels for non-EU trading partners, including the United States. The free trade arrangements with the EU and EFTA, and the CEFTA, result in customs duty differentials for many U.S. products, often of as much as 30 percent. U.S. exporters have voiced concerns about these tariff differentials, including exporters of distilled spirits, pharmaceuticals, wheat, animal feed supplements, wine, rubber tires, upholstery, lightning arresters, switching gear for telephone lines, and commercial washers and dryers. Romania has bound most of its tariff rates in the WTO for both agricultural products (average rate of 109 percent) and non-agricultural products (average rate of 34.4 percent). Lower applied rates are generally used, resulting in average applied rates of 30 percent in the case of agricultural products and 16.2 percent in the case of non-agricultural products. Romania is a party to the WTO Information Technology Agreement and eliminated tariffs on products covered by the agreement effective January 1, 2000. High most-favored-nation (MFN) rates on distilled spirits (60 percent *ad valorem*, except for bourbon whisky, taxed at 35 percent), wine (60 percent), and textiles (12 percent to 32 percent) provide limited access to the Romanian market for these U.S. products.

FOREIGN TRADE BARRIERS

As a result of petitions filed by the Pharmaceutical Research and Manufacturers of America and the Distilled Spirits Council of the United States and concerns expressed by agricultural producers, the U.S. Government is reviewing Romania's continued eligibility for the U.S. Generalized System of Preferences (GSP) program in view of the preferential treatment it affords to the EU. The United States has urged the Romanian government to lower MFN tariffs on a range of items to reduce the tariff differential and its negative effect on U.S. exports.

STANDARDS, TESTING, LABELING AND CERTIFICATION

Romania has begun to harmonize sanitary and phytosanitary measures with those of the EU. Adoption and implementation of EU measures will have a negative impact on U.S. exports of pork, poultry, beef and biotechnology products to Romania. The U.S. Government has been working closely with Romanian officials to ensure that U.S. products continue to have market access for these key products.

GOVERNMENT PROCUREMENT

Romania is an observer in the WTO Committee on Government Procurement and would become subject to the WTO Government Procurement Agreement (GPA) upon its accession to the EU, which is a GPA Party. With the exception of the procurement of armaments and public works, Romania's government procurement law covers purchases by central government bodies, the parliament, the presidency, the ministries, institutions of higher learning, the judiciary, as well as state-owned enterprises. According to Romanian law, foreign suppliers are accorded the same treatment that Romanian suppliers enjoy in the foreign supplier's home country.

The Romanian government's web-based public procurement project, which has been in operation since 2002, has improved government efficiency and helped curb institutional corruption. Romania's tender announcements, bid processing, and offer appraisals are entirely computer-based; the list of ongoing and closed auctions, names of adjudicators, and closing prices are available to the public. The e-procurement system has grown to include complex projects (e.g., state-financed sports halls for public schools and road transportation licenses) and has saved the budget over €100 million.

EXPORT SUBSIDIES

The Romanian government provides export subsidies for certain wines. Only wines of controlled origin exported to destinations other than EU are eligible for the program.

INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

Romania's criminal enforcement with respect to copyright piracy and trademark counterfeiting remains inadequate. Although Romania's legislation is fairly modern and comprehensive, enforcement remains quite weak.

FOREIGN TRADE BARRIERS

Due to inadequate enforcement against copyright piracy, Romania remained on the Special 301 “Watch List” in 2005. Although the authorities have made gradual, limited improvements, the rates of copyright piracy are high. Industry reports that levels of DVD piracy have risen to 80 percent, while levels of videocassette piracy are down to 20 percent and the most blatant retail piracy has been eliminated.

While legislative improvements allow for greater criminal prosecution, very few IPR cases are prosecuted and many law enforcement officials refuse to recognize IP crime as an important issue. Despite some seizures, infringement is increasing as pirated DVDs continue being smuggled into Romania. Furthermore, police acknowledge that sources in Romania may be building capacity to start domestic production of pirated CDs.

The appointment in 2003 of a special IPR prosecutor in the General Prosecutor's Office (GPO) has helped efforts to combat IPR piracy as has the establishment of a small IPR office in the GPO in 2005. The government recently approved an action plan which designates the GPO as the national coordinator for IPR enforcement. Information sharing is increasing in the law enforcement community. Specially appointed IPR prosecutors have been designated for all Romanian counties, and specialized judges have been designated to serve on the Bucharest Tribunal. IPR training sessions in 2004 and 2005 specifically focused on training prosecutors, judges, local and border police officers, and customs officials to better understand and recognize violations of intellectual property rights.

Another area of concern is the illegal sale of counterfeit decoder devices. The stealing of video signals is hindering cable companies’ efforts to upgrade networks and keep subscription rates as low as possible. Currently, Romanian law stipulates fines for the trading of counterfeit decoders but the law is not enforced. One video provider estimates that for each legitimate subscriber, five others are fraudulently watching transmissions through counterfeit devices.

SERVICES BARRIERS

In accordance with its Association Agreement with the EU, Romania was required to implement the EU Broadcast Directive that provides for European content quotas. However, Romania is also covered by a provision of the Directive that gives the government flexibility in implementing this rule. Specifically, Law 119 of 1999, which amended the Audio-Visual Law 48/1992, provides that television stations must gradually devote at least 51 percent of total broadcast time to European productions, minus news and sport shows, games, advertising, and teletext services. The result is that at least 40 percent of total broadcasting must be Romanian. Many Romanian Parliamentarians regard the amendment of Romanian legislation to reflect EU requirements impractical, because Romanian stations that comply with the requirement would dramatically lose market share and revenues.

FOREIGN TRADE BARRIERS

Foreign lawyers not licensed in the practice of Romanian law can only provide legal advice on foreign or international law. They can, however, provide legal advice on Romanian legislation after passing an examination on Romanian legislation given by the Romanian Lawyers Union Exam. A law passed in 2004 increased flexibility for EU lawyers, enabling them to practice in Romania after a three-year probationary period as an alternative to taking the exam in Romanian legislation. Foreign lawyers may work in Romania as individuals in law offices associated with Romanian firms or international law firms.

Romanian law previously required that doctors and health care professionals be Romanian citizens. A law passed in 2004 makes it possible for doctors and healthcare professionals from EU member states to practice in Romania, but maintains the restriction for non-EU citizens. This effectively hinders the provision of medical services by non-EU medical professionals.

Foreign insurance companies must establish a partnership venture with a Romanian partner to enter the Romanian market. Romania has made limited GATS commitments for cross-border provision of insurance services.

During 2003, Romania phased-in many of its GATS telecommunications commitments, which included the pro-competitive regulatory principles contained in the WTO Reference Paper. Nonetheless, concerns remain regarding a lack of transparency and the existence of discriminatory treatment in the licensing system.

However, Romania's telecommunications regulator – the National Regulatory Authority for Communications (ANRC) – has simplified the authorization procedure for private communications licenses. Additionally, in October 2005, the ANRC imposed the obligation on Romtelecom – Romania's dominant provider – to charge cost-oriented interconnection rates, which will result in a significant reduction in price (from 11.3 percent to 69.8 percent, depending on the segment). The ANRC has also announced that it will impose this same obligation on mobile operators that it deems to have significant market power.

INVESTMENT BARRIERS

In 2003, to address potential incompatibilities between Bilateral Investment Treaty (BIT) obligations and EU law, the United States and eight prospective EU members agreed to make several narrow amendments to the texts of the relevant BITs. Both the United States and Romania have ratified the BIT amendments, but the amendments will not enter into force until Romania joins the EU. A law on securities that was passed in 2004 entitles majority shareholders owning 95 percent of the total stock in a firm to buy residual shares. This law is considered to be a compromise to provide very limited minority shareholder protection.

A continued impediment to foreign investment is Romania's inconsistent legal and regulatory system. Tax laws change frequently and are unevenly enforced. Tort cases often require lengthy, expensive procedures, and judges' rulings are often not enforced.

FOREIGN TRADE BARRIERS

ELECTRONIC COMMERCE

Romania has one of the highest incidences of Internet credit card fraud in Europe, which has discouraged international vendors from making electronic payments to Romania. The most common problems result from the use of stolen credit card numbers for the purchase of goods on the Internet. Romanian hackers have also attacked U.S. companies' servers and stolen proprietary information. Since 2002, Romania has had a law on electronic commerce that defines and punishes cyber crime and includes criminal sanctions for falsifying cyber-pay instruments, carrying out fraudulent financial transactions, accepting fraudulent financial transactions, or performing unlicensed cyber transactions.

OTHER BARRIERS

Though more than two-thirds of Romanian gross domestic product is created by private entities, large state-owned enterprises and government-subsidized enterprises are major impediments to free and fair market competition in certain sectors. Preferential debt rescheduling and total or partial cancellation of debts (including taxes) by the Romanian government, as well as granting of state aid to state-owned enterprises and the firms of well-connected Romanians, continued up to 2004. While the Competition Council has brought new state aid under control and in compliance with EU requirements, it still has not dealt with improperly granted state aid from 2004 and before.

The most common complaints of American companies operating in Romania are the frequency with which the government changes its laws, unfair public procurement, weak enforcement of existing laws, concerns about judicial competence, lack of court impartiality, limited consultation with businesses in the passage of economic legislation, and corruption.

FOREIGN TRADE BARRIERS

RUSSIA

TRADE SUMMARY

The U.S. goods trade deficit with Russia was \$11.3 billion in 2005, an increase of \$2.4 billion from \$8.9 billion in 2004. U.S. goods exports in 2005 were \$3.9 billion, up 33.1 percent from the previous year. Corresponding U.S. imports from Russia were \$15.3 billion, up 28.5 percent. Russia is currently the 33rd largest export market for U.S. goods.

The stock of U.S. foreign direct investment (FDI) in Russia in 2004 was \$2.2 billion, up from \$1.8 billion in 2003. U.S. FDI in Russia is concentrated largely in the mining sector.

Russia is in the process of negotiating terms of accession to the World Trade Organization (WTO). By the end of 2005, the Government of Russia had met over 30 times with WTO members in formal and informal Working Party meetings. Russia tabled its initial goods and services market access offers in February 1998 and October 1999, respectively. Russia has subsequently revised these offers and continues negotiations with Working Party members. As of the end of 2005, Russia reported concluding bilateral market access and services negotiations with most WTO members.

The United States and Russia signed a Bilateral Investment Treaty (BIT) in 1992. Though ratified by the U.S. Senate that same year, it was never ratified by the Russian State Duma.

IMPORT POLICIES AND PRACTICES

Russia continues to maintain a number of barriers with respect to imports, including tariffs and tariff-rate quotas; discriminatory and prohibitive charges and fees; and discriminatory licensing, registration, and certification regimes. Discussions continue within the context of Russia's WTO accession to eliminate these measures or modify them to be consistent with internationally-accepted trade policy practices.

Quotas

In January 2003, the Russian government announced the imposition of a quota for poultry and tariff-rate quotas for pork and beef. Quotas became effective in April and May 2003, respectively. The United States reached an agreement in principle with the Russian government in September 2003 for market access parameters on poultry, pork, and beef. After much delay by the Russian side, the agreement was signed in Washington, D.C. on June 15, 2005. There have been a number of persistent concerns about how the agreement has been implemented, namely, the potential for the quota to be used by other countries. Discussions between the two sides on current and future quota allocation procedures continue in the WTO accession context. Russia announces quota allocation based on historical export levels as provided for in the agreement.

FOREIGN TRADE BARRIERS

Import Licenses

During 2005, the Russian government eliminated and streamlined many existing import license requirements. Import licenses are now required for explosive substances, drugs, nuclear substances, medicines, white spirits, hazardous wastes, some food products, and products containing encryption technology. Additionally, licenses to import many of these products, including alcoholic beverages, pharmaceuticals, and products containing encryption technology, are limited to companies that have been granted Activity Licenses to produce or distribute in Russia.

Russia has proposed a new regulatory regime that would formalize previously informal controls on imports and exports of products containing encryption or ciphering technology. As proposed, the Federal Security Service (FSB) and the Ministry of Economic Development and Trade (MEDT) would apply a multi-stage inspection and permit process consisting of an experts' evaluation, authorization by the FSB, and import and activity licensing by MEDT. The draft regulation raises strong concerns about the transparency of its implementation. The scope of its coverage appears to be unnecessarily broad and the time required for obtaining all of the relevant evaluations, approvals, and licenses is estimated to be more than 80 days if the product is covered by the broad list. There is the potential for the experts' evaluation process to be expensive and arbitrary.

In September 2005, to protect its domestic fish resources, Russia announced new licensing requirements for fish and roe. Russia is a large importer of roe, including from the United States. Most import licenses are issued by MEDT or its regional branches and are enforced by the Federal Customs Service.

Customs

A new Customs Code, intended to bring Russia's customs regime into compliance with WTO requirements, came into force on January 1, 2004. It simplified the customs process and established specific procedures for the application and payment of tariffs, but several problems still remain. Russia continues to assess the value for compact discs (CDs) and digital video discs (DVDs) on the royalty value of imported audiovisual materials - such as TV master tapes and DVD masters - rather than basing these duties on the physical value of the medium on which the content is recorded. This artificially increases the effective tariffs imposed on imported U.S. products. Amendments to the Customs Tariff Law that address customs valuation are being reviewed within the Duma.

The weighted average applied import tariff for Russia is 10.4 percent for industrial goods and 21 percent for agricultural goods. Earlier reforms in 2001 consolidated Russian tariffs into basic categories and lowered some tariff rates, but many tariffs still are accompanied by alternative minimum specific tariff rates (these are not included in the averages) and higher tariffs remain on some used goods. Tariff consolidation helped to combat customs fraud and improve collections, yet, the overall weakness of the Russian customs administration still leads to many abuses. Producers of the following goods, among others, have complained about excessively high tariffs: automobiles, aircraft and aircraft parts, motorcycles, sugar, distilled spirits, wine, fruit, processed food and forest products.

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A value-added tax (VAT) is applied to virtually all imports, and excise taxes are applied to a small selection of goods. As of January 1, 2004, the VAT, which is applied to the price of the imported good plus its tariff, was reduced to 18 percent. In the case of automobiles, combined tariffs, VAT and engine displacement-weighted excise duties can increase import prices by 70 percent for larger U.S.-made passenger cars and sport utility vehicles. When the import tariff is added to the VAT and other customs handling fees, the amount of total taxes paid on the importation of foreign aircraft exceeded 40 percent in 2005. Pharmaceutical importers have complained that new pharmaceuticals imported solely for clinical trials (prior to registration) nevertheless had the VAT assessed because the importers could not produce a certificate of registration, which is impossible for them to obtain as registration is only granted to drugs that have completed clinical trials. These issues are key subjects under discussion in Russia's WTO accession negotiations.

Non-Tariff Barriers

Non-tariff barriers are frequently used to restrict foreign access to the market and are also a significant topic of discussion in Russia's WTO negotiations. While phytosanitary certificates are customarily required for agricultural goods, Russia's Federal Service for Veterinary and Phytosanitary Surveillance (VPSS) has recently begun to require such certificates for products such as styrofoam cups, furniture, and various processed agricultural products.

For the importation of pharmaceutical products, Russia requires product registration, an "experts' analysis," product certification, and an import and activity license. In the context of its WTO negotiations, Russia is working to eliminate discriminatory fees for experts' analysis and product registration and is moving towards manufacturers' self-certification for Good Manufacturing Practices on pharmaceuticals. Russian government decisions regarding which products to place on reimbursement lists for state-provided healthcare are having an adverse impact on U.S. exports to Russia. U.S. industry reports that higher-priced imports, which are often safer and of a higher quality than locally-produced pharmaceuticals, are often excluded from reimbursement lists and state purchases because the government focuses more on price concerns than on the quality and safety of the products.

The Russian government has retained tight controls on the production, importation, and distribution of alcoholic products, including wine. Current requirements include the need for importers to obtain an import and activity license and to pay high excise taxes to obtain excise stamps. On January 1, 2005, the excise tax for distilled spirits with an alcohol content greater than 25 percent was increased to 146 rubles per liter of pure alcohol. Spirits containing between 9 percent and 25 percent are assessed an excise tax of 108 rubles per liter of pure alcohol. The rate for spirits below nine percent alcohol is 76 rubles per liter of pure alcohol. The vast majority of U.S. spirits are subject to the highest excise tax rate. In 2005, Russia eliminated import quotas and minimum import prices for imports of alcoholic products and eliminated the need for an import license for non-white spirits. A July 2005 law effective January 1, 2006, requires that excise stamps only be affixed to imported goods once they are in the territory of the Russian Federation. This requirement was eliminated through amendments in late 2005. There continue to be concerns, however, about the timely availability of excise stamps for use during 2006.

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Manufacturers of telecommunications equipment, construction materials and equipment, and oil and gas equipment have reported serious difficulties in obtaining product approvals. A new Law on Telecommunications, however, overrode an amendment to the Federal Law on Communications that had encouraged government agencies to purchase Russian-produced equipment.

Although Russia is expected to represent a significant market for new nuclear plants, instrumentation, and nuclear fuel over the next decade, U.S. companies are largely excluded from the market. One significant obstacle is Russia's lack of a nuclear liability regime providing adequate protection for U.S. firms that creates a prohibitive risk to business operations. Because few private companies will operate without such liability protections, Russian state-owned nuclear suppliers largely control the domestic market. Although Russia did ratify the Vienna Convention on nuclear liability in 2005, that convention remains incompatible with domestic U.S. legislation, and therefore offers no additional protection to U.S. firms.

EXPORT POLICIES AND PRACTICES

The Russian government's industrial policy guidelines emphasize export promotion, but this process is still in its infancy and there has been limited budgetary funding for such initiatives. The subsidy-like effect (for Russian industrial consumers of natural gas) of Russia's current domestic gas pricing policy is a key issue due to the potentially adverse impact this policy may have on certain U.S. industries. There is uncertainty as to whether prices in Russia's domestic market are below the full cost of production. Russia has indicated that it is currently considering numerous reform plans for the sector, and has been gradually increasing domestic prices (prices rose 23 percent in January 2005 and are expected to rise a further 10 percent to 15 percent in 2006). However, the gas sector and Gazprom, Russia's monopoly distributor, play a significant role in Russia's economy and foreign relations. The Russian government is proceeding slowly and cautiously with any changes in the sector, even ones that bring prices up to cover full production cost, including recovery. Russia has no direct export subsidies on agricultural products, although it has asserted in WTO accession talks that it would like to reserve the option to use agricultural export subsidies in the future.

Russia maintains export taxes on a large but slowly decreasing variety of products. Russia currently imposes a 15 percent export tariff on ferrous steel scrap (amounting to not less than 15 euros per metric ton). This policy further restricts world supplies of steel scrap and artificially ensures that Russian steel producers have access to scrap. Russia also currently maintains a 10 percent export tariff on copper cathode and no export duty on copper wire rod, allowing Russian copper wire rod producers to have access to copper cathode at favorable prices for the production of the value-added copper wire rod, which then can be exported from Russia duty free.

STANDARDS, TESTING, LABELING AND CERTIFICATION

Russia continues to work to bring its technical regulations, including those related to product and food safety, into conformity with international standards. Companies continue to report frequently shifting requirements and inconsistent enforcement. In November 2004, the Russian Federation published a list of 74 laws and regulations that will be amended within the next two years according to the Law on Technical Regulation.

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This effort is designed to bring Russian legislation into compliance with WTO norms. Targets for reform include many statutes and regulations relating to agriculture, including food safety, biotechnology, and agricultural production. Drafts of these measures are in the process of being submitted or have been submitted to the Duma for approval.

On June 1, 2005, Russia unified the administration of its certification and standards setting agricultural agencies under its Federal Service for Veterinary and Phytosanitary Surveillance (VPSS), eliminating the Russian State Plant Quarantine Service (SPQS). Many certifying responsibilities of State Sanitary and Epidemiological Health Service were also moved to the VPSS. Sanitary and phytosanitary restrictions have had a major negative affect on U.S. trade, with products deemed as “sensitive” by Russia being blocked, seemingly without a scientific basis.

The ban on U.S. beef and liver for Bovine Spongiform Encephalopathy (BSE) is approaching its third year. There also are continuing concerns about Russian poultry plant inspections, restrictions on U.S. pork exports due to trichinae issues, regulations related to biotechnology, and reporting requirements for avian influenza. U.S. horses, genetics, dairy, eggs, and other products remain affected by a lack of agreed certification between the United States and Russia. In addition to these specific issues, in the context of Russia’s WTO accession, the two sides are discussing Russia’s adoption of international standards, guidelines and recommendations set by internationally recognized bodies such as Codex Alimentarius, Office of International Epizootics (OIE), and International Plant Protection Convention (IPPC).

GOVERNMENT PROCUREMENT

The Russian government spends more than a third of its budget on procurement - \$30 billion in 2005. A new law on government procurement went into effect in July 2005, which provides for auctions on all government purchases over \$8,000 (except for those made in commodity exchanges). To improve transparency in the procurement process, auctions will have to be advertised on agency websites as well as on a consolidated government procurement website. The new law eliminates restrictions on the participation of foreign suppliers, though it permits exceptions for reasons of national security or defense. A special enforcement agency will oversee implementation of the new regulations.

INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

While Russia has made advances in its efforts to improve its IPR protection regime, many challenges remain, particularly in the area of copyright piracy. The United States is reviewing Russia’s status as a beneficiary country under the U.S. Generalized System of Preferences (GSP) Program. Russia has also been on the Special 301 “Priority Watch List” since 1997, and will be subject to a review in early 2006. IPR is a key issue of discussion in Russia’s WTO accession negotiations.

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Copyright

U.S. industry is increasingly concerned about the deteriorating IPR situation in Russia. U.S. copyright industries estimate they lose in excess of \$1.7 billion annually due to copyright piracy (films, videos, sound recordings, books and computer software). The U.S. film industry estimates that over 80 percent of all DVDs on the Russian market are pirated. Piracy of music is estimated at approximately 66 percent of sales. The business and entertainment software industries, however, report declining levels of piracy.

2005 saw a continued increase of optical disc production capacity far in excess of domestic demand, with pirated products apparently intended not only for domestic consumption, but also for export. U.S. industry reports that unauthorized domestic production of optical media has increased in Russia. There are approximately 46 known optical disc plants now in operation, an estimated 30 of which are believed to be engaged at least part-time in the illegal production of pirated goods. Between 12 and 16 of these plants are operating on government-controlled military-industrial sites. Further, Russia's large, porous border contributes to the worldwide spread of pirated materials produced in Russia.

The Russian government's Licensing Law, adopted in August 2001, included licensing requirements for optical media producers. While several licenses were suspended in 2005 as a result of pirate activity, only a court can revoke a license. Rosokrankultura, the responsible agency, successfully went to court to revoke two licenses for illegal operation in 2005, and has delayed approval of some applications where it was not able to determine that the operators would only be engaged in legitimate production. The Russian government has so far been unable to strengthen the licensing regime to revoke licenses of pirate operators and to deny new licenses to applicants known to have been engaged in piracy. U.S. copyright industries have pressed the Russian government to adopt a comprehensive regulatory framework dealing with the production and distribution of optical media.

Internet piracy has become a growing concern with the growth of internet access. Russia is home to some of the world's most used Internet-based pay download services for pirated music, such as allofmp3.com, which offers global distribution from its well-protected location inside Russia.

Enforcement

Russian law enforcement has begun to take a more aggressive approach toward pirate optical disc producers. In late 2005, Russian authorities conducted a series of raids on production facilities and launched criminal proceedings against allofmp3.com. It remains to be seen whether these efforts will result in sustained reduction of piracy rates, the seizure of equipment and materials used to create pirated optical media, and prison sentences for violators. Even where Russian law provides for serious penalties such as the destruction of counterfeit or pirated goods, machinery seized during enforcement actions are rarely destroyed, and consequently, may return to the stream of commerce even if they are found to be illegal. In the vast majority of cases, alleged infringers receive miniscule fines or suspended prison sentences.

Administrative and judicial review bodies are also beginning to become active in protecting IPR in Russia, and the number of police and judges with relevant expertise, though still small, is expanding. At the prosecutorial and judicial levels, many officials still do not consider IPR infringement a serious offense when compared to other crimes, although an increasing number of prosecutors are willing to file cases related to copyright piracy. U.S. investors also consider the Russian court system ill-prepared to handle sophisticated patent cases. On the other hand, a specialized higher patent chamber has been established at Rospatent, which has brought greater expertise and efficiency to resolution of patent and trademark disputes.

Legislative Framework

In 2004, Russia passed amendments to the Law on Copyright and Related Rights to provide protection for pre-existing copyrighted works and sound recordings. These amendments included provisions for giving rights holders control over Internet distribution of their work. However, entry into force will not occur until September 2006. In 2002 and 2003, Russia enacted amendments to laws on trademark and appellations of origin, patents, protection of layout designs for integrated circuits, plant varieties, and protection of computer software and databases. Strengthened criminal penalties for IPR infringement went into effect on January 1, 1997, and even stronger penalties were adopted in Article 146 of the Criminal Code in 2003.

Despite concerted efforts to put into place a strong legislative framework for intellectual property rights protection, several deficiencies remain in Russia's legal regime. Russia continues not to provide national treatment for the protection of geographical indications. Upon completion of its WTO accession, Russia would be required by Article 39.3 of the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS Agreement) to protect against unfair commercial use of undisclosed data submitted to government authorities to obtain marketing approval of pharmaceutical and agricultural chemical products. Russia currently does not provide such protection. The United States is working with the Russian government in the WTO accession negotiations to amend its Law on Medicines so that Russia complies with the TRIPS Agreement. In late 2005, the Russian government proposed legislative changes to address these concerns; these changes, however, have not yet been considered by the Duma.

Patents and Trademarks

U.S. and multinational companies continue to report counterfeiting of patented and trademarked goods as a serious problem, especially for consumer goods, wine, distilled spirits, pharmaceuticals and other products. Several U.S. firms have also experienced problems with trademark counterfeiting, with Russian enterprises attempting to use well-known foreign trademarks not currently active in Russia. Rights holders have been moderately successful in countering these schemes through the Russian court system or with Rospatent. U.S. firms need to take steps to protect their intellectual property, including registering their trademarks with Rospatent.

SERVICES BARRIERS

Discrimination against foreign providers of non-financial services is, in most cases, not the result of federal law, but can stem from abuse of power, sub-national regulations and practices that may violate Russian law. For example, a few foreign providers of services have sometimes noted discrimination in obtaining licenses from local authorities. Foreign providers are forced to pay a range of fees that domestic companies allegedly avoid through bribery.

Central Bank regulation 721-U previously required that purchases of foreign currency of greater than \$10,000 for a limited number of imported services, mainly in the hospitality and tourism sector (e.g. Russians seeking to buy foreign currency to pay foreign suppliers), receive advance permission from the Ministry of Finance. While intended to combat capital flight, this measure had the potential to delay financial transactions and impede the participation of foreign firms in this sector. The Law on Currency Monitoring and Regulation, signed by President Putin on December 10, 2003, eliminates the need for advance permission, but requires Central Bank notification in most circumstances unless specifically noted in the law. Under the new law, all currency controls are to be lifted by 2007.

Financial Services and Insurance

The federal law on "Banks and Banking Activity of 1996" permits foreign banks to establish subsidiaries in Russia. However, the law also allows the Central Bank to impose a ceiling on the total amount of foreign bank capital calculated as a percentage of the total bank capital in Russia. To date, the Central Bank has never invoked this authority. Since 1997, the Central Bank has required new foreign bank subsidiaries to have a minimum of Euro 10 million in capital (the same requirement is applied to domestic banks). There is a further requirement that at least 75 percent of the bank's employees and 50 percent of the bank's management board are of Russian nationality. Heads of foreign banks' Russian offices are required to be proficient in the Russian language. In WTO accession talks, the United States has urged the Russian side to liberalize completely by allowing bank branches, as well as subsidiaries. To date, Russian officials remain unreceptive.

Since 1999, foreign majority-owned insurance companies have been subject to a 49 percent equity restriction in the life-insurance, compulsory and statutory insurance sectors. (Foreign majority-owned firms that were actively selling these products in Russia when this requirement came into effect were grandfathered). In addition, total foreign capital in the Russian insurance sector is limited to 25 percent. In January 2004, however, a law came into force (based on a 1994 Russia-EU treaty) that exempts EU-based insurance companies from the 49 percent cap on these sub-sectors. This exemption also applies to EU subsidiaries of non-EU foreign insurance companies. The Russian government has stated that these preferences given to EU-based insurance companies will be eliminated upon Russia's accession to the WTO. Until then, however, EU firms will enjoy an advantage over their counterparts from the United States and elsewhere, since they can offer life and mandatory forms of insurance in Russia directly, without the requirement to work through a majority Russian-owned partner. The new law retains the requirement that chief executives and chief accountants of foreign insurers operating in Russia be Russian citizens.

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Telecommunications

A new Law on Communications went into effect on January 1, 2004. Final implementing regulations, however, have still not been released. The Law's impact on the business of competitive alternative telecommunications operators (many of which enjoy large foreign investment), could be substantial because these companies will now be subject to tighter government regulation. In particular, new regulations on interconnection -- the process by which alternative operators connect their networks to the Russian public switched telephone network -- place interconnection contracts and fees under the tight regulatory authority of the Ministry of Communications. Alternative operators fear that interconnection fees will be raised to subsidize network upgrades of government-owned and ministry-controlled local and long distance operators.

Many in the telecommunications industry were disappointed that the new law did not improve transparency in the licensing process and have criticized the five-year to ten-year limit on licenses, which they argue do not allow them sufficient time to recoup their investment. Russian policy in the telecommunications sector is a subject of discussion in negotiations on Russia's WTO accession, and WTO members have expressed concern that the new Law on Communications may restrict access to a now relatively open market, particularly through the adoption of new rules and regulations as set forth under the new Law.

In 2005, no progress was made in clarifying the legal situation in the telecommunications sector. As noted above, the Law on Communications is a framework law that depends on implementing regulations in order to function properly. Very few of these regulations have been completed, leading to much legal confusion in the sector over such important issues as licensing requirements and procedures, equipment certification, and the nature of the Law's universal services provision. Regulators are also attempting to deal with such social issues as the control of spam, access of minors, and pornography. The regulations are not expected to be completed until sometime in 2006 at the earliest.

On January 8, 2006 the Prime Minister signed a resolution approving the rules for auctions or tenders for licenses to provide communication services for territories with a limited number of frequency resources. In addition, the Minister for Information Technologies and Communications has said that the government will begin in 2006 to offer licenses for third generation (3G) mobile telephones which will provide music, TV, video and internet access. At that time, the largest mobile phone operators will seek tenders for this technology, and U.S. companies will be seeking a substantial share of the new business. Certification of new products in the telecommunications industry takes an average of two months, down from four months a few years ago, but the process still lacks transparency.

Significant barriers have been identified in the provision of satellite telecommunications services in Russia. In particular, satellite regulation is not transparent, and the legal requirements and administrative responsibilities associated with the provision of these services appear to be discriminatory. The Russian Federation maintains a preference for the use of Russian satellite communications systems.

Russian entities with more than 50 percent foreign ownership are prohibited from sponsoring television or video programs or from establishing television organizations capable of being received in more than 50 percent of Russia's territory or by more than 50 percent of the population.

INVESTMENT BARRIERS

Despite a law regulating foreign investment being in effect since June 1999, Russian foreign investment regulations and notification requirements can be confusing and contradictory. The law on foreign investment provides that a single agency, which still has not been designated, will register foreign investments and that all branches of foreign firms must be registered.

Corruption in commercial and bureaucratic transactions and problems with the implementation of customs regulations inhibit investment. Trade and investment would benefit, for example, from improved dispute resolution mechanisms, the systematic protection of minority stockholders rights, the adoption of international accounting standards and adherence by companies to codes of conduct related to ethics and good governance. Initiatives to address these shortcomings, either through regulation, administrative reform, or government-sponsored voluntary codes of conduct have made little headway in countering endemic corruption. Accession and implementation of the OECD Bribery Convention would help provide more discipline in addressing bribery of foreign public officials and is a requirement for OECD membership. More transparent implementation of customs, taxation, licensing and other administrative regulations is necessary.

National Treatment

The 1999 Investment Law codifies the principles of national treatment for foreign investors, including the right to purchase securities, transfer property rights, protect rights in Russian courts, repatriate funds abroad after payment of duties and taxes, and receive compensation for nationalizations or illegal acts by Russian government bodies. The law, however, goes on to state that federal law may provide for a number of exceptions, including, where necessary, for "the protection of the constitution, public morals and health, and the rights and lawful interest of other persons and the defense of the state." The potentially large number of exceptions thus gives considerable discretion to the Russian government. The law also provides a "grandfather clause" which stipulates that existing 'priority' foreign investment projects with foreign participation of over 25 percent be protected from unforeseeable changes in the tax regime or new limitations on foreign investment. The law defines 'priority' projects as those with a foreign charter capital of over \$4.1 million and with a total investment of over \$41 million. The lack of corresponding tax and customs regulations, however, means that any protection afforded investors by this clause remains theoretical.

The Land Code that was passed in 2001 provides for equal treatment of domestic and foreign entities to buy most land and buildings, although purchase of agricultural land by foreigners is still prohibited. Discussion on specific land policy continues, including legislation on transfer of use, but a conclusion has not yet been reached. Foreign entities are restricted from buying land close to federal borders and in areas that the President determines are critical to national security.

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Current Russian legislation restricts foreign investment in the aerospace industry to less than 25 percent of an enterprise. Foreign investment in the state-owned natural gas company, Gazprom, is formally limited to 20 percent. Foreign investment in the electrical power giant, Unified Energy Systems, is limited to 25 percent.

Foreign investment in the Russian spirits industry is limited to 49 percent. In addition, a new draft Law on Natural Resources or Subsoil Law (see Energy section below) regulating the licensing and oversight of natural resource assets is currently being debated within the Russian government. It is possible that the government will include language in the draft that would restrict foreign company participation to minority stakes in certain “strategic” fields. A draft law on investment in strategic sectors is also being discussed within the government, which could involve reviews of proposed inward investment for national security reasons.

In addition to a burdensome certification process, the satellite industry reports that a local presence requirement and discriminatory treatment create barriers to doing business in Russia. Telecommunications companies also report investment restrictions.

Taxes

In response to investor concerns over the arbitrary application of the tax code by the tax administration in the case of the Russian oil company Yukos, the Russian government developed a package of tax reforms in 2005 that is designed to limit aggressive tax collection practices while lowering the overall tax burden. The series of laws and amendments to the tax regime to be ratified by the Duma would: (1) introduce transparency measures to the auditing process; (2) simplify the procedure for refunding VAT on exports (see below); (3) introduce tax benefits for the high-technology sector through changes to the profit tax structure; and (4) protect the rights of investors who possess licenses to work in the energy sector. In 2005, the Duma also lowered the statute of limitations on all transactions, including privatization deals, from ten years to three years, signaling that the privatization deals of the 1990s are unlikely to be reexamined. Effective January 1, 2005, the Unified Social Tax, which is paid by employers and covers pensions, healthcare, and social security, dropped from an effective rate of about 30 percent to a top rate of 26 percent on salaries up to 280,000 rubles (about \$10,000) a year. The Russian flat income tax rate of 13 percent for residents and 30 percent for non-residents in 2001 and corporate profit tax of 24 percent, established in 2001 and 2002, respectively, remain in effect. The U.S. securities industry also complains about the low threshold for triggering criminal investigations of underpayment of tax (currently about \$50,000) and the need for a motives test to distinguish between criminal intent and honest mistakes.

Regions and municipalities have the authority to grant exemptions to the regional portion of profits taxes, with some regions granted specific regional exemptions. Legislation related to Kaliningrad is under consideration in the Duma. Regions are not able to grant individual tax exemptions.

Duties on the production and export of oil, which are generally quite high, have been adjusted several times over the past several years. In 2003, new legislation restored full discretion to the Russian government in establishing export duties on refined petroleum products. Changes in the tax code in 2004 shifted the burden away from manufacturing and services sectors and towards the

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energy sector. Given the slowdown in oil production growth, the Russian government is considering ways to stimulate output, including implementing a differentiated tax regime on oil production.

Energy Sector

A new Law on Natural Resources (also called the Subsoil Law) that would regulate the licensing and oversight of natural resource assets is currently being debated within the Russian government. The most recent version of the draft law represents a modest improvement over the current law (as amended). In the current draft, the government has included several of the key provisions that industry had been seeking, including a guarantee that licenses will carry over from the exploration to the development stage, a provision that licenses will be based on civil rather than administrative law, and a limitation on the number of reasons for license revocation. It is possible, however, that the government will include language in the draft that would restrict foreign company participation to minority stakes in certain “strategic” fields. It is also unclear whether the new Subsoil Law will be used to exclude foreign energy service suppliers from offering their services on the gas or oil production site.

In 2005, the energy sector continued to undergo significant reorganization with the government assuming a larger role. First, the state-owned oil firm Rosneft took over the largest production subsidiary of the embattled oil company Yukos. More recently, Gazprom purchased the private Russian oil company Sibneft for \$13.1 billion in the largest-ever merger in Russian corporate history. The “ring-fence” -- the cap on foreign share ownership in Gazprom -- was eliminated. Removal of the “ring fence” would clearly be a boon for investors (increased ability to trade in Gazprom shares) and Gazprom (improved access to capital), but the long-term significance is that it is the first step in reforming Gazprom. It is unclear, however, whether the government has the political will to follow through with reform of the company. In addition, Gazprom has been acquiring other assets in related industries (electrical generation and oil) in what appears to be an effort to create a national champion in the energy sector. Several major oil companies are working out the terms for joint exploration and development of large gas fields under Gazprom’s control.

In 2003, President Putin signed legislation implementing legal amendments restricting Russia’s use of production-sharing agreements (PSAs). PSAs are designed for energy projects that require high capital expenditure and a long period before profits or significant tax revenues are generated. These amendments severely limit the number of energy deposits eligible for PSA status and favor companies that bid to develop energy deposits on a non-PSA basis. The PSA amendments include local content requirements or targets for the use of locally produced equipment and local labor. Another provision in the existing PSA regime limits the total amount of foreign investment to 30 percent of Russia’s “strategic” oil reserves. The precise meaning and significance of this restriction remain unclear.

More than \$5 billion has been invested to date in the Sakhalin II consortium, and in September 2005 ExxonMobil celebrated the first production of oil at its \$12 billion Sakhalin I venture. The \$2.6 billion Caspian Pipeline Consortium (CPC) project, inaugurated in 2001, continues to work with the Russian government to come up with an agreement that will allow the intended expansion of the pipeline's capacity.

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Pipeline expansion requires unanimous approval from the 11 shareholders in the consortium. The producing companies have acquiesced to almost all of the Russian government's demands and have now taken a unified stance and presented the GOR with a final proposal for expansion.

Central Bank restrictions on medium-term loans (more than 180 days) of hard currency for the purchase of imported inputs have also presented an obstacle to foreign investment projects in Russia's energy sector. In addition, non-transparent regulations concerning environmental permits and pipeline access remain of concern to potential U.S. investors.

Aviation

Many of the Russian-flagged carriers have aging fleets and use outmoded avionics and engines, and several are seriously considering significant purchases or leases of foreign aircraft in an attempt to be more competitive with Western airlines. The domestic civil aviation industry cannot keep up with the airlines' demand for modern, relatively fuel efficient aircraft, so Russian airlines are looking to foreign manufacturers despite a 20 percent import tariff plus VAT imposed by the GOR. Current Russian law stipulates preferential treatment (tax holidays and guarantees on investment) for Russian and foreign investors in aviation-related research and manufacturing ventures. The law, however, limits the share of foreign capital in aviation enterprises to less than 25 percent and requires that board members and senior management staff be Russian citizens. There is speculation that the 25 percent limit could be raised or eliminated to facilitate further investment. Some observers, however, doubt that recent proposals to raise the limit to 49 percent would be sufficient to attract capital from abroad for Russia's aircraft industry from abroad.

In 1996, the United States and Russia concluded a Joint Memorandum of Understanding (MOU) reflecting U.S. concerns about barriers to the Russian civil aircraft market and the application of international trade rules to the Russian aircraft sector. The MOU states that U.S. aircraft manufacturers will be able to participate in the Russian market and share in its growth. The MOU also makes clear that the Russian aircraft industry will become fully integrated into the international economy over time. Russia pledged to eventually undertake the same international trade principles in the aircraft sector as the United States and many others have done, as embodied in the Agreement on Trade in Civil Aircraft.

The Russian government is also looking to reorganize and revitalize Russia's aircraft industry in the context of a larger restructuring plan for Russia's defense industry. Specifically, large-scale consolidation of the aircraft industry took place with the government creation of the Unified Aircraft Corporation. Government officials have suggested using proceeds from Russia's Stabilization Fund to support this new corporation. The GOR expects it to fulfill no less than twenty contracts in the next year for helicopters, sports planes, and engines (worth approximately \$380 million). Several Russian airlines operate Western aircraft, however, despite the import tariff plus VAT. Two airlines, Aeroflot and Transaero, previously received tariff-waivers and discounts for these planes, but have exhausted their tariff discount and are now purchasing aircraft at full tariff rates, just as other airlines have always had to do. Russian airlines and foreign governments have been vocal about seeking further tariff waivers. For the first time in 2005, Russian Ministers have suggested that the Russian domestic aircraft industry is not capable of producing the number of high-quality passenger jets Russian airlines want in a timely fashion. Discussions within the Russian government on possible tariff reductions continue.

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Despite previous bilateral assurances that the Russian government would join the Agreement on Trade in Civil Aircraft, Russia has expressed an unwillingness to join the Agreement in the context of WTO accession.

Capital Flows

Russia has assumed obligations under Article VIII of the IMF Articles of Agreement to permit free payment of current transactions, but the Central Bank continues to maintain controls on capital flows. A new law on currency controls took effect in 2004, which reduces the maximum amount to which Russia's surrender requirement for export earnings may be set to 30 percent, and will completely abolish the requirement by 2007. In November 2004, this surrender requirement was reduced to 10 percent of export earnings, well under the 30 percent limitation imposed on the Central Bank. Investors may repatriate coupon payments on government and corporate bonds and invest in other bonds. Licenses are not required for most transactions transferring money into or out of Russia, but proper notification is required. Russia also maintains an advance import prepayment requirement that serves as a trade barrier.

ELECTRONIC COMMERCE

E-commerce in Russia was expected to increase from \$660 million in 2004 to \$1 billion in 2005, but the Russian market is still embryonic. Despite this growth, there are only about 700 electronic stores on the Russian Internet. The draft Law on Electronic Trade has been stalled in the Duma for several years, but it was under consideration again in late 2005 by the Duma's Committee for Information Policy. Although Internet access in Russia is steadily growing, penetration is only around 15 percent to 20 percent of the population, with roughly half of these users located in the Moscow and St. Petersburg regions. Relatively low usage, combined with a low number of credit card users and onerous tax laws, means that e-commerce will grow slowly in the near future. On January 1, 2005, the Law on the Protection of Consumer Rights took effect, which allows consumers a seven-day period to return goods purchased online.

The electronic trade legislation, while closely following the International Chamber of Commerce model bill, has significant problems, such as limiting on electronic transactions to the sale and purchase of moveable goods, services agreements, and shipments.

Russian law does not currently provide identical legislative protection for both electronic and paper documents. Settlement issues need to be considered in conjunction with applicable currency control provisions. The tax effect of electronic commerce is virtually unexplored, and this area of the law is still developing.

In Russia, registered trademarks are not recognized as entailing rights to the equivalent domain names. Further, the property rights that trademarks secure for their registered owners are currently not protected for the purposes of Internet advertising and commerce through web sites. This has led to cases of cyber-squatting where domain names have been established in conflict with trademark names. The courts have taken divergent approaches to litigation arising from such disputes.

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A law on electronic digital signatures came into effect in 2002. This law does not follow the Model Law on Electronic Signatures of the U.N. Commission on International Trade Law, but rather defines electronic signatures strictly, making public-key technology the sole acceptable digital signature technology. It also requires that hardware and software used in digital signature authentication programs be certified in Russia. This gives the Russian government the right to insist on the decompilation of electronic signature programs, and thus gives the government access to the source code.

OTHER BARRIERS

The U.S. logging industry reports that illegal logging accounts for as much as 20 percent to 30 percent of Russia's timber harvest. Illegal wood supplies have begun to appear in China, hurting U.S. exports to that market.

SOUTHERN AFRICAN CUSTOMS UNION (SACU)

TRADE SUMMARY

The U.S. goods trade deficit with SACU countries was \$2.7 billion in 2005, a decrease of \$901 million from \$3.6 billion in 2004. U.S. goods exports in 2005 were \$4.1 billion, up 22.7 percent from the previous year. Corresponding U.S. imports from SACU countries were \$6.8 billion, down 2.1 percent.

The stock of U.S. foreign direct investment (FDI) in SACU countries in 2004 was \$5.0 billion, up from \$3.8 billion in 2003.

OVERVIEW

The Southern African Customs Union (SACU) links the trade regimes of Botswana, Lesotho, Namibia, South Africa, and Swaziland. The South African economy dominates SACU, representing approximately 91 percent of SACU's 2003 GDP of \$175 billion. There are currently no internal tariff barriers among SACU members. All SACU members except Botswana are members of the Common Monetary Area, with currencies pegged to the South African rand. Imports from outside SACU are subject to a common external tariff. The 2002 SACU Agreement, which became fully operational in 2004, provided for a more democratic structure that reduces reliance on South Africa for administrative decisions. The agreement set up a Council of Ministers (COM) as the supreme decision making body for SACU. The COM is supported by the Commission of Senior Officials (a group of technical experts) and a SACU Secretariat located in Windhoek, Namibia. A SACU Tariff Board reports directly to the COM and formulates and implements tariff policy.

The United States began free trade agreement (FTA) negotiations with the five SACU countries in June 2003. Through an FTA, the United States would seek to address trade constraints on U.S. exports to SACU countries, including relatively high tariffs and import restrictions on certain U.S. exports; insufficient copyright protection for software, films, and music; and barriers in telecommunications and other key service sectors. SACU countries have recently negotiated free trade agreements with Mercosur and the European Free Trade Association (EFTA).

IMPORT POLICIES

Tariffs and Non-Tariff Barriers

Nearly all intra-SACU trade in goods is free of barriers. Imports from the rest of the world face a common external tariff and a common excise tax. Revenue flows into a common consolidated revenue fund controlled by South Africa. Since the WTO's

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Uruguay Round in 1994, SACU countries, led by South Africa, have reformed and simplified their common tariff structure. Tariff rates have been reduced from a simple average of more than 20 percent to 5.8 percent. Notwithstanding these reforms, importers have complained that the SACU tariff schedule remains complex and can create uncertainty. In addition, tariff rates mostly fall within eight levels ranging from zero to 30 percent, but some are higher, such as for most apparel items. Many of South Africa's specific and composite duties were converted to *ad valorem* rates, with a few exceptions remaining in a limited number of sectors, including textile and apparel products. In the Uruguay Round, South Africa agreed to a twelve-year phase-down of duties on textiles and apparel, but unilaterally moved to expedite its phase-down process. As of September 1, 2002, the following SACU rates, which are also the final phase-down rates, apply: apparel - 40 percent; yarns - 15 percent; fabrics - 22 percent; finished goods - 30 percent; and fibers - 7.5 percent. Tariff rates on cars, light trucks, and vans are still at the high level of 36 percent, while the rate of duty on new automobile parts is 28 percent.

Country-specific information on the five SACU Members follows.

1. SOUTH AFRICA

IMPORT POLICIES

The International Trade Administration Commission (ITAC) is tasked with administering South African trade laws. Its specific responsibilities include:

- **Tariff Administration:** ITAC administers tariff-related programs, including the Motor Industry Development Program (MIDP) and the Duty Credit Certificate System (DCCS). In addition, interested parties may petition ITAC to review tariffs with the purpose of reducing or increasing them;
- **Trade Remedies:** ITAC administers the antidumping and countervailing duty and safeguard laws. Although introduced in 2004, safeguard procedures have not been used. The textiles and clothing industry is reportedly preparing several petitions in light of rising Chinese imports; and
- **Import and Export Control:** ITAC issues import and export permits for certain items designated by the Minister of Trade and Industry under the authority of the International Trade Administration Act of 2002 (which replaced the Import and Export Control Act of 1963).

Tariffs

ITAC continues to receive requests for tariff protection from a number of industries, and U.S. companies have cited protective tariffs as a barrier to trade. Under SACU, products from Botswana, Lesotho, Swaziland, and Namibia enter South Africa duty-free. In a few cases, products from these countries compete directly with U.S. goods that are subject to

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duties. One example is soda ash imported from Botswana at a zero duty, while soda ash from the United States faces a 5.5 percent duty. If tariffs on U.S. soda ash were removed, U.S. industry estimates that U.S. exports of high quality soda ash to South Africa could increase from less than \$8 million to \$25 million, closer to its historical level. The soda ash duty benefits Botswana, the only producer of soda ash within SACU. A standing complaint from this Botswana producer to South Africa's Competition Commission law could result in a prohibition of U.S. exports of soda ash. Initially, the Competition Commission accepted the complaint as a "per se" offense, but a recent decision by the South African Supreme Court of Appeal remanded the case to the Competition Commission to confirm that U.S. exports have actually damaged the South African market. As of late 2005, the Competition Commission indicated a willingness to settle the case and avoid further litigation.

Non-Tariff Measures

The Minister of Trade and Industry may, by notice in the Government Gazette, prescribe that no goods of a specified class or kind be imported into South Africa, except under the authority of and in accordance with the conditions stated in a permit issued by ITAC. The main categories of controlled imports are as follows:

- Used goods: ITAC may require import permits on used goods or substitutes if not manufactured domestically, thus creating a *de facto* ban on most used goods. While designed to protect the domestic manufacture of clothing, motor vehicles, machinery, and plastics, these restrictions limit imports of a variety of low-cost used goods from the United States and Europe;
- Waste, scrap, ashes, and residues: The objective of import controls on these goods is to protect human health and the environment under the Basel Convention;
- Other harmful substances: Imports of substances such as ozone-depleting chemicals under the Montreal Convention and chemicals used in illegal drug manufacturing under the 1988 United Nations Convention are controlled for environmental, health, and social reasons; and
- Goods subject to quality specifications: This restriction permits the monitoring of manufacturing specifications that enhance vehicle safety (such as in the case of tires) or protect human life.

Other often-cited non-tariff barriers to trade include port congestion, customs valuation above invoice prices, theft of goods, import permits, antidumping measures, IPR violations, an inefficient bureaucracy, and excessive regulation.

Antidumping

The government promulgated antidumping regulations in 2003. In 2003 and 2004, local industry filed twelve antidumping petitions. In 2005, South Africa initiated 22 new

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antidumping investigations involving eleven industries and ten different countries. China was the object of the largest number of new investigations involving five different products. Transparency and due process also remain issues regarding the actions of the ITAC and its administration of South Africa's antidumping laws and regulations.

ITAC initiated an antidumping investigation into the alleged dumping of L-Lysine Sulphate imported from the United States. ITAC also initiated a sunset review of antidumping duties on frozen chicken meat portions from the United States, and completed a sunset review of acetaminophen imported from the United States. In addition to frozen chicken meat portions and acetaminophen, South Africa imposes anti-dumping duties on U.S.-origin suspension PVC, roller bearings, and lysine feed supplements.

Free Trade Agreement with the European Union

In 2000, South Africa and the European Union (EU) began to implement provisions of their Trade, Development, and Cooperation Agreement (TDCA). Under the TDCA, South Africa and the EU agreed to establish a free trade area over a transitional period of up to 12 years for South Africa, and 10 years for the EU. The agreement provides for the reduction and eventual elimination of duties on approximately 85 percent of the products imported by South Africa from the EU, and 95 percent of the products exported by South Africa to the EU. The agreement exempts certain agricultural products from liberalization. Some U.S. businesses exporting to South Africa are concerned that their products will be less competitive because of EU preferences that the TDCA provides. An example includes the tariff differential between EU and U.S. bottled and bulk distilled spirits; another example is automobiles.

In November 2005, South Africa and the EU completed the work program on automobile trade as part of the TDCA. The EU agreed to phase out all tariffs on South African automotive imports by 2010. South Africa agreed to reduce tariffs on European car imports from 25 percent to 18 percent by 2012. Currently, 51 percent of South Africa's vehicle and component exports go to the EU. Given strong U.S. presence in the EU market, U.S. companies are divided on whether they are disadvantaged by the TDCA.

STANDARDS, TESTING, LABELING AND CERTIFICATION

Apparel, Textiles, Shoes, and Leather Goods

The Minister of Trade and Industry published regulations that prohibit the importation of or the sale of textiles, apparel, shoes, and leather goods in South Africa unless they are labeled in such a way that it is clear which country produced the goods. These regulations came into force on May 23, 2005, and required the inclusion of the South African importer's registration code on the label of each item.

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U.S. industry reports that special production runs are necessary to comply with these regulations, as labels are typically attached during the manufacturing process. Therefore, the regulations make exporting those products more costly. The South African Revenue Service (SARS) is working to establish clear guidelines and procedures that are less onerous and, in the meantime, is not enforcing the regulations.

Biotechnology

There has been an active debate in South Africa about agricultural biotechnology. The Genetically Modified Organisms Act (“the GMO Act”), entered into force in 1999, aims to ensure that all activities involving the use of agricultural biotechnology (including production, import, release, and distribution) will be carried out in such a way as to limit possible harmful consequences to the environment. Since 1999, some retail groceries have promoted a limited range of biotech-free products and a few consumer groups have urged the Department of Health to introduce compulsory labeling of biotech products.

Based on work by the Department of Health’s Directorate of Food Control, the South African government issued labeling regulations on biotech products in early 2004. The regulations mandate labeling foods containing agricultural biotechnology in certain cases, including when allergens or human/animal proteins are present and when biotech food products differ significantly from a non-biotech equivalent. The rules also require validation of enhanced-characteristic claims for food containing agricultural biotechnology. The regulations do not address labeling claims that products are biotech-free. Biotechnology advocates are concerned about this omission, noting it could lead to fraudulent claims. Trade organizations seem satisfied with the regulations, which follow internationally recognized, scientific guidelines (under CODEX). South Africa’s CODEX representative comes from the Directorate of Food Control.

In November 2004, the government published draft changes to the GMO Act to bring it into compliance with the Cartagena Biosafety Protocol. The government solicited public comments on the draft changes and, as of late 2005, was still evaluating those comments.

In June 2001, the South African government published the National Biotechnology Strategy for South Africa, a document that articulated the South African government’s intent to stimulate industries based on biotechnology. The document states that biotechnology can make an important contribution to achieving national priorities, particularly in the areas of human health, food security, and environmental sustainability. Environmental groups continued to exert pressure on the South African government in 2005 to examine the safety of foods derived from agricultural biotechnology.

The government approved for commercial production biotech soybeans that are tolerant to herbicides, as well as cotton, yellow maize, and white maize that are resistant to insects. Farmers are enthusiastically adopting the new technology, planting biotech crops on 500,000 hectares in 2004 and on an estimated 700,000 to one million hectares in 2005. The use of these products is widespread in the food processing industry.

U.S. grain producers raised concerns about the treatment of “stacked events” when it comes to import approval for biotech products. Although the U.S. government considers products containing a combination of two previously approved genetic modifications (such as for insect resistance and herbicide tolerance) as “conventional,” only encouraging producers to notify the U.S. government of such “stacked events,” South Africa -- like the EU -- considers “stacked events” to constitute a completely new event, thus requiring a *de novo* review for registration purposes. This requirement creates significant delays in registering products, causing U.S. exporters to lose export opportunities.

The South African government has not approved U.S. yellow corn for importation because of its treatment of “stacked events” for approval purposes. As it stands, if yellow corn were in short supply in South Africa, importers would have to apply to the government for a special waiver to import it, with the guarantee that the corn would be milled near the port to ensure that it cannot be planted.

In 2004, Biowatch, an environmental lobby group, took legal action against the National Department of Agriculture (NDA) to obtain information on how it made licensing decisions on biotech crops. The local courts ruled in favor of the NDA, allowing it to continue protecting certain information on a business proprietary basis.

In September 2003, countries of the Southern African Development Community (SADC), including South Africa, developed common guidelines on the regulation of products resulting from biotechnology. The guidelines assert that the region should develop common policy and regulatory systems based on either the Cartagena Protocol or the African Model Law on Biosafety. The leaders of SADC member states also agreed to develop national biotechnology policies and strategies, and to increase their efforts to establish national biosafety regulatory systems. Leaders urged member states to commission studies on the implications of biotechnology for agriculture, the environment, public health, and socio-economics.

Agricultural Standards

The South African government requires prospective importers to apply for an import permit for certain controlled products. Public health officials still ban the importation of irradiated meat from any source. U.S. horticultural producers have complained about various South African sanitary or phytosanitary barriers when it comes to the importation of apples, cherries, and pears from the United States. They estimate that, if these barriers were removed, U.S. exports of each of these fruits to South Africa could increase by \$5 million to \$25 million in annual sales. U.S. producers have also expressed concern about unnecessary sanitary and phytosanitary requirements for some grains, pork, poultry, and horticultural products.

To fulfill South Africa’s commitment under the WTO Marrakesh Agreement on market access, the NDA published the rules and procedures regarding the application for market access permits for agricultural products on October 24, 2003. The NDA issues permits to

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importers registered with the South African Revenue Service (SARS) and the Department of Trade and Industry (DTI) for agricultural products listed in the Table of Import Arrangements. Ten percent of such permits are reserved for “new importers” (those who have not imported within the past three years), and 10 percent are reserved for small, medium, and micro-enterprises.

In response to the Bovine Spongiform Encephalopathy case in Washington State announced on December 23, 2003, South Africa banned all ruminant animals and products originating in the United States. By January 15, 2004, South Africa, in accordance with World Organization for Animal Health (OIE) standards, exempted non-risk products such as hides, skins, wool, and mohair from the ban. At the end of 2005, the ban on ruminant meat products was still in place. The South African Department of Agriculture was impressed with USDA’s surveillance program, but wanted to see a full report with data from the surveillance program before lifting the ban.

GOVERNMENT PROCUREMENT

Government purchases are by competitive tender for project, supply, and other contracts. The government uses its position as both buyer and lawmaker to promote the empowerment of the historically disadvantaged majority population in South Africa through its Black Economic Empowerment (BEE) policy.

South Africa’s Preferential Procurement Policy Framework Act of 2000 and its implementing regulations created the legal framework and set forth a formula for evaluating tenders on government contracts. To augment this, the Department of Trade and Industry has been working on regulations to clarify the Framework Act and incorporate the intentions of the Broad-Based BEE Act of 2003. The new regulations give greater preference to bidders according to their compliance with BEE objectives. The regulations include BEE thresholds for tender qualification. Companies bidding on procurement valued up to 1 million rand earn 80 percent of their points from their bid price and 20 percent from their commitment to BEE objectives. For tenders valued over 1 million rand, companies earn 90 percent of their points from their bid price, and 10 percent from their commitment to BEE objectives. The National Treasury is working with the Department of Trade and Industry to align preferential procurement regulations with the BEE Codes of Good Practice on Procurement, which DTI released in December 2005 for comment by March 31, 2006. The Codes will help standardize how firms are evaluated on their compliance with industry BEE scorecards.

South Africa’s Industrial Participation (IP) program, introduced in 1996, subjects all government and parastatal purchases or lease contracts for goods, equipment or services with an imported content equal to or exceeding \$10 million (or the rand equivalent thereof) to an IP obligation. This obligation requires the seller/supplier to engage in local commercial or industrial activity valued at 30 percent or more of the value if the imported content of total goods purchased or leased under government tender. The intent of the program is to benefit South African industry by generating new or additional business.

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In August 2004, the Minister of Finance issued the BEE Code of Good Practice for Public Private Partnerships (PPPs). The Code sets out BEE targets for PPPs and provides greater clarity for private sector participants. In October 2005, the Minister of Trade and Industry issued final Codes of Good Practice on BEE Equity and BEE Management.

South Africa is not a signatory to the WTO Agreement on Government Procurement.

INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

Legal Regime

South Africa's intellectual property laws and practices generally conform to those of developed countries, except in the area of geographical indications where there are notable deficiencies. There are, however, issues with enforcement and in guaranteeing the protections afforded under these laws. The U.S. government has raised its concerns with the South African government. The United States has also provided training on IPR enforcement to South African government and private sector representatives.

The U.S. software industry has cited three principal deficiencies in South Africa's 1978 Copyright Act:

- *Lack of criminal penalties for end user piracy.* South African law currently provides that the sale of infringing software is a criminal offence, but there is no criminal penalty for end users;
- *Lack of presumptions relating to copyright subsistence and ownership.* Amending the law to add ownership and subsistence presumptions would reduce the procedural burden on rights holders in proving their cases; and
- *Non-deterrent civil damages.* Amending the law to introduce statutory damages and to ensure that monetary damages serve as a deterrent would improve IPR protection. According to the U.S. software industry, neither the current provisions on damages nor the application of these provisions are sufficient to serve as a deterrent to future infringement.

Until the government amends existing legislation, the lack of evidentiary presumptions in the law will continue to complicate enforcement of individual copyright claims.

In 2001, the South African Government introduced measures to enhance enforcement of the 1997 Counterfeit Goods Act. The government appointed more inspectors, designated more warehouses for counterfeit goods, destroyed counterfeit goods, and improved the training of customs, border police, and police officials. In 2004, there were 100 convictions for people arrested with counterfeit DVDs and computer games, compared to 14 in 2003. Figures for 2005 will be available in March 2006. Despite these efforts, monetary losses from trademark counterfeiting and copyright piracy remain high. U.S. industry is increasingly concerned about illegal commercial photocopying, especially at

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universities, libraries, and other on-campus venues. U.S. industry also expressed concern about Internet piracy, advertisements of “burn-to-order” services, and the unwillingness of South African Internet Service Providers (ISPs) to shut down infringing sites or access thereto. In addition, counterfeit medicines are also a growing problem. Although law enforcement authorities often cooperate with the private sector in investigating allegations of trade in pirated or counterfeit goods, there are concerns about laxity in enforcement of IPR laws against imports of infringing goods, as well as slow and cumbersome court proceedings. . Complainants can take both civil and criminal action against offenders. U.S. industry reports that South Africa is becoming a transshipment point for pirated and counterfeit goods into the rest of Africa, adding that South African Customs has the power to interdict such shipments and should exercise that power.

U.S. firms have complained that South Africa does not adequately protect safety and efficacy studies (also called “registration data”) submitted to national authorities with applications for product approval. U.S. firms have claimed that these studies are unfairly “referenced” by competitors for the purposes of registering competing products.

South Africa is a member of the World Intellectual Property Organization (WIPO), but has yet to ratify the WIPO Copyright Treaty and the WIPO Performances and Phonograms Treaty. South Africa has acceded to the Stockholm Text of the Paris Convention for the Protection of Intellectual Property.

Software/Audio Visual IPR Issues

Software piracy still occurs frequently in South Africa. In 2005, the Business Software Alliance estimated that the piracy rate was 36 percent and that U.S. industry in South Africa lost an estimated \$110.5 million in sales. Piracy in the video and sound industry also continues to be a concern. In 2004, piracy rates in the audiovisual industry were 40 percent; with losses of \$35 million (2005 figures were not yet available at the time of this report).

SERVICES BARRIERS

Telecommunications

Despite South Africa’s WTO commitments to the reference paper on pro-competitive regulatory principles and market access commitments for value-added telecommunications and basic telecommunications services, South Africa’s main telecommunication provider, Telkom, continues to maintain a monopoly on these services, presenting difficulties in this sector. Many businesses have complained about high telecommunications prices, many of which are a result of control of the underlying network by Telkom. In 2004, Telkom was cited by the South African Competition Commission for anti-competitive conduct with respect to Value Added Network Services (VANS). A new complaint was filed by the South African Internet Service Provider Association alleging further abusive practices by Telkom. In addition to such practices, one company has pursued extensive legal remedies against Telkom to honor the results of

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binding arbitration to honor a multi-million dollar contract. Instead of honoring the arbitrator's findings, Telkom took steps to block the arbitral award and appealed the award to a local trial court. The appeal is ongoing. By March 2005, Telkom had parlayed its market dominance into \$1.7 billion in operating profit on \$6.5 billion in sales. In 2005, the Department of Communications (DOC) sponsored two colloquiums to discuss measures to lower telecommunications prices. DOC intends to release an action plan in early 2006.

Some of the problems facing VANS and Internet service providers may be addressed by new telecommunications policies and regulations. On February 1, 2005, the Minister of Communications effected sweeping liberalization of the telecommunications sector. Because of this liberalization, mobile operators are allowed to use any fixed lines in the provision of their service, VANS can be offered through infrastructure other than that which is owned by Telkom, and VANS providers are allowed to employ Voice Over Internet Protocols. In addition, private telecommunications network operators are allowed to sell spare capacity. On May 20, 2005, the Minister approved additional regulations for the licensing of VANS. These developments should help resolve past complaints by ISPs and VANS providers that Telkom has limited their access to Telkom's network.

In its WTO commitments, South Africa committed to license a second national operator (SNO) to compete in long-distance, data, telex, fax, and privately leased circuit services no later than January 1, 2004. The Minister of Communications conditionally approved a license for the SNO in September 2004, but disagreements between SNO shareholders over operational control and allocation of equity stakes have delayed the launch until 2006. The result has been that Telkom has enjoyed monopoly privileges well beyond its period of exclusivity, which ended in May 2002.

While new direction in telecommunications may resolve some of the shortcomings in this sector, some of the problems are related to legislative efforts dating back to 2003. In that year, the DOC released a draft Convergence Bill that industry analysts hope will simplify the existing legislative framework, empower the regulator, and open the telecommunications industry to greater competition. Comments received during a public comment period were highly critical of the draft bill and, as a result the DOC revised the bill. In 2005, the DOC released for comment its modified version, entitled the Electronic Telecommunications Bill. South Africa's Parliament is currently debating the revised bill and amendments. Critics charge that the bill will increase the authority of DOC at the expense of ICASA (the regulatory body) and, therefore, the bill is likely to incorporate greater political bias in future regulatory decisions. Critics believe that ICASA should be strengthened to better carry out its regulatory mandate.

One U.S. company withdrew from the South African market in 2005 after having made a substantial investment in an earth station for mobile satellite services. The U.S. company cited ICASA's demands for an excessively high license fee as its reason for withdrawing.

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Other Services

The United States and the South African government met in August 2005 to discuss a possible Open Skies Agreement. Open Skies agreements provide for open route rights, capacity, frequencies, designations, and pricing, as well as opportunities for cooperative marketing arrangements, including code-sharing and airline alliances. At the talks, South Africa argued for incremental liberalization of the existing 1996 bilateral Air Transport Agreement. South African Airways (SAA), the national airline wholly owned by the state-owned enterprise Transnet, had previously registered its concern about U.S. airlines exercising “fifth-freedom rights” in Africa (i.e., carrying passengers to and from countries other than the United States and South Africa), which could impinge on SAA’s strategic regional market. At this time, the two sides have no plans to re-engage on an Open Skies agreement.

U.S. financial services providers have expressed ongoing concerns about the implementation of the Black Economic Empowerment (BEE) charter for the financial services sector. In 2003 and 2004, several of these providers participated in the negotiations with government, labor, and industry stakeholders that resulted in the drafting of the BEE Financial Services Charter. Since then, the Department of Trade and Industry (DTI) has released generic scorecard targets, including a 25 percent equity ownership target. It is unclear whether this will affect the Financial Services Charter, which currently permits foreign financial institutions to substitute equity ownership with financing and/or investing in BEE companies or projects. DTI wants to finalize all BEE Codes of Good Practice, including those on multinational corporations, by the end of 2006.

INVESTMENT BARRIERS

Uncertain Implementation of the BEE Act

In January 2004, President Mbeki signed into law the Broad-Based Black Economic Empowerment (BEE) Act of 2003, giving force of legislation to the government’s Black Economic Empowerment strategy. The intention of black economic empowerment is to move the historically disadvantaged majority population in South Africa into the mainstream of the economy. U.S. businesses strongly support the goals of BEE, and many have a long history of instituting human resource management, procurement, and enterprise development policies in South Africa that are consistent with BEE objectives. These businesses hope BEE implementation will allow them to continue these policies and to participate fully in South Africa’s economy. However, the government’s BEE strategy has been evolving slowly, through a series of policies on human resource development, management, procurement, enterprise development (investment in black-owned firms), and equity ownership. Twenty-nine industry charters have been negotiated or are being negotiated with government in such areas as accounting, agriculture, chemicals, cosmetics, clothing and footwear, construction, engineering services, financial services, forestry, health, information and communications technology (ICT), liquid fuels, mining, property, tourism, marketing, transportation, liquor, and wine.

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Conflicting precepts among these charters and questions about implementation and verification programs have created considerable uncertainty for both local and foreign firms.

The BEE Act directs the Minister of Trade and Industry to develop a national strategy for BEE, issue implementing guidelines in the form of Codes of Good Practice, encourage the development of industry-specific BEE charters, and establish a National BEE Advisory Council to review progress in achieving BEE objectives. Codes of Good Practice, formulated by the DTI, are intended to harmonize existing and future industry BEE charters. On October 31, 2005, the Minister released the final version of the first-phase Codes of Good Practice for Broad-Based Black Economic Empowerment. These include codes on the BEE framework, BEE in equity ownership, and BEE in management. The codes include a new generic scorecard with suggested BEE targets for equity ownership, management, purchasing, and employment. Questions remain about interpretation of the codes, and the measurement and verification of BEE adherence. The draft Codes of Good Practice on multinational companies and BEE purchasing were distributed in December 2005, along with draft Codes of Good Practice on employment equity, skills development, and enterprise development. DTI wants to promulgate the new Codes of Good Practice in the Government Gazette by the end of 2006.

Because of their corporate structure, most U.S. businesses cannot easily transfer equity to BEE shareholders, and are concerned that mandatory equity transfers could – for very practical reasons – put the future of their South African operations in doubt and/or deter further investment. U.S. businesses have concerns about some of the uncertainties in the implementation of BEE, especially with regards to the issue of equity ownership. U.S. government agencies and the U.S. Embassy in Pretoria have been closely monitoring the ongoing development and implementation of South Africa's BEE policies and have maintained a continuous dialogue with the South African government and U.S. industry on BEE.

ANTICOMPETITIVE PRACTICES

Ownership Patterns

There is a historical legacy of concentrated ownership in some sectors of the South African economy. Between 1961 and 1994, the apartheid government prevented a large portion of the South African population from participating actively in the economy by disallowing them the opportunity to gain higher education and managerial experience or to take advantage of entrepreneurial and investment opportunities. Apartheid policies also prohibited successful companies such as South African Breweries, AngloAmerican, DeBeers, and SASOL from investing abroad. Therefore, these enterprises expanded their businesses domestically in horizontal and vertical conglomerates. As a result, major South African companies entangled themselves into complex ownership structures and a series of crossholdings that resulted in the accumulation of considerable power in the South African marketplace. This situation has changed considerably since 1994, as many of the major players have disentangled their businesses, got back to basics, expanded

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internationally, and even listed on foreign stock exchanges. Together with more effective competition laws and BEE initiatives to enlarge the share of black participation in the economy, South Africa's business environment has become more transparent, more competitive, and more open to new entrants (including U.S. companies) than it was ten years ago. The exceptions have been the energy, transportation, and telecommunications sectors, which are still dominated by state-owned or state controlled monopolies.

ELECTRONIC COMMERCE

The Electronic Communications and Transactions Law, effective July 31, 2002, governs all companies that conduct electronic commerce in South Africa. The law was designed to facilitate electronic commerce, but may instead increase the regulatory burden and introduce an unacceptable level of uncertainty for some businesses. The law requires government accreditation for certain electronic signatures, takes government control of the ".za" domain name, and requires a long list of disclosures for web sites that sell via the Internet.

The South African Law Reform Commission has submitted draft legislation and discussion documents on privacy and data protection for public comment by February 28, 2006. The South African Law Reform Commission plans to hold a series of workshops on the legislation in February 2006. Legislation may negatively impact the ability of South African and foreign companies to receive and send trans-border flows of personally identifiable data.

OTHER BARRIERS

Transparency, Corruption and Crime

South African law provides for prosecution of government officials who solicit or accept bribes. Penalties for offering or accepting a bribe may include criminal prosecution, monetary fines, dismissal from government employment, or deportation (for foreign citizens). South Africa has no fewer than ten agencies engaged in anticorruption activities. Some, like the Public Service Commission, Office of the Public Protector, and Office of the Auditor-General, are constitutionally mandated to address corruption as only part of their responsibilities. Others, like the South African Police Anti-Corruption Unit and the Directorate for Special Operations (more popularly known as the "Scorpions"), are dedicated to combating crime and corruption. High rates of violent crime, however, are a strain on capacity and make it difficult for South African criminal and judicial entities to dedicate adequate resources to anti-corruption efforts.

During the last few years, crime has been a far more serious problem than either corruption or political violence when it comes to being an impediment to or raising the cost of doing business in South Africa. The South African Police have not been effective or well accepted in many communities because of their historical role in enforcing minority rule. The lack of training and internal crime and corruption within the police force has only compounded the situation.

FOREIGN TRADE BARRIERS

Although statistics on violent crime have declined in recent years, the perception that crime is a serious problem remains high. The level of crime has deterred some U.S. companies from doing business in South Africa.

New laws, such as the Promotion of Access to Information Act, signed into law in February 2000, have helped to increase transparency in government during the last few years. The Public Finance Management Act, which became effective on April 1, 2000, helped to raise the level of oversight and control over public funds and improve transparency in government spending, especially with regard to off-budget agencies and state-owned enterprises. Notwithstanding these efforts, businesses complain about the lack of certainty and consistency in interpreting and implementing some government policies.

On April 28, 2004, President Mbeki signed The South African Prevention and Combating of Corrupt Activities Act (PCCAA) into law. The PCCAA, *inter alia*, defines graft, bars the payment of bribes by South African citizens and firms to foreign public officials, and obliges public officials to report corrupt activities. One shortcoming of the Act has been its failure to protect whistleblowers against recrimination or defamation claims. This is now receiving some political attention.

Immigration Laws

For a number of years, U.S. and other foreign companies have complained that South African immigration legislation and the application of the law made it extremely difficult to get work permits for their foreign employees. Previously, South Africa relied on the apartheid-era Aliens Control Act, which did not take into account international developments and the opening up of the South African market. A new immigration law entered into force on May 31, 2002. The legislation establishes yearly quotas for granting work permits to foreigners. Local businesses have criticized the new law for creating uncertainty because the quota system sets limits on the number of skilled people that may enter the country in particular categories. Under a separate dispensation, corporate investors may make blanket applications for the people they need. It is not clear whether these corporate permits fall within the quota system. The Minister of Home Affairs has said that the new law is an enormous improvement over previous legislation and places South Africa on a par with other countries, especially with respect to investors and intra-company transfer permits. The Minister for Trade and Industry and the Minister of Finance have suggested that the South African government may need to revise the law to acquire critically needed skills in South Africa.

2. BOTSWANA

IMPORT POLICIES

Tariffs

Botswana is a member of various regional and international economic and trade bodies including the WTO and Southern African Development Community (SADC). Botswana uses the Harmonized System of Classification and applies the SACU common external tariff (CET).

Non-Tariff Measures

Import permits are required for goods entering Botswana directly from countries outside of SACU, with the exception of Malawi, and are obtainable from the Department of Trade and Consumer Affairs in the Ministry of Trade and Industry. The import permits are not transferable and are usually granted upon request.

Prohibited imports include illicit drugs and objectionable literature (pornographic magazines and videotapes). Importation of certain agricultural products and plants requires approval from the Ministry of Agriculture prior to obtaining the import permit from the Department of Trade and Consumer Affairs. Imports of fresh pork are banned, but processed pork products may be imported. Imports of beef and beef products are banned. Poultry imports are permitted only when there is a domestic market deficit. Imports of some vegetables and dairy products are seasonally banned. The government “discourages” the importation of used clothing, although there are no written regulations to this effect. The importer is required to apply for an import permit which may be issued for a duration of 6 months, obtainable from the Department of Trade and Consumer Affairs. Fumigation is required.

GOVERNMENT PROCUREMENT

The Public Procurement and Asset Disposal Board (PPADB) was created in 2003 under the Public Procurement and Asset Disposal Act of 2002 as an independent parastatal. The PPADB took over the functions of its predecessor organization, the Central Tender Board. The PPADB is responsible for the award of all government contracts. The tender process is open. The Independent Complaints Review Committee of the PPADB, established in November 2004, reviews the Board’s decisions subject to challenge by stakeholders (e.g., contractors and procuring entities). Since December 2003, the PPADB has published its decisions concerning awarded contracts, prequalification lists and newly registered contractors.

FOREIGN TRADE BARRIERS

Government procurement practices do involve some preference schemes and some contracts are reserved for 100 percent citizen-owned companies, including all contracts valued at P300,000 (approximately \$54,000) or less. The PPADB has stated that it considers these schemes to be consistent with Botswana's obligations under the WTO, SADC, and SACU. Botswana is not a signatory to the WTO Agreement on Government Procurement.

INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

In 1998, Botswana became a member of both the Berne and Paris Conventions, the international baseline intellectual property rights agreements. The Botswana Copyright Law, enacted in 2000 but not yet fully implemented, is intended to improve standards of protection for rights in literary, artistic, dramatic, and cinematographic works, computer programs, and sound recordings, as well as the rights of broadcasting organizations. To further enhance copyright protection, the Parliament is scheduled to consider the Copyright and Neighboring Rights (Amendment) Act of 2005, which is aimed at updating the 2000 Act legislation to enhance protection of artistic and literary works. Botswana's legislation is now generally in line with international standards, but there are notable deficiencies with respect to geographic indicators and integrated circuits, and enforcement of intellectual property rights remains a challenge.

SERVICES BARRIERS

The Government of Botswana is continuing to reorganize and restructure some ministries and departments to improve the efficiency and effectiveness of services delivery, and it is moving towards privatizing a number of parastatal businesses. One reform requires the government to establish autonomous authorities or boards, working largely on commercial principles. One such authority is the Public Enterprise Evaluation and Privatization Agency (PEEPA), which was established in 2000 to oversee the implementation of the Privatization Policy. PEEPA will ultimately determine the extent of foreign participation in the privatization process and the mechanics that will be used to promote citizen participation. The government intends to use privatization as a tool to increase foreign direct and portfolio investment in the country.

The Ministry of Finance and Development Planning, to which PEEPA reports, welcomes foreign investment, but has stated that local investors may be given preference in privatization initiatives in some instances.

The telecommunications market was liberalized in 1996 following the adoption of the Telecommunications Policy of 1995 and the enactment of the Telecommunications Act (Act No. 15 of 1996), which abolished Botswana Telecommunication Corporation's (BTC) monopoly in some segments of the market and established an independent regulator, the Botswana Telecommunications Authority (BTA). Botswana did not participate in the WTO extended telecommunications and financial services negotiations.

FOREIGN TRADE BARRIERS

The BTA was created to safeguard competition and inter-connection to the public network, yet the state-owned BTC still maintains a monopoly as the sole licensed supplier of fixed-line voice services, including international calls. Market segments that have been liberalized so far include mobile telephones, data communications, payphones, sale of telecommunications equipment, and Internet services. Competition in the cellular phone industry is dominated by two international firms, Mascom (Portuguese) and Orange (French), which compete for the bulk of the local market share. Voice Over Internet Protocol (VOIP) is not allowed (except over private networks). This prevents licensed Internet providers, as well as suppliers of international data transmission through very small aperture terminals (VSATs), from offering voice services in competition with BTC.

BTC must operate any new telecommunications services as subsidiaries or associated entities to allow sufficient accounting separation from its fixed-line operations (BTC Act and 1996 amendments). BOTSNET, a BTC subsidiary, for example, is competing in Internet services with 21 other licensed providers. The BTA Amendment Act of 2004, however, undermined BTA's autonomy as the regulator by transferring final authority for licensing and fee decisions to the Minister of Communications, Science and Technology, thereby re-establishing the operators of the government-owned BTC as the regulators of the industry.

INVESTMENT BARRIERS

All foreign investors wishing to invest in Botswana are required to register a company in accordance with the Companies Act and to comply with other applicable legislation; transfer technology to Botswana, as appropriate; transfer skills to citizens of Botswana by promoting their involvement and participation in positions in the supervisory, middle and senior management levels of companies; and ultimately replace expatriate employees with Botswana citizens within an agreed period, though there are often exceptions to this rule in practice. The acquisition of land, work permits, and business licenses are all encumbered by significant bureaucratic and political constraints.

In March 2005, the government adopted a Privatization Master Plan that identified potential parastatal companies for privatization on a phase-in basis. However, these recommendations lack the authority of legislation and no timeframe for execution has been established. The government passed a competition policy in August 2005 to regulate the development of industries in Botswana and encourage competition, and the government is now in the process of developing a Competition Law that will allow for enforcement and protection against anti-competitive business practices. The government is also formulating a foreign direct investment strategy, which is scheduled to be completed by March 2006. These new initiatives are all geared towards attracting foreign investment by clarifying the rules and regulations for participation in the Botswana economy.

FOREIGN TRADE BARRIERS

OTHER BARRIERS

The legal system is sufficient to conduct commercial dealings, and foreign and domestic parties have equal access to, and standing under, the judicial system. Botswana courts will, in general, accept and enforce decisions of a foreign court found to have jurisdiction in a given case. A backlog of cases, however, has seriously impeded international companies that have won government procurement contracts, which have subsequently been challenged in court. There is a growing concern that the backlog could deter American companies interested in competing for contracts in Botswana.

3. LESOTHO

IMPORT POLICIES

Tariffs

Lesotho applies the SACU Common External Tariff. Additional charges include clearing fees ranging from M750 to M1,000 (approximately \$130 to \$175). Lesotho is a member of the WTO, the Southern Africa Development Community (SADC), and the Africa, Caribbean and Pacific-European Union (ACP-EU) Cotonou trade agreement.

Non-Tariff Barriers

Lesotho applies a permit system for all imports from non-SACU members. The system is applicable to all consignments imported by individual consumers and investors. Manufacturers are accorded preferential treatment through which a "Blanket Permit" is allowed with a validity of 12 months and an additional grace period of 3 months.

The agricultural sector has witnessed some structural reforms involving the removal of price subsidies and import controls on maize and wheat produce in favor of market-determined prices. The 1967 Agricultural Marketing Act, however, continues to control the importation of bread, legumes, sugar, eggs, meat, dairy products, fruits and vegetables.

With the exception of eggs, sugar and legumes, the import restrictions allow a minimum exemption for consumer purchases outside the country. The Department of Marketing under the Ministry of Trade and Industry, Cooperatives and Marketing monitors the level of production of these commodities and issues import licenses in the event of short supply. However, national production has never met local demand. As a result, import permits are issued as a matter of course. Non-automatic licenses apply to imported used clothing. In practice, no licenses are issued, constituting a de-facto ban.

The Ministry issues permits for the import of used vehicles from outside the SACU area, Japan being a popular source for Lesotho.

FOREIGN TRADE BARRIERS

STANDARDS, TESTING, LABELING AND CERTIFICATION

Lesotho does not have a national standards body. The Standards and Quality Assurance section of the Ministry of Trade and Industry, Cooperatives and Marketing functions as the focal point for standards and quality assurance. No national standards have been developed to date. Industries in Lesotho have traditionally relied on the South African Bureau of Standards for voluntary standards facilities and quality assurance schemes. Local exporters have relied on traditional export markets and have developed their standards according to technical and quality requirements of importing countries or international standards.

Lesotho participates in a regional program on Standardization, Quality, Accreditation and Metrology for the SADC. The program aims to harmonize standards for adoption by all member states. Efforts are also underway to develop a regional accreditation authority.

GOVERNMENT PROCUREMENT

Lesotho is not a signatory to the WTO Agreement on Government Procurement.

Government procurement rules do not give Lesotho nationals preference in bids for goods and services. The Ministry of Trade and Industry encourages joint ventures.

Lesotho is working on a procurement policy intended to conform with SACU and WTO standards. New procurement guidelines are being considered which, among other things, would authorize the publication of tender notices on the Internet to increase their visibility.

INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

Lesotho's Industrial Property Order (1989), Copyright Order (1989) and the Industrial Property Regulations (1989) are the basis for legal protection of intellectual property rights. Patents, valid for 15 years from the date of application, have rarely been issued in Lesotho, but trademark protection is widely sought and granted. Lesotho is a member of WIPO and the African Regional Intellectual Property Organization.

SERVICES BARRIERS

Foreign participation is not restricted in the service sector. The banking and telecommunications sectors are largely controlled by foreign ownership, in particular by South African institutions.

The Trading Enterprises Order of 1996 restricts foreigners from participating in small trading activities that are reserved for nationals only. These include butcheries, barbershops, general cafes and hair salons.

FOREIGN TRADE BARRIERS

INVESTMENT BARRIERS

Lesotho welcomes foreign investment. Foreign investors have participated in the country's privatization program without discrimination.

ELECTRONIC COMMERCE

The Ministry of Communications, Science and Technology is circulating a National Information and Communication Technology policy paper which proposes the introduction of electronic commerce and the formulation of related regulatory mechanisms.

OTHER BARRIERS

Corruption

Business people state that solicitation of bribes in connection with government services does not occur. The government has received international accolades for its prosecution of multinational companies for corruption related to the awarding of contracts for construction of the Lesotho Highlands Development Project. In cases that have been upheld by the Lesotho Court of Appeals, the former Chief Executive of the Lesotho Highlands Development Authority and three multinational corporations have been convicted for fraud and bribery.

The government has established a Directorate on Corruption and Economic Offenses that continues to prosecute cases regarding the LHDA project, as well as others involving embezzlement and bribery.

4. NAMIBIA

IMPORT POLICIES

Namibia is a member of various regional and international economic and trade bodies including the WTO and the Southern African Development Community (SADC). Namibia uses the Harmonized System of Classification and applies the SACU common external tariff (CET).

The Directorate of International Trade of the Ministry of Trade and Industry (MTI) is responsible for coordinating the country's trade policies and overseeing Namibia's participation in international trade bodies. The Directorate is responsible for managing import/export procedures. Importers must have an import permit from the Ministry of Trade and Industry. Namibia is a party to the WTO Agreement on Import Licensing. A limited number of products is subject to non-automatic import licensing: medicines; chemicals; frozen, chilled, fish and meat; live animals and genetic materials; controlled petroleum products; firearms and explosives; diamonds, gold and other minerals; and seemingly all second-hand goods such as clothing and motor vehicles. In practice,

FOREIGN TRADE BARRIERS

however, the Ministry of Trade and Industry does not issue licenses for imports of used clothing, with the effect of a *de facto* ban on this product. Most non-agricultural imports require a permit issued by MTI. With respect to agricultural trade, the Namibian Agronomic Board issues permits for the import, export, and transit of controlled agronomic crops (i.e., wheat and wheat products and corn and corn products). Imports of agronomic crops and derivatives, as well as all plants and plant products, also require the issuance of a phytosanitary certificate by the Ministry of Agriculture, Water and Rural Development. The Namibian Meat Board regulates the import and export of live animals (cattle, sheep, goats and pigs) and derivative meat products. Importers of live animals and meat products must demonstrate compliance with the country's animal health standards by obtaining a veterinary import permit from the Directorate of Veterinary Services.

In January 2005, Namibia introduced a new regulation to ban the importation of used vehicles older than five years from non-SACU countries, as well as left-hand drive vehicles.

STANDARDS, TESTING, LABELING AND CERTIFICATION

Namibia is a party to the Convention on Biological Diversity and a signatory to the subsequent Cartagena Protocol on Biosafety. To meet its international commitments, the government is drafting new legislation – the Biosafety Act – which will regulate the importation, sale and use of products of agricultural biotechnology and will establish new regulatory and administrative structures. It will impose new registration obligations on facilities that use or produce agricultural biotechnology products and will require persons and companies to receive authorization prior to importing such products. It will require biotechnology products to be clearly labeled and identified for purposes of traceability. Pending passage of the Biosafety Act, the government has imposed a moratorium on the importation of agricultural biotechnology products.

GOVERNMENT PROCUREMENT

Most government transactions, including the awarding of contracts and the purchase of supplies, are made through the Tender Board of Namibia. The Board is comprised of representatives from various government ministries and appointed by the Minister of Finance. Government procurement tender notices are publicized in the local media. The Tender Board gives preference for goods manufactured and/or assembled in Namibia. Namibia is not a signatory to the WTO Agreement on Government Procurement.

EXPORT PROMOTION

Since independence in 1990, the government has pursued policies to diversify its economy and to create employment. To achieve that goal, the government has put in place tax and non-tax incentives to attract manufacturers and export-oriented businesses.

FOREIGN TRADE BARRIERS

The Offshore Development Company administers the country's Export Processing Zone (EPZ) regime. Companies granted EPZ status can set up operation anywhere in Namibia. There are no restrictions on the industrial sector so long as the exports are destined for markets outside the SACU region. Benefits of the EPZ regime include no corporate tax, no import duties on the importation of capital equipment or raw materials, and no VAT, stamp or transfer duties. Non-residents operating in an EPZ may hold foreign currency accounts.

INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

Namibia is a member of the World Intellectual Property Organization. The responsibility for IPR protection is divided between two government ministries. The Directorate of Internal Trade of the Ministry of Trade and Industry oversees industrial property and is responsible for the registration of companies, private corporations, patents, trademarks and designs. The Ministry of Information and Broadcasting manages copyrights.

The government is in the process of updating copyright legislation to bring it in line with the TRIPS Agreement and the WIPO Treaties on Performance and Phonograms and Copyrights. A draft bill is scheduled to be tabled in Parliament in 2006. Absent new legislation, Namibia lacks adequate legal and enforcement mechanisms to address the problems associated with piracy and copyright infringement.

SERVICES BARRIERS

Services account for nearly 60 percent of Namibia's GDP with government services representing the largest single component. Foreign participation in the services sector is generally unrestricted. Due to historical links between the two economies, South African companies dominate many commercial services in Namibia, particularly in the retail and financial sectors. Other services -- including telecommunications, water, electricity and most major transport services -- are dominated by Namibian parastatals. Many of the 41 recognized parastatals operate as "commercialized" entities, meaning they are profit-seeking and are not maintained on the national budget. However, only a limited number produce annual reports on a regular basis. There is currently little U.S. participation in the Namibian service sector.

Under the Namibia National Re-insurance Act of 1998, insurance companies are required to cede 20 percent of any policy issued or renewed to the state-owned Namibia National Reinsurance Corporation (NamibRe). In 2001, the government and private insurers reached an agreement in which the mandatory cessions clause would not be enforced for five years. The government-industry agreement will be re-evaluated in 2006.

FOREIGN TRADE BARRIERS

INVESTMENT BARRIERS

Namibia's Foreign Investment Act of 1990 provides for equal treatment of domestic and foreign investors and provides non-discriminatory access to all sectors. The government guarantees foreign investors access to foreign currency, repatriation of capital, and dispute settlement through international arbitration. There are few restrictions on the establishment of private businesses or the size of an investment. The Namibian Investment Centre, which was created by the 1990 Act, is responsible for implementing the country's investment promotion policies.

There is no local participation requirement for foreign investments, but the government actively encourages partnerships with historically disadvantaged Namibians. In certain industries, such as the fishing sector, there has been a concerted campaign to "Namibianize" existing investments.

Land reform is at the forefront of public debate. The Namibian Constitution provides for the government-initiated purchase of private property in the public interest subject to the payment of "just" compensation under a "willing buyer-willing seller" system, and the government has begun to implement this program as prescribed by the Constitution. The process has been criticized recently for the slow pace of acquiring commercial farmland and resettling Namibia's landless. The government considers foreign-owned and non-productive farmland primary targets for expropriation. The government introduced a land tax at the beginning of April 2005 in an effort to raise money for land acquisition. Absentee landowners are subject to higher tax rates per hectare than resident farmers.

ELECTRONIC COMMERCE

Electronic commerce is still relatively unknown to Namibian consumers. Only a small percentage of Namibians enjoy access to the Internet. The government is in the early stages of formulating policies to regulate electronic commerce. MTI's Directorate of Internal Trade has included a section on electronic commerce in an updated version of the Companies Act, which is awaiting Parliamentary action.

OTHER BARRIERS

According to recent surveys, there is a growing public perception that official corruption is on the rise. Several presidential commissions have been established in recent years to investigate allegations of kickbacks and irregularities in Namibian parastatals.

Despite the growing perception of corruption, similar studies have shown that Namibians retain confidence in government institutions to address the problem. Anti-corruption was the centerpiece of President Pohamba's election campaign, and it is a top priority of his administration along with the elimination of mismanagement and fraud. Anti-corruption legislation is in place to combat public corruption. President Pohamba's government is actively investigating several widely publicized corruption cases, a welcomed departure from previous administrations.

FOREIGN TRADE BARRIERS

Anti-corruption bodies include the Office of Ombudsman and the Office of the Auditor-General. In 2003, an Anti-Corruption Bill was passed that provides for the establishment of an independent Anti-Corruption Commission. Prime Minister Angula recently appointed two candidates to head the Anti-Corruption Commission, which President Pohamba inaugurated on February 1, 2006. In addition, a large court backlog continues to cause a lengthy delay of trials.

5. SWAZILAND

IMPORT POLICIES

Tariffs

Swaziland is a member of the WTO, the Common Market for Eastern and Southern Africa (COMESA) and the Southern African Development Community (SADC). As a member of SACU, Swaziland applies the SACU common external tariff (CET). Swaziland has at times exercised its right under the SACU Agreement to protect infant industries such as fertilizer, cement, and beer by applying tariff rates higher than those in the CET.

Non-Tariff Measures

There are no restrictions on imports into Swaziland and no prohibited imports (except illegal drugs and arms). Permits are required for certain imports, including all agricultural products, mineral fuels, used clothes, mineral oils, motor vehicle parts, used cars, medicinal drugs, and electrical appliances. Licensing permits issued by the Ministry of Finance are generally easy to obtain and are valid for one shipment. Goods consigned to Swaziland from outside SACU must be cleared through customs at the first port of importation into SACU. A bill of entry must be completed and submitted to customs along with copies of the supplier's invoices and a Swaziland import permit.

GOVERNMENT PROCUREMENT

Although the government accords local business a 15 percent price preference in the tendering process for government contracts, it appears that this preferential treatment is not always granted. A large portion of government contracts is filled by firms from South Africa and other southern African countries. However, for small- and medium-sized tenders, bidding companies must be registered in Swaziland. The government inspects the premises of all suppliers prior to awarding the tender.

The government issues tender notices 7 to 30 days before tenders are due, depending on the size of the contract. Potential suppliers must pay a fee to obtain tender documentation and participate in government procurements. Tenders are returned to the Central Tender Board and suppliers are invited for the opening of the tenders. In some instances, a Ministry can apply for a waiver if there are too few companies supplying a particular commodity.

Swaziland is not a signatory to the WTO Agreement on Government Procurement.

FOREIGN TRADE BARRIERS

INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

Swazi legal protection for patents, trademarks, and copyrights is inadequate. Swaziland has an intellectual property rights regime inherited from the colonial era, under which copyrights, patents, and trademarks were more or less protected under various acts promulgated by the colonial authorities. The Ministry of Justice, responsible for these concerns, has been working on improved laws.

Patents are currently protected under a 1936 act that automatically extends patent protection upon proper application to products that have been patented in either South Africa or Great Britain. Updated patent legislation has been approved by the Cabinet, passed by both houses of Parliament, and is now awaiting the King's royal assent. Under the new legislation, patents would be granted by the government with technical assistance from the African Regional Industrial Property Organization in Harare. Protection would be extended to pharmaceutical and agricultural chemical products.

Copyright protection is addressed under four statutes, enacted in 1912, 1912, 1918, and 1933. According to the Registrar General for the Ministry of Justice, the statutes have yet to be implemented and copyright protection in Swaziland is "limited." The Ministry of Justice is in the process of drafting an updated Copyright Act, based on the World Intellectual Property Rights Organization (WIPO) model.

Swaziland is not Party to the WIPO Internet treaties.

SERVICES BARRIERS

Foreign participation in the services sector is generally not restricted, except for the insurance industry. Swaziland Royal Insurance remains the sole insurer in the country.

INVESTMENT BARRIERS

Although Swaziland's government strongly encourages foreign investment, and has done so for the past 15 years, the results have been limited. Swaziland does not have an investment code. The emphasis on foreign investment is more a matter of policy statements by the government and individual Ministers than a matter of laws and institutions to support such policy. Calls for more concerted action on this policy have intensified in the last few years, as Swaziland has suffered from drought and general economic recession.

Major legislation to support a solid investment climate is lacking in Swaziland. There is a need for a Securities Code to support investors who buy shares in the securities market. A Securities Bill has been proposed but not yet passed. Companies are governed by the outdated Companies Act of 1912, which is retooled from an 1889 South African law. A bill replacing the Companies Act has been drafted and will regulate incorporation, registration, management, administration, and dissolution of companies. The Minister of Enterprise and Employment has said he will take

FOREIGN TRADE BARRIERS

the bill to Parliament in 2006. While foreign businesses currently operating in Swaziland complain about the lack of regulations, some also emphasize that it would be a mistake to decide against investing in Swaziland for this reason alone.

There are no formal policies or practices that discriminate against foreign-owned investors and companies in Swaziland. Foreign investors are free to invest in most sectors of the Swazi economy; however, investors should be aware of state-run or state-sanctioned monopolies. Pineapple canning, cellular telephone network, landline network, electricity, water, and insurance are all state-sanctioned or state-owned monopolies. A Trade and Business Facilitation Bill, drafted in 2001, limiting certain sectors to some degree of Swazi ownership and encouraging small-scale entrepreneurship in rural areas, had not been passed by Parliament as of December 2005.

Privatization of parastatals has become an issue in Swaziland. Key parastatals are targeted for privatization, with the possibility of joint ventures for foreign investors. Swazi Post and Telecommunications Corporation (SPTC) is one such potential opportunity. Parastatals successfully privatized include the Swaziland Dairy Board and Royal Swazi Airways, which formed a joint venture with South African Airways to form Swazi Airlink.

SAUDI ARABIA

TRADE SUMMARY

Saudi Arabia became a member of the World Trade Organization (WTO) on December 11, 2005. During the process of accession to the WTO, Saudi Arabia extensively revised its trade regime to come into compliance with WTO requirements. Saudi Arabia is working to implement all of the commitments undertaken as part of its accession.

The U.S. goods trade deficit with Saudi Arabia was \$20.4 billion in 2005, an increase of \$4.7 billion from \$15.7 billion in 2004. U.S. goods exports in 2005 were \$6.8 billion, up 29.9 percent from the previous year. Corresponding U.S. imports from Saudi Arabia were \$27.2 billion, up 29.9 percent. Saudi Arabia is currently the 26th largest export market for U.S. goods.

U.S. exports of private commercial services (i.e., excluding military and government) to Saudi Arabia were \$1.7 billion in 2004 (latest data available), and U.S. imports were \$432 million. Sales of services in Saudi Arabia by majority U.S.-owned affiliates were \$625 million in 2003 (latest data available), while sales of services in the United States by majority Saudi Arabia-owned firms were \$546 million.

The stock of U.S. foreign direct investment (FDI) in Saudi Arabia in 2004 was \$3.8 billion, up from 3.5 billion 2003.

IMPORT POLICIES

Tariffs

As a member of the Gulf Cooperation Council (GCC), Saudi Arabia applies the GCC common external tariff of five percent for most products, with a number of country-specific exceptions. Saudi Arabia's exceptions to the common external tariff include 394 products that may be imported duty-free, including aircraft and most livestock. The Saudi government also applies a 12 percent tariff on 492 products, in some cases to protect local industries. Certain textile imports, including carpets but excluding apparel, are among the products to which the 12 percent rate applies. A number of Saudi industries enjoy 20 percent tariff protection, including those producing sesame extract, furniture, cooking salt, edible offal, rabbit meat, mineral water, and plastic pipes. In addition, long-life milk and nine other agricultural products are subject to a 25 percent tariff on a seasonal basis. Saudi Arabia imposes a 40 percent tariff on dates. Saudi Arabia also imposes a 100 percent tariff on cigarette and other tobacco imports. (Saudi Arabia's complete tariff schedule is available online at www.saudi-customs.net.)

FOREIGN TRADE BARRIERS

Import Licensing

In Saudi Arabia, the importation of certain articles is either prohibited or requires special approval from competent authorities. Specifically, the importation of alcohol, firearms, pork products, and used clothing is prohibited. Imports of agriculture seeds, live animals, fresh and frozen meat, books, periodicals, movies, tapes, religious books and tapes, chemicals and harmful materials, pharmaceutical products, wireless equipment, horses, radio-controlled model airplanes, products containing alcohol, natural asphalt, and archaeological artifacts require special approval.

Documentation Requirements

To export products to Saudi Arabia from the United States, the U.S. Department of State's Authentication Division and the Saudi Embassy or Consulate must authenticate the documentation. The U.S.-Saudi Arabian Business Council is not required to certify legal documents, but will do so if requested. Some products, most notably agricultural biotechnology products, need a certificate from the country of origin attesting to the product's fitness for human consumption and that it is sold widely in the country of origin. All consumer products must have a certificate of conformity issued under the guidelines of the Certificate of Conformity Program (COCP) before entering the country. The Saudi Arabian Standards Organization's (SASO) role, which previously included governance of certificates of conformity, is now limited to issuance of applicable Saudi standards for consumer products.

STANDARDS, TESTING, LABELING AND CERTIFICATION

Saudi Arabia in 2005 abolished the International Conformity Certification Program (ICCP), a pre-shipment certification program initiated in 1995 to monitor and control the quality of certain products imported into the country. In place of ICCP, the certification program is now under the control of the Certificate of Conformity Program (COCP). The new program will require all exporting companies to provide a certificate of conformity with every shipment to Saudi Arabia. The regulations pertaining to the new COCP have not yet been published. As a transitional measure, Saudi Arabia has implemented a temporary rule that a certificate of conformity shall accompany every imported consumer product bound for Saudi Arabia. The COCP shall be signed by an approved laboratory in the country of origin specifying that the imported goods either abide by or meet applicable Saudi standards, if available, or adhere to international standards.

Saudi Arabia will utilize third-party laboratories to clear incoming shipments from customs after these laboratories are established and drafted regulations approved.

The Saudi Arabian Standards Organization (SASO) imposes shelf-life requirements on food products. In practice, the Saudi government requires imported food products to arrive in port with at least one-half of their shelf-life remaining, calculated from the date of production. Over the past few years, SASO has shortened the shelf life duration for baby foods, eggs, stuffed cookies, chilled meats, and some snack foods, all products of

FOREIGN TRADE BARRIERS

interest to U.S. exporters. Saudi Arabia requires an animal protein-free certificate for imports of poultry, beef, and lamb and their by-products. In addition, the Saudi Government bans the import of therapeutic medicines used in animal feed. These measures were taken with little to no advance notice. The United States addressed these issues during bilateral negotiations with Saudi Arabia and accession to the WTO will eliminate or improve many of these restrictions.

Saudi Arabian Ministries of Agriculture and Commerce and Industry implemented biotech-labeling decrees on animal feed and processed foodstuffs in January 2004 and December 2001, respectively. The decrees require a positive biotechnology label if a product contains more than one percent of genetically modified vegetable (plant) ingredients. Thus far, the Saudi biotechnology-labeling requirement has not drastically affected imports of U.S. agricultural products. Biotechnology grains such as corn and soybean meal are being imported from the U.S. and other suppliers. According to Saudi importers, U.S. high value food products declared biotechnology free have tested negative and companies whose products test negative will not be tested again for another six months. The Kingdom is currently reviewing both ministerial biotechnology-labeling decrees to establish a comprehensive biotechnology standard that would govern imports of all agricultural products.

GOVERNMENT PROCUREMENT

Saudi Arabia agreed to become an observer to the WTO Government Procurement Agreement and to initiate negotiations on membership as part of its accession to the WTO. Several royal decrees that strongly favor GCC nationals apply to Saudi Arabia's government procurement contracts. However, most defense contracts are negotiated outside these regulations on a case-by-case basis. Under a 1983 decree, contractors must subcontract 30 percent of the value of any government contract, including support services, to firms majority-owned by Saudi nationals. An exemption is granted in instances where no Saudi-owned company can provide the goods and services necessary to fulfill the procurement requirement.

In addition, Article 1(d) of the tender regulations requires that Saudi individuals and establishments be given preference over all other suppliers in government procurement. However, the regulations extend the preference to other suppliers if Saudi nationals hold at least 51 percent of such suppliers' capital.

Article 1(e) of the tender regulations gives preference to products of Saudi origin that satisfy the requirements of the procurement. Saudi Arabia also gives priority in government purchasing programs to GCC products. These items receive up to a 10 percent price preference over non-GCC products in all government procurements in which foreign suppliers participate.

Foreign suppliers that participate in government projects are required to establish a training program for Saudi nationals. Some government contracts will also require a minimum level of subcontracting with Saudi companies.

FOREIGN TRADE BARRIERS

In addition, the Saudi Government may favor joint venture companies with a Saudi partner over foreign firms and will also support companies that use Saudi goods and services. For large military projects, there is frequently an offset requirement; this is determined on a project-by-project basis.

Foreign companies providing services to the Saudi Arabian government can do so without a Saudi service agent and can market their services to various other public entities directly through a temporary registration office. Foreign contractors working only for the government, if not already registered to do business in Saudi Arabia, are required to obtain temporary registration from the Ministry of Commerce and Industry within 30 days of contract signing. Foreign companies also are allowed to establish a branch office through new Foreign Investment Regulations. These branch offices are usually approved only for foreign defense contractors and high-technology companies. For others, a liaison office may be established to supervise work in Saudi Arabia and to facilitate coordination between the Saudi government and company headquarters.

In June 2003, the Saudi Council of Ministers passed a resolution calling for increased transparency in government-budgeted projects and government contracts. The contract information to be made public includes: title, parties, date, financial value, brief description, duration, place of execution, and point of contact information. The Council of Saudi Chambers of Commerce and Industry and the Ministry of Finance have begun publishing the details of government contracts on its website.

INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

Saudi Arabia remained on the Special 301 Watch List in 2005. The U.S. government initiated an out-of-cycle review focusing on improved IPR enforcement efforts, enactment, and implementation of IPR legislation that is compliant with the WTO TRIPS agreement and improved patent protection, but the review was not complete at the time of publication of this report. As of the end of 2005, Saudi Arabia has enacted laws that cover a range of IPR issues, including patents, trademarks, copyright, trade names, commercial data, border protection of IPR, and protection of confidential commercial information. The laws also increased penalties for violators, including fines and prison sentences.

Saudi Arabia has made progress on copyright enforcement over the past few years, with a steadily increasing number of raids/seizures and fines imposed. However, U.S. software manufacturers seek greater Saudi government enforcement action against software copiers and unauthorized end-users of software. Another area of concern involves counterfeiting of U.S. trademarked products. The Saudi government is aware of these problems and is considering options to combat them. U.S. industry has expressed frustration with the lack of transparency in the enforcement system, procedural hurdles to judicial enforcement, and failure to impose punishment at the higher end of deterrent penalties. U.S. companies have also complained of widespread piracy of pay television signals.

FOREIGN TRADE BARRIERS

Although Saudi Arabia has passed new patent legislation and in recent years has taken measures to hire and train more examiners, translators, and clerks, the processing of patent applications has historically suffered from extreme delays. The previous inadequate patent application process has resulted in a large backlog of patent applications. Patent applications are still outstanding dating back to 1989, however, Saudi Arabia expects under the new legislation to clear this backlog by the end of 2006 and maintain a backlog free system thereafter.

Recently, American companies with patent applications pending have expressed concern that the new patent law will not allow patent protection to their pending patent applications that were filed under provisions of the old law, which permitted filing of applications after a patent was issued in another country. Pending cases since 1989 reportedly have been denied because the applications were not filed within one year of the invention. A case now before the Saudi patent court will likely provide guidance and interpretation of the new patent law and its effect on those backlogged patent applications.

SERVICES BARRIERS

Insurance

In the last two years, the Saudi Arabian Government has implemented a series of laws giving structure to what had been an essentially unregulated sector and mandating certain types of insurance coverage within the Kingdom. In June 2002, the Cooperative Health Insurance Council issued the by-laws of a mandatory cooperative health insurance scheme. The scheme will be implemented gradually and will require employers to pay for insurance coverage of foreign workers and dependent family members. In November 2002, third party motor vehicle insurance became mandatory in the Kingdom. In October 2003, the Saudi Arabian Government enacted the Control Law for Co-Operative Insurance Companies. The law requires all insurance companies operating in the Kingdom to be locally registered, publicly owned firms. In keeping with adherence to Islamic principles, insurance companies will need to operate on a cooperative or mutual basis. Firms will need to register with the Saudi Arabian Monetary Agency (SAMA). The law sets capitalization requirements for insurers at SR100 million (\$26.7 million) and re-insurers at SR200 million (\$53.4 million).

SAMA began accepting applications for insurance operations in November 2003 v 33. Insurance firms operating in the Kingdom may offer any insurance product in both the commercial and personal markets as long as the firm is organized consistent with the cooperative insurance structure.

On April 13, 2005, Royal Decree No. 3120/MB allowed foreign insurance companies to operate in Saudi Arabia through direct branches, which are not subject to the requirements of public ownership and cooperative form.

FOREIGN TRADE BARRIERS

Banking

Although the Saudi Banking Control Law does not limit foreign participation, for the past twenty years the Saudi Arabian Monetary Agency has capped foreign ownership in commercial banks to 40 percent of any individual bank operation. In the last few years, the Saudi Government has taken steps to increase foreign participation in its banking sector by granting operating licenses to foreign banks. The Bahrain-based Gulf International Bank (GIB), Dubai-based Emirates Bank International, BNP Paribas, and National Bank of Kuwait currently operate in the Kingdom. In November 2003, the Saudi Government granted an operational license to Deutsche Bank. The Saudi Capital Markets Law came into effect in February 2004. The law provides for the creation of investment banks and brokerages in the Kingdom. Levels of foreign participation in these ventures have been fixed at 60 percent. As capital markets regulations are finalized, Saudi Arabian investment banking will likely see significant growth.

Shipping

Saudi Arabia gives preferences to national carriers for up to 40 percent of government-related cargoes. Under these rules, the National Shipping Company of Saudi Arabia and United Arab Shipping Company receive preferences.

Agent and Distributor Rules

Saudi law requires that domestic distributors register with the Ministry of Commerce and Industry. Currently, only Saudi citizens can obtain registration as distributors. A recent GCC decision may broaden this to make all GCC citizens eligible. Nationals from the GCC countries are also allowed to engage in trading and retail activities, including real estate. By the same token, foreign nationals are allowed to own real estate on a limited basis. Saudi Arabia's WTO commitments, which came into effect on December 11, 2005, open distribution to non-nationals on a gradual basis, up to 75 percent of total equity within three years. In July 2001, the Saudi Council of Ministers canceled the requirement for foreign companies with government contracts to have a Saudi service agent.

INVESTMENT BARRIERS

In April 2000, Saudi Arabia's Council of Ministers approved a new foreign direct investment code with the goal of facilitating establishment of foreign companies, both joint ventures and 100 percent foreign-owned, in Saudi Arabia. Key provisions allow foreign investors to transfer money freely into and out of the country, allow joint-venture companies to sponsor their foreign investors as well as their foreign employees (all foreigners in Saudi Arabia need a legal sponsor in order to reside in the country), and permit foreign investors to own real property for company activities. The Saudi Arabian General Investment Authority (SAGIA) was established to manage investments under the new code, with guidance from the Supreme Economic Council. In addition to its existing Service Centers, in March 2003, SAGIA opened a Women's Investment Center.

FOREIGN TRADE BARRIERS

In principle, SAGIA must decide to grant or refuse a license within 30 days of receiving an application and supporting documentation from the investor. Wholly domestic projects funded with Saudi money do not need licenses through SAGIA's investment services center, which was specifically designed for foreign investors. However, many of the licenses are issued for projects jointly owned with Saudi investors. Some foreign investors have complained that the licensing process was not as streamlined as SAGIA intended. Impediments, often caused by other Ministries' bureaucratic mechanisms, often delayed the application process. SAGIA continues to take steps to address these impediments and streamline the process, including making 17 separate agreements in 2005 with other Ministries and government agencies to facilitate foreign investment. While SAGIA is intended to operate as a one-stop shop, where foreign investors can obtain all of the necessary permits or authorizations, some companies still experience delays in subsequent steps, for example in obtaining a commercial registry or purchasing property.

Following SAGIA's recommendations, the Supreme Economic Council published in 2001 a negative list of sectors in which foreign investment is prohibited (www.sagia.gov.sa). Foreign investment is currently prohibited in 18 manufacturing and service sectors and subsectors.

In October 2003, the Saudi Government passed the Capital Markets Law, which took effect in February 2004. The law allows for the creation of financial intermediaries (stock brokerages and investment banks) and creates an independent stock market and an independent stock market regulatory body. The law sets SR50 million (\$13.3 million) capitalization requirements for brokerages and provides penalties for insider trading and wrongful dissemination of information. The law also allows for the development of long-term investment instruments and limits to 49 percent the maximum equity share that may be held by foreign investment banking and brokerage firms that establish joint ventures with Saudi entities. Saudi Arabia agreed to raise the the percentage of the foreign partner to 60 percent after WTO accession. Two new joint ventures with foreign partners were licensed by the Capital Market Authority in November 2005. The new law does not repeal the prohibition on direct foreign participation in the Saudi stock market. Foreigners can continue to purchase shares in bank operated investment funds, however. Foreign participation in these funds is limited to 10 percent of the total value of the fund.

ELECTRONIC COMMERCE

Pursuant to the Council of Ministers' decree concerning the regulation of use of the Internet in Saudi Arabia, all Web sites that contain content in violation of Islamic tradition or national regulations are blocked. Pornographic Web sites are identified and blocked through a filtering system, which does occasionally prevent access to sites that appear to fall outside stated prohibited topics. Non-pornographic sites are placed on the blocked list based upon direct requests from the security bodies within the government.

FOREIGN TRADE BARRIERS

SINGAPORE

TRADE SUMMARY

The U.S. goods trade surplus with Singapore was \$5.5 billion in 2005, an increase of \$1.3 billion from \$4.2 billion in 2004. U.S. goods exports in 2005 were \$20.6 billion, up 5.3 percent from the previous year. Corresponding U.S. imports from Singapore were \$15.1 billion, down 1.6 percent. Singapore is currently the 11th largest export market for U.S. goods.

U.S. exports of private commercial services (i.e., excluding military and government) to Singapore were \$5.6 billion in 2004 (latest data available), and U.S. imports were \$2.7 billion. Sales of services in Singapore by majority U.S.-owned affiliates were \$6.7 billion in 2003 (latest data available), while sales of services in the United States by majority Singapore-owned firms were \$1.5 billion.

The stock of U.S. foreign direct investment (FDI) in Singapore in 2004 was \$56.9 billion, up from \$50.3 billion in 2003. U.S. FDI in Singapore is concentrated largely in the manufacturing, finance, and information sectors.

FREE TRADE AGREEMENT (FTA)

The United States and Singapore signed a free trade agreement (FTA) on May 6, 2003, which entered into force on January 1, 2004. In addition to the FTA with the United States, Singapore has concluded bilateral FTAs with Australia, the European Free Trade Association, Japan, Jordan, New Zealand, South Korea, India, and Panama, and a quadri-lateral agreement with Chile, New Zealand, and Brunei. Singapore is negotiating FTAs with Bahrain, Canada, Egypt, Mexico, Peru, and Sri Lanka. Singapore is also part of the ASEAN-China FTA negotiations.

IMPORT POLICIES

Tariffs

Singapore generally imposes no tariffs on goods. For goods originating in the United States, it eliminated the last four remaining tariffs covering imports of beer and certain alcoholic beverages when the FTA came into force. For social and/or environmental reasons, however, Singapore levies high excise taxes, applicable to U.S. and other exporters, on distilled spirits and wine, tobacco products, motor vehicles (all of which are imported), and gasoline. Singapore does not impose any restrictions or duties on imports or exports of textiles and apparel. During the Uruguay Round of Multilateral Trade Negotiations, Singapore agreed to bind 70.5 percent of its tariff lines. Singapore is a signatory to the WTO Information Technology Agreement (ITA).

FOREIGN TRADE BARRIERS

Import Licenses

All imports require an import permit, primarily for statistical tracking purposes. Special import licenses are required for certain goods, including designated strategic items, hazardous chemicals, films and videos, arms and ammunition, as well as agricultural biotech products, food derived from agricultural biotechnology products, prescription drugs, over-the-counter drugs, vitamins with very high dosages of certain nutrients, and cosmetics/skin care products. As a result of the FTA, Singapore now allows the importation of chewing gum with therapeutic value for sale, subject to certain provisions.

STANDARDS, TESTING, LABELING AND CERTIFICATION

Under the 2002 Consumer Protection (Safety Requirements) Regulations, 45 categories of electrical, electronic, and gas home appliances and accessories are listed as controlled goods and require a stamp of approval from the Government of Singapore's standards and certification authority (SPRING Singapore). SPRING Singapore recognizes test reports issued by accredited testing laboratories and national certification bodies, including those in the United States. Labels conforming to standardized formats are required on imported foods, drugs, liquors, paints, and solvents.

The Singapore government's food import policy is to guarantee a steady and sufficient supply of healthy and quality foods from a broad number of countries. Singapore allows meat and poultry imports solely from countries with which it has protocol agreements. Doing so preserves its rigorous food safety requirements through the integration of foreign farm accreditation, inspection, and regular testing. Export health documentation endorsed by federal health institutions must go with every shipment of imported meat and poultry. In addition, Singapore health authorities test every shipment of imported meat and poultry visually for wholesomeness and to ensure it is free from spoilage and disease. For instance, meat and poultry products samples are sent to government laboratories for evaluation to guarantee that they do not exceed the allowable microbiological specifications for raw meat and poultry products. Singapore's Agri-food and Veterinary Authority (AVA) enforces a zero tolerance for salmonella enteritidis and E-coli E. 0157 in raw meat products, causing concerns among U.S. exporters.

AVA prohibits beef imports from nations in which Bovine Spongiform Encephalopathy (BSE) has been detected, including the United States. Singapore previously required six years of non-BSE detection in a country before re-establishing trade, but has now established a minimum risk rule in line with OIE guidelines. On January 17, 2006, Singapore announced the re-opening of its market to U.S. boneless beef from animals under 30 months of age.

Singapore also requires all meat and poultry exporting countries to have a mark of inspection and to confirm that the bird or animal has been born and raised in the exporting country, which could be viewed as overly restrictive.

The U.S. government is presently coordinating with the Government of Singapore to streamline the certification process for U.S. poultry feet exports to Singapore.

Fresh produce imports are tagged to secure their traceability to farms. Routinely, fresh produce is tested to guarantee that it does not exceed maximum pesticide residue limitations (MRLs).

GOVERNMENT PROCUREMENT

Singapore has been a signatory to the WTO Government Procurement Agreement (GPA) since 1997. The FTA provides additional government procurement access to U.S. firms by expanding the contracts covered by Singapore's GPA commitments, in part by subjecting additional contracts to FTA disciplines. Some U.S. firms, however, have expressed concerns that government-owned and government-linked companies (GLCs) may receive preferential treatment in the government procurement process. Singapore's government denies that it gives any preferences to GLCs or that GLCs give preferences to other GLCs.

EXPORT SUBSIDIES

Singapore's government does not directly subsidize exports, although it offers significant incentives to attract export-oriented foreign investments. In addition to tax incentives and reimbursements to exporters for certain trade promotion costs, the government also offers grants to new service suppliers.

INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

In line with its FTA commitments, Singapore has developed one of the strongest IPR regimes in Asia. Amendments to the Trademarks Act and the Patents Act, a new Plant Varieties Protection Act, and a new Manufacture of Optical Discs Act came into effect in July 2004. The amended Copyright and Broadcasting Acts became effective in January 2005, and further amendments to the Copyright Act went into effect in August 2005. Singapore has implemented Article 1 to Article 6 of the World Intellectual Property Organization (WIPO) Joint Recommendation Concerning Provisions on the Protection of Well-Known Marks of 1999, and has signed and ratified the International Convention for the Protection of New Varieties of Plants (1991), the Convention Relating to the Distribution of Program-Carrying Signals Transmitted by Satellite (1974), the WIPO Copyright Treaty (1996), and the WIPO Performances and Phonograms Treaty (1996). Singapore is a signatory to three other international IPR agreements: the Paris Convention, the Patent Cooperation Treaty, and the Budapest Treaty. The WIPO Secretariat opened offices in Singapore in June 2005.

FOREIGN TRADE BARRIERS

Parallel Imports

Under the amended Patents Act, the patent owner has the right to bring an action to stop an importer of “grey market goods” from importing the patent owner's patented product, if the product has not previously been sold or distributed in Singapore.

Transshipment

Although a major transshipment and transit point for sea and air cargo, Singapore does not collect information on the contents and destinations of most transshipment and transit trade, which account for 80 percent of the cargo coming through the port. This lack of information makes enforcement against transshipment or transit trade in infringing products virtually impossible. In addition, goods in transit are not subject to seizure under the Copyright Act, although it may be possible if a search warrant is obtained in advance. Under its FTA commitments, Singapore passed legislation in November 2003 to provide for information-sharing with U.S. Customs and Border Protection and also with those of its other FTA partners.

Internet

In accordance with the FTA, Singapore’s amended Copyright Act provides improved protection for digital works, and outlines requirements and procedures for removing infringing material from Internet sites. Despite the amendment, the copyright industry maintains that the new law fails to impose full liability on service providers engaged in infringing activity. U.S. industry also maintains that Internet piracy in Singapore is on the rise as a result of the increasing availability of the country’s broadband facilities.

Enforcement

In line with its FTA obligations, Singapore has taken steps to improve IPR protection. Law enforcement efforts have contributed to a sharp reduction in the production of pirated material and blatant storefront retail piracy. According to the Singapore Police, the value of counterfeit and pirated goods seized in 2005 was \$12 million, compared to \$8 million in 2004. In September 2005, the Singapore Police initiated its first corporate end-user enforcement action under the amended Copyright Act, raiding a private company suspected of using approximately \$30,000 in illegal software.

According to industry estimates, Singapore’s music piracy rate averaged 9 percent, while it was roughly 12 percent for movies. Software piracy levels in Singapore, while among the lowest in the Asia-Pacific region are almost double the estimated level in the United States. Business software losses were estimated at nearly \$96 million in 2004.

Over the past few years, a number of local educational institutions (the majority government-operated) have signed agreements to come into compliance with their legal obligations to pay royalty fees to publishers in exchange for the right to duplicate copyrighted printed works for use in course materials.

Some commercial copy centers, however, continue to routinely take orders to copy entire textbooks. While the police have conducted some raids, their effectiveness has been limited.

SERVICES BARRIERS

Basic Telecommunications

On April 1, 2000, Singapore began removing all barriers limiting foreign entry to the telecommunications sector. Any foreign or domestic company can provide facilities-based (fixed line or mobile) or services-based (local, international, and callback) telecommunications services. Under the Telecoms Competition Code 2000 (Competition Code), the former monopoly (and 62.0 percent government-owned) telecommunications service provider, Singapore Telecommunications (SingTel), faces competition in all market segments, including fixed-line, mobile, and paging services. Its main competitors, MobileOne and StarHub, are also government-linked companies. The Infocomm Development Authority (IDA) finalized its triennial review of the Competition Code, which aims to enhance market transparency, in March 2005. SingTel has implemented most provisions of the Code, including making public its prices for interconnection services.

In October 2005, in accordance with its FTA commitments to reduce wholesale prices for local leased circuits, IDA directed SingTel to amend its Reference Interconnection Offer (RIO) to provide for an appropriate, open-standard technical interface. SingTel has appealed this directive. IDA is expected to issue a decision on SingTel's amended RIO in early 2006. Depending on how the decision is finally implemented, U.S. and other companies remain concerned about whether they will be able to take full advantage of the more competitive pricing structure initially mandated by IDA in December 2003. Under the FTA, Singapore also agreed that dominant licensees (SingTel and StarHub) must offer cost-based access to submarine cable-landing stations and allow sharing of facilities. The interpretation of this commitment has, in some cases, differed from U.S. companies' understandings.

In April 2005, IDA announced its decision to accept SingTel's proposal to exempt eight of the ten services that come under its Dominant Licensee obligations, with provisions to review three of these services in 2007. SingTel is no longer required to file tariffs on these particular services and has more flexibility in packaging and bundling them.

Audiovisual and Media Services

Singapore's local free-to-air broadcasting, cable, and newspaper sectors are effectively closed to foreign firms. Section 47 of the Broadcasting Act restricts foreign equity ownership of companies broadcasting to the Singapore domestic market to less than 49 percent, although the Act also gives the Media Development Authority (MDA) authority to waive this requirement. The government also limits individual equity stakes in broadcasting companies to no more than five percent of issued shares.

FOREIGN TRADE BARRIERS

MediaCorp TV is the only free-to-air TV broadcaster. It is 80 percent owned by the government and 20 percent by publicly-listed Singapore Press Holdings (SPH). Under MDA rules, MediaCorp TV must outsource at least 285 hours of local content production to independent television production companies per year. The sole subscription TV provider, StarHub Cable Vision (SCV), is a 100 percent-owned subsidiary of a majority government-owned publicly listed company. Free-to-air radio broadcasters are mainly government-owned, with MediaCorp Radio Singapore being the largest operator. BBC World Service is the only foreign free-to-air broadcaster in Singapore. MDA is considering imposition of restrictive regulations governing the relationships between content/channel providers and pay TV operators in Singapore, i.e., SCV. Singapore restricts the use of satellite receiving dishes and has not authorized direct-to-home satellite television services. MDA must license the installation and operation of broadcast-receiving equipment, including satellite dishes. Satellite broadcasters that want to operate their own uplink facility must get a special license from MDA. Satellite broadcasters lacking their own facility are restricted to using one of four available uplink facilities.

The Newspaper and Printing Presses Act restricts equity ownership (local or foreign) to five percent per shareholder, unless the government approves a larger shareholding, and requires that all the directors of a newspaper company be Singapore citizens. Newspaper companies must issue two classes of shares, ordinary and management, with the latter available only to citizens of Singapore or to Singapore companies that have been approved by the government.

Media businesses or professionals must be licensed by MDA in order to provide services or apparatus and equipment. Printed and audio material is no longer subject to prior review, but licensees are advised to abide by MDA guidelines. MDA requires all film and video material for distribution and screening to be certified and classified. The government can deny or revoke permits without warning or without giving a reason. Some foreign news publications are "gazetted," i.e., numerically limited by the government.

Legal Services

U.S. and other foreign law firms with offices in Singapore face certain restrictions. They cannot practice Singapore law, employ Singapore lawyers to practice Singapore law, or litigate in local courts. Since June 1, 2004, U.S. and other foreign lawyers have been allowed to represent parties in arbitration in Singapore without the need for a Singapore attorney to be present. U.S. law firms can provide legal services in relation to Singapore law only through a Joint Law Venture (JLV) or Formal Law Alliance (FLA) with a Singapore law firm, subject to the Guidelines for Registration of Foreign Lawyers in Joint Law Ventures to Practice Singapore Law. Singapore relaxed one of these guidelines for U.S. law firms under the FTA. As of October 2005, 16 of the 62 foreign law firms in Singapore were from the United States. Additionally, there was one U.S. JLV.

FOREIGN TRADE BARRIERS

Except for law degrees from certain Australian, New Zealand and British universities, no foreign university law degrees are recognized for the purpose of admission to practice law in Singapore. Under the FTA, Singapore committed to recognizing law degrees from four U.S. law schools. In March 2006, Singapore announced it would recognize degrees from the law schools of Harvard University, Columbia University, New York University, and the University of Michigan.

Engineering and Architectural Services

Engineering and architecture firms can be 100 percent foreign-owned. In line with FTA provisions, and also applicable to all foreign firms, Singapore has removed the requirement that the chairman and two-thirds of the firm's board of directors must be composed of engineers, architects or land surveyors registered with local professional bodies. Practicing engineers and architects must register with the Professional Engineers Board and the Architects Board, respectively. Under amended legislation, local and foreign job applicants, including U.S. degree-holders, will be required to have at least four years of practical experience in engineering or architectural works and pass an examination set by the respective Board.

Accounting and Tax Services

The major international accounting firms all operate in Singapore. Public accountants and at least one partner of a public accounting firm must reside in Singapore. Only public accountants who are members of the Institute of Certified Public Accountants of Singapore and registered with the Public Accountants Board of Singapore may practice public accountancy in the country. The Board recognizes U.S. accountants registered with the American Institute of Certified Public Accountants.

Banking and Securities

Retail Banking

Singapore maintains legal distinctions between offshore and domestic banking units, and the type of license held (full, wholesale or offshore). Except for retail banking, Singapore laws do not distinguish operationally between foreign and domestic banks.

In 1999, Singapore embarked on a five-year banking liberalization program to ease restrictions on foreign banks and supplemented this with phased-in provisions under the FTA. Since then, the government has removed a 40 percent ceiling on foreign ownership of local banks and a 20 percent aggregate foreign shareholding limit on finance companies. It has granted "qualifying full bank" (QFB) or full service licenses to six foreign banks, including two U.S. banks. Since January 2004, under the FTA, U.S. licensed full-service banks have been able to operate at up to 30 customer service locations (branches or off-premise ATMs); non-U.S. foreign full-service banks have been allowed to operate at up to 25 locations since January 2005, up from 15 previously.

These full-service banks can also freely relocate existing branches, and share ATMs among themselves. They also can provide electronic funds transfer, point-of-sale debit, and Central Provident Fund (Singapore's compulsory pension fund) related services.

The FTA obligates Singapore to further improve market access for U.S. banks. In June 2005, Singapore lifted its ban on new licenses for full-service banks, and will do the same for wholesale banks by January 1, 2007. Since January 1, 2006, licensed full-service banks are able to operate at an unlimited number of locations. Locally incorporated subsidiaries of U.S. full-service banks can apply for access to local ATM networks beginning June 30, 2006. Non-locally incorporated subsidiaries of U.S. full-service banks can begin doing so January 1, 2008.

Despite liberalization, foreign banks (including U.S. banks) in the domestic retail banking sector still face barriers. Local retail banks do not face similar constraints on customer service locations or access to the local ATM network. Foreign charge card issuers are prohibited from allowing their local card holders to access their accounts through the local ATM networks. Customers of foreign banks are also unable to access their accounts for cash withdrawals, transfers, or bill payments at ATMs operated by banks other than their own.

The Minister of Finance must approve acquisition of 5 percent, 12 percent, and 20 percent or more of the voting shares of a local bank. Although it has lifted the formal ceilings on foreign ownership of local banks and finance companies, the government has indicated that it will not allow a foreign takeover of a local financial institution. Foreign penetration of the Singapore banking system is comparatively high, with foreign banks holding about 40 percent of non-bank deposits. The government has stated publicly that it wants local banks' share of total resident deposits to remain above 50 percent.

Restricted and Offshore Banking

Since 2001, Singapore's licensing regime has shifted away from distinguishing between on-shore and offshore banking activities to one that distinguishes between retail and wholesale activities. Over time, the Monetary Authority of Singapore (MAS) intends to upgrade all offshore banks to wholesale bank status, thus enabling them to conduct a wider range of activities. New foreign bank entrants are also eligible to apply for wholesale banking licenses. Unless otherwise approved by MAS, wholesale banks can operate in only one location.

Restrictions on Singapore Dollar Lending

Non-residents can borrow local currency freely if the proceeds are used in Singapore. Non-resident financial entities may borrow local currency freely for their use in or outside Singapore if the amount does not exceed S\$5 million; if it does, the amount must be swapped or converted into foreign currency upon drawdown. There are no controls on the borrowing of Singapore dollars by residents.

FOREIGN TRADE BARRIERS

MAS requires banks to report their monthly aggregate outstanding Singapore dollar lending to non-resident financial institutions.

Securities

In January 2002, Singapore removed all trading restrictions on foreign-owned stockbrokers. Aggregate investment by foreigners, however, may not exceed 70 percent of the paid-up capital of dealers that are members of the Singapore Exchange Limited (SGX). Foreign funds may be registered directly, provided the prospectus is from an entity registered as a foreign company in Singapore, and the fund is approved by MAS.

Distribution Services

Beginning January 2002, the Ministry of Trade and Industry implemented a Multi-Level Marketing and Pyramid Selling (Excluded Schemes and Arrangements) Order to clarify which kinds of multi-level and direct marketing/selling arrangements, whether local or foreign, are legal in Singapore. The order prohibits compensation for recruitment of participants. It prohibits any Singapore-registered company or citizen/resident from promoting any overseas pyramid selling marketed through the Internet. Insurance businesses licensed under the Insurance Act and its subsidiary legislations, master franchise schemes, and direct selling schemes that meet conditions listed in the Order are exempted from the Act.

INVESTMENT BARRIERS

Singapore has a generally open investment regime and no overarching screening process for foreign investment. Singapore places no restrictions on reinvestment or repatriation of earnings and capital. The investment chapter of the United States-Singapore FTA, which entered into force on January 1, 2004, provides for national and most-favored nation treatment, the right to make financial transfers freely and without delay, disciplines on performance requirements, international law standards for expropriation and compensation, and access to binding international arbitration.

ELECTRONIC COMMERCE

Singapore has no significant barriers hindering the development and use of electronic commerce. The FTA contains state-of-the-art provisions on electronic commerce, including national treatment and most-favored nation obligations for products delivered electronically, affirmation that services disciplines cover all services delivered electronically, and permanent duty-free status of products delivered electronically.

Singapore considers the Internet to fall within the scope of its Broadcasting Act. Internet service providers (ISPs) must channel all Internet traffic through Internet access service providers (IASPs) that function as main “gateways” to the Internet.

FOREIGN TRADE BARRIERS

Internet service resellers, Internet content providers (ICPs), individuals who put up personal web pages, software developers and providers of raw financial information, and news wire services do not have to register with the Singapore Broadcasting Authority.

OTHER BARRIERS

Competition

The FTA contains specific conduct guarantees to ensure that commercial enterprises in which the Singapore government has effective influence will operate on the basis of commercial considerations and will not discriminate in their treatment of U.S. firms. In accordance with its FTA commitments, Singapore enacted the Competition Act in 2004, which will be implemented in three phases. Phase I established the Competition Commission of Singapore in January 2005. Phase II involves implementation of provisions on anti-competitive agreements, decisions and practices, abuse of dominance, enforcement, and the appeals process; these will come into effect during the first half of 2006. Phase III provisions will address mergers and acquisitions and will come into effect in 2007.

The FTA also includes obligations for greater transparency among government enterprises with substantial revenues or assets. Singapore has an extensive network of GLCs that are active in many sectors of the economy. Some sectors, notably telecommunications, power generation/distribution, and financial services, are subject to sector-specific regulatory bodies and competition regulations, typically less rigorous than those being implemented under the Competition Act. Some observers have raised concerns that GLCs may act in anticompetitive ways, a charge government officials strongly deny.

Transparency

The United States welcomes actions by Singapore to circulate more draft laws and regulations for public comment, including those relating to the implementation of the FTA, in keeping with the FTA's transparency obligations.

SRI LANKA

TRADE SUMMARY

The U.S. goods trade deficit with Sri Lanka was \$1.9 billion in 2005, an increase of \$93 million from \$1.8 billion in 2004. U.S. goods exports in 2005 were \$198 million, up 20.5 percent from the previous year. Corresponding U.S. imports from Sri Lanka were \$2.1 billion, up 6.5 percent. Sri Lanka is currently the 104th largest export market for U.S. goods.

The stock of U.S. foreign direct investment (FDI) in Sri Lanka in 2004 was \$33 million, down from \$47 million in 2003.

IMPORT POLICIES

Following parliamentary elections in April 2004, Sri Lanka witnessed a change of government. The current government has espoused a shift to a mixed economy from the largely free market policies of the previous government. The government's Economic Policy Framework has backtracked on the previous government's trade liberalization strategy. It specifically calls for protection of small and medium enterprises and agriculture.

The government has created the National Council of Economic Development (NCED). NCED consists of approximately 18 clusters representing both private and public sector officials which examine various sectors of the economy. The Trade and Tariff cluster is charged with designing trade policy. Sri Lanka's main trade policy instrument has been the import tariff. The tariff structure is subject to frequent changes. In November 2004, the number of tariff bands was reduced from six to five. In addition, departing from the previous liberalization path, the Sri Lankan government imposed a new import tax on selected items by way of a levy (referred to as a "cess" in Sri Lanka) in light of a decline in foreign reserves. The government also hopes this new tax will protect domestic agriculture and industry. Despite an improvement in the foreign reserve position, the government has not revoked the tax.

Import tariffs and other import charges: Currently, there are 5 tariff bands of 0 percent, 2.5 percent, 6 percent, 15 percent, and 28 percent. The highest tariff band was increased from 25 percent in 2002 to 27.5 percent in January 2004, and to 28 percent in November 2004. Textiles, pharmaceuticals, and medical equipment are free of duty. Basic raw materials are generally assessed a 2.5 percent duty. Semi-processed raw material tariffs are 6 percent, while intermediate product tariffs are 15 percent. Most finished products are at 28 percent. There are also a number of deviations from the five-band tariff policy. Tobacco and cigarette tariffs range from 75 percent to 250 percent. In addition, there are specific duties on certain items, including footwear, ceramic products, and agricultural products. These specific duties are designed to protect domestic producers. Some items are subject to an *ad valorem* or a specific duty, whichever is higher, and there is intermittent use of exemptions and waivers. Imports for export industries enter duty free.

FOREIGN TRADE BARRIERS

Export Development Board (EDB) Levy: In November 2004, the Sri Lankan government introduced a new additional tax on a range of imports identified as “non-essential.” The EDB levy is applied on C.I.F value, and ranges from 10 percent to 20 percent. Together with import tariffs, the EDB levy effectively increases charges on most finished good imports to over 48 percent of the import value, with the highest charges on goods subject to specific duties.

Other charges on imports:

- 1) a 10 percent import duty surcharge on all dutiable imports;
- 2) a 2.5 percent ports and airports development levy (PAL) on imports (This tax was increased from 1.5 percent from January 1, 2006);
- 3) Value Added Tax (VAT) of 0 percent, 5 percent, 15 percent and 20 percent;
- 4) excise fees on some products such as aerated water, liquor, beer, motor vehicles and cigarettes. Excise fees on motor vehicles were increased sharply in 2004;
- 5) a port handling charge that varies by container size; and
- 6) a surcharge of 1 percent assessed on the import duty for Social Responsibility Levy (to fund the National Action Plan for Children). (This tax was increased from 0.25 percent from January 1, 2006).

Import prices are increased by 7 percent (by adding an imputed profit margin) when calculating the VAT and excise duty.

According to U.S. trade data, the total value of imports affected by the EDB cess will be about \$5 million out of a total of about \$143 million annual U.S. exports to Sri Lanka. The total effect on U.S. exports could be much higher, because U.S.-sourced products sent via other trading hubs are not captured in the export data used to compile this analysis. The United States Embassy has received complaints from affected U.S. exporters and US companies in Sri Lanka regarding the new “prohibitive” tariff regime.

Import Licensing

Sri Lanka requires import licenses for over 300 items at the 6-digit level of the Harmonized System (HS) code, mostly for health, environment, and national security reasons. Importers must pay a fee equal to 0.1 percent fee of the import price to receive an import license.

Customs Barriers

The Government of Sri Lanka implemented the WTO Customs Valuation Agreement in January 2003 and follows the transaction value method to determine the C.I.F. value. The scheme has operated quite successfully, and major companies have not faced problems. Customs is also in the process of installing an Electronic Data Interchange (EDI) system to support an automated cargo clearing facility. When implemented, this system should improve customs administration and facilitate trade.

STANDARDS, TESTING, LABELING AND CERTIFICATION

At present there are 85 items that come under the Sri Lanka Standards Institution (SLSI) mandatory import inspection scheme. These importers have to obtain a clearance certificate from the SLSI to sell their goods. SLSI accepts letters of conformity from foreign laboratories, but retains the discretion to take samples and perform tests.

There is discussion within some sections of the health sector to introduce a labeling requirement for imports of genetically modified (GM) food. The Ministry of Health has drawn up a draft law to regulate the import of GM food. The regulation has been discussed at public fora with key stakeholders. Some large US food exporters have expressed concern about this proposed regulation, which is thought to be excessive and could hinder exports of US brands to Sri Lanka. The Sri Lankan government previously considered implementing such a requirement in 2000 – 2001.

A new labeling and advertising regulation came into effect from April 01, 2004. These regulations have been issued under the Food Act No 26 of 1980 and govern the information that should appear on a label of any pre-packaged food product offered for sale, transported or advertised for sale in Sri Lanka. This includes all imported food items as well. New features of the latest regulations include the date of manufacture, the name or INS number of the food additives, claims that are allowed and disallowed, etc.

Poultry and meat: There is a temporary ban on all poultry imports due to fears of HPAI. However, this ban is being periodically reviewed and the Sri Lankan government has assured that an appropriate decision will be made if the risks of the disease being transmitted to Sri Lanka are reduced. Imports of beef from the United States are banned due to fears of Bovine Spongiform Encephalopathy (BSE).

GOVERNMENT PROCUREMENT

Sri Lanka is not a member of the WTO Agreement on Government Procurement. Government procurement of goods and services is mostly done through a public tender process. Some tenders are open only to registered providers. The government of Sri Lanka publicly subscribes to principles of international competitive bidding, but charges of corruption and unfair awards continue. There are no professional evaluation experts in Sri Lanka. The Government recently created a National Procurement Agency (NPA) to introduce an improved system of procurement. In August 2005, the government signed several initial agreements with Chinese public companies for development projects. According to news reports, the projects are to be funded by a loan provided by the People's Republic of China. These agreements to build a coal power plant, phosphate fertilizer plant, a rail link and an oil tank farm were signed outside the normal tender procedure.

EXPORT SUBSIDIES

Exporting companies approved by the BOI, are generally entitled to corporate tax holidays and concessions. Exporters receive institutional support from the Export Development Board in

FOREIGN TRADE BARRIERS

marketing. Imports for exporting industries and BOI approved projects usually are exempted from payment of VAT. For others, the VAT is refunded. The airports and ports' levy on imports for export processing is 0.25 percent of the CIF value.

INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

Local agents of the U.S. and other international companies representing recording, software, movie, and consumer product industries continue to complain that the lack of IPR protection is damaging their business. Piracy levels are very high for sound recordings and software, making it difficult for the legitimate industries to protect their market and realize their potential in Sri Lanka. Sri Lanka is a party to major intellectual property agreements, including the Berne Convention for the Protection of Literary and Artistic Works, the Paris Convention for the Protection of Industrial Property, the Madrid Agreement for the Elimination of False or Deceptive Indication of Source on Goods, the Nairobi Treaty, the Patent Co-operation Treaty, the Universal Copyright Convention and the Convention establishing the World Intellectual Property Organization (WIPO). Sri Lanka's intellectual property law is based on the WIPO model law for developing countries. Sri Lanka and the United States signed a Bilateral Agreement for the Protection of Intellectual Property Rights in 1991, and Sri Lanka is a party to the WTO Trade-Related Intellectual Property Rights (TRIPS) Agreement.

In November 2003, a new intellectual property law came into force. This law was intended to meet both the U.S.-Sri Lanka Bilateral IPR Agreement and TRIPS obligations to a great extent. The law governs copyrights and related rights, industrial designs, patents for inventions, trademarks and service marks, trade names, layout designs of integrated circuits, geographical indications, unfair competition and undisclosed information. All trademarks, designs, industrial designs and patents must be registered with the Director General of Intellectual Property. Infringement of IPR is a punishable offense under the new law, and IPR violations are subject to both criminal and civil jurisdiction. Relief available to owners under the new law includes injunctive relief, seizure and destruction of infringing goods and plates or implements used for the making of infringing copies, and a prohibition of imports and exports. Penalties for the first offense include a prison sentence of 6 months or a fine of up to \$5,000. The penalties could double for a second offense. Enforcement, however, against piracy and counterfeiting is a serious problem, as is public awareness of IP protection. Aggrieved parties must seek redress of any IPR violation through the courts, a frustrating and time-consuming process.

During 2004-2005 Sri Lanka began enforcing the new IPR law. The Sri Lankan police uncovered a Malaysian-owned CD/VCD production facility in a Colombo suburb in October 2004. It is alleged to have produced pirated copies of music, movie and software violating rights of several US companies. The police investigation continues. The police have also conducted a few other raids of stores selling pirated movie and music CDs as well as counterfeit apparel. However, counterfeit goods continue to be freely available. Software companies complain of the lack of IPR enforcement within government institutions. Government agencies continue to procure hardware and use unlicensed software.

FOREIGN TRADE BARRIERS

The government's Director of Intellectual Property and international experts have begun IPR legal and enforcement training for customs and police officials. In September 2004, a group of five lawyers and a judge attended an IPR program in the United States under the International Visitor program of the U.S. State Department. In July 2005, the U.S. Patent and Trademarks Office (USPTO) organized a lecture series in Sri Lanka on IPR protection which helped to increase IPR awareness among judicial and police officers and the private bar. An active U.S. Embassy-led IPR working group comprising adversely affected industries is also working closely with the Sri Lankan government to pursue more aggressive enforcement and enhance public awareness. It will take time before new procedures and court precedents are established under the new law.

In addition, Sri Lanka needs to ratify and conform to the WIPO Performances and Phonograms Treaty (WPPT) and the WIPO Copyright Treaty (WCT). Sri Lanka is completing its accession to the WTO Information Technology Agreement.

SERVICES BARRIERS

Sri Lanka has opened its services sector to foreign investment. Foreign ownership of 100 percent of equity is allowed in a range of service sectors such as banking, insurance, telecommunications, tourism, stock brokerage, the construction of residential buildings and roads, the supply of water, mass transportation, production and distribution of energy, professional services and the establishment of liaison offices or local branches of foreign companies. These services are regulated and subject to approval by various government agencies. The screening mechanism is non-discriminatory and, for the most part, routine.

Banking

Foreign commercial banks are allowed to open branch offices in Sri Lanka, subject to an economic needs test and approval by the Central Bank. Foreign investors are allowed to hold 100 percent equity in local banks, subject to limits on individual share ownership. Currently, there are twelve foreign commercial banks operating in Sri Lanka, including one US bank.

Listed below are the main constraints faced in the commercial banking sector:

- 1) restriction of banking business by government ministries and departments to state-owned banks;
- 2) restriction on speculative foreign exchange trading by commercial banks; banks are allowed to buy or sell foreign exchange for commercial transactions only; and
- 3) a VAT on profit before tax and salaries.

Insurance

One hundred percent foreign ownership is allowed in insurance. Foreign insurance companies are required to incorporate in Sri Lanka to conduct insurance business. The government has recently privatized the state-owned insurance companies. Resident Sri Lankans are prohibited from obtaining foreign insurance policies except for health and travel.

FOREIGN TRADE BARRIERS

A major insurance company has reported difficulty in penetrating government business due to corruption. Sri Lanka's insurance regulatory body retains powers to introduce minimum and maximum premiums for various insurance products.

Telecommunications

The telecommunications sector is the most dynamic service industry in Sri Lanka. There is one fixed wire line operator, Sri Lanka Telecom (SLT), two wireless local loop operators and four mobile phone operators. Several private operators also provide radio paging, data communication, internet service and satellite link-ups. The government of Sri Lanka sold a 35 percent stake in SLT to NTT of Japan in 1997. The government sold a further 12.5 percent stake of SLT in 2003 to the public. SLT has recently acquired a mobile phone operator. Due to the past monopoly status under government control, SLT continues to own most of the national telephone infrastructure (including main switches) and the only two international cable landing stations and continues to dominate the sector affecting the competitiveness of other operators. All other operators are privately owned.

In early 2003, the government liberalized international telecommunications and issued 33 non-facilities based gateway licenses, ending the SLT monopoly over international telephony. Since then, international outgoing call rates have dropped sharply. However, since new licensees are not allowed to establish terrestrial facilities, they are forced to use the infrastructure of existing domestic operator networks (including SLT, wireless and mobile operators) to terminate or originate international calls.

A key problem facing the telecommunications sector is restriction on interconnection. The Regulatory Authority has failed to enforce regulations provided under the Telecommunications Act to establish an efficient and transparent interconnection regime. As a result, SLT, the wireless operators and the mobile operators have effectively restricted interconnection for other operators. This has adversely affected the operations of most of the other operators and new international gateway licensees who are unable to make use of their licenses due to lack of interconnection by the local exchange operators. This situation has resulted in illegal bypass by some operators. Spectrum management is also weak and frequencies are not properly allocated which affect telecommunication operators.

Quotas on Foreign Films

The state-owned National Film Corporation's (NFC) approval is required to import films. There is a quota restriction on imports of English language films, which is currently set at 100 per year. The quota does not effectively restrict access as annual imports are well below the limit. There are controls on the screening of films: except for the 6 top cinemas, all other theaters in Sri Lanka are required to screen at least 60 percent local films. The theaters exempted from the rule are free to screen foreign films without any restrictions. In addition, the NFC also does not allow subtitling of movies into local languages which restrict the patronage of non English speaking customers. The availability of pirated films also makes it difficult to sell movies. In this context, the only way to combat this is by releasing the movies simultaneously with the rest of the World.

FOREIGN TRADE BARRIERS

However, the NFC delays simultaneous release by delaying approvals. The NFC also charges a tax of \$0.031 per ticket from screenings. Part of the fee on tickets for local films is paid by the NFC to local film producers. NFC, which was instituted by an Act of Parliament, has wide powers that can be used to effectively restrict foreign film imports.

Tax on foreign TV shows

Following a proposal contained in the 2006 government budget, the government is moving to impose a tax on foreign movies and television programs. The date of implementation has not been confirmed. According to current information, imported movies would be taxed at Rs 75,000 (\$750) while teledramas will also be taxed at Rs 75,000 (\$750) per blocks of five half-hour episodes. Documentaries of educational interest will be exempted. President Rajapakse, who is also the Finance Minister, proposing this tax said the revenue will be used to assist the local film and tele-drama industry. Sri Lankan television stations import English, Tamil and Hindi movies and teledramas in addition to locally made Sinhala and Tamil ones. Several private television stations in Sri Lanka have complained that the tax as currently contemplated would be prohibitively high.

Professional Services

There is no formal national policy on professional services. In practice, many foreign doctors, nurses, engineers, architects, and accountants work in Sri Lanka. Most of them are employed by foreign companies. Sri Lanka has not made any WTO commitments on the presence of natural persons, and national treatment is not accorded to foreign nationals working in Sri Lanka. Most foreign nationals do not have statutory recognition in Sri Lanka and cannot sign documents presented to government institutions or regulatory bodies.

The Immigration Department grants resident visas for expatriates and professionals whose services are required for projects or by companies approved by the Board of Investment. The Department also grants visas for expatriates required for projects approved by the government. Non-BOI companies such as banks can also recruit expatriate staff. Sri Lanka also operates a resident guest visa program for foreign investors and professionals who are recommended by the relevant Ministry.

Legal Services

A person can provide legal consultancy services without being licensed to practice law in Sri Lanka. Foreigners are not allowed to practice law (appear in courts) and do not have statutory recognition in Sri Lanka. Sri Lankan citizens with foreign qualifications need to sit for exams conducted by the Sri Lanka law college in order to practice and register in the Supreme Court.

Doctors

The Sri Lanka Medical Council allows qualified foreign doctors and medical specialists to work in Sri Lanka. They have to be sponsored by a medical institution or a non-government organization, and are required to obtain temporary registration from the Sri Lanka Medical Council (SLMC). Many Indian doctors have been issued resident work visas recently to work in an Indian-owned hospital in Sri Lanka.

Engineers and architectural services

Over the years, most foreign funded projects have used foreign consultants and contractors.

INVESTMENT BARRIERS

Sri Lanka welcomes foreign investment. One hundred percent foreign investment is allowed in most manufacturing and services sectors.

Foreign investment is not permitted in the following businesses: non-bank money lending; pawn brokering; retail trade with a capital investment of less than \$1 million (with one notable exception: the Board of Investment (BOI) permits retail and wholesale trading by reputable international brand names and franchises with an initial investment of not less than \$150,000); coastal fishing; education of students under 14 years of age for local examinations; and the awarding of local university degrees. Investment in additional sectors is restricted and subject to screening and approval on a case-by-case basis, when foreign equity exceeds 40 percent: shipping and travel agencies; freight forwarding; higher education; mass communications; fishing; timber-based industries using local timber; mining and primary processing of non-renewable national resources; growing and primary processing of tea, rubber, coconut, rice, cocoa, sugar and spices. Foreign investment equity restrictions and government regulations also apply to air transportation, coastal shipping, lotteries, large-scale mechanized gem mining, and "sensitive" industries such as military hardware, dangerous drugs and currency.

The BOI offers a range of incentives to both local and foreign investors. To qualify for BOI incentives, investors need to meet minimum investment and minimum export requirements. In general, the treatment given to foreign investors is non-discriminatory. Even with incentives and BOI facilitation, however, foreign investors can face difficulties operating in Sri Lanka. Problems range from difficulties in clearing equipment and supplies through customs to obtaining land for factories. The BOI encourages investors to locate their factories in BOI-managed industrial processing zones to avoid land allocation problems. Investors locating in industrial zones also get access to relatively better infrastructure facilities such as improved power reliability, telecommunication and water supplies.

Government treatment of foreign investors in the privatization process has been largely non-discriminatory with foreigners buying controlling interest in some companies. The privatization process has not always been transparent, however. For instance, in 2003, the government sold part of the retail operations of state-owned Ceylon Petroleum Corporation (CPC) to a foreign entity without a formal tender process. A major U.S. supplier that had earlier acquired a

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government-owned lubricant plant has complained that the government had reneged on the terms of an exclusivity agreement extending up to mid-2004. A supposed additional stake in the retail sector has been rumored to be reserved for another Indian oil company, though no official information has been forthcoming. In August 2005, the government signed several initial agreements with Chinese public companies for development projects. According to news reports, the projects are to be funded by a loan provided by the People's Republic of China. These agreements to build a coal power plant, a phosphate fertilizer plant, a rail line and an oil tank farm were signed outside the normal tender procedure.

Access to local credit markets by foreign-owned companies incorporated in Sri Lanka was liberalized in 2003 and such firms can now borrow rupee funds without the approval of the Central Bank. Foreign-owned companies, BOI-approved firms and exporters can access dollar denominated loans. Applications for dollar denominated loans from local firms are considered on a case-by-case basis and not encouraged.

Capital Repatriation

Sri Lanka has accepted Article VIII status of the IMF and has liberalized exchange controls on current account transactions. There are no surrender requirements on export receipts, but exporters need to repatriate export proceeds within 120 days to settle export credit facilities. Other export proceeds can be retained abroad. Currently, contracts for forward bookings of foreign exchange are permitted for a maximum period of 360 days for the purposes of payments in trade and 720 days for the repayment of loans. There are also no barriers, legal or otherwise, to the expeditious remitting of corporate profits and dividends for foreign enterprises doing business in Sri Lanka. Remittance of business fees (management fees, royalties and licensing fees) is also freely permitted. Funds for debt service and capital gains of BOI approved companies exempted from exchange control regulations are freely permitted. Other foreign companies remitting funds for debt service and capital gains require Central Bank approval. Prior to Central Bank approval they also need a tax clearance certificate. All stock market investments can be remitted without prior approval of the Central Bank. Investment returns can be remitted in any convertible currency at the legal market rate.

Controls on capital account (investment) transactions usually prohibit foreigners from investing in debt and fixed income securities. One exception has been the Central Bank's local market dollar denominated bond issues in 2001, 2002 and 2004, which were opened to foreign investors. The government has proposed allowing foreign investment in corporate debentures and government bonds. Local companies require Central Bank approval to invest abroad. The process of granting approval for such investments was streamlined in 2002, resulting in an increase in approvals.

OTHER BARRIERS

Delays in litigation are a problem. For example, a U.S. investor with a substantial investment in an export manufacturing company has faced lengthy delays in a court case over a large insurance claim. The company instituted legal action in June 1999 and court proceedings are still on-going, and the company has suffered financial losses as a result. The government has established a commercial court to hear business litigation, but delays are common.

In order to support the domestic software industry, private sector companies using locally produced software will be allowed to depreciate 100 percent of the cost in the first year, according to 2005 budget proposals. The depreciation allowance on foreign software is only 25 percent. The public sector is required to give preference to locally produced software and ensure at least 50 percent local value addition when using foreign software.

In 2004, the government reintroduced a 100 percent transfer tax on property purchased by foreign nationals and companies. For this purpose, a “foreign company” is defined as an entity with at least 25 percent foreign equity. Apartments above the third floor of condominium buildings, land for the development of factories, large housing schemes, hospitals, hotels, and large infrastructure projects are exempted from the tax.

SWITZERLAND

TRADE SUMMARY

The U.S. goods trade deficit with Switzerland was \$2.2 billion in 2005, a decrease of \$99 million from \$2.3 billion in 2004. U.S. goods exports in 2005 were \$10.7 billion, up 15.7 percent from the previous year. Corresponding U.S. imports from Switzerland were \$13.0 billion, up 11.7 percent. Switzerland is currently the 17th largest export market for U.S. goods.

U.S. exports of private commercial services (i.e., excluding military and government) to Switzerland were \$8.7 billion in 2004 (latest data available), and U.S. imports were \$8.8 billion. Sales of services in Switzerland by majority U.S.-owned affiliates were \$19.8 billion in 2003 (latest data available), while sales of services in the United States by majority Switzerland-owned firms were \$34.6 billion.

The stock of U.S. foreign direct investment (FDI) in Switzerland in 2004 was \$100.7 billion, up from \$88.9 billion in 2003. U.S. FDI in Switzerland is concentrated largely in the manufacturing, wholesale, and banking sectors.

IMPORT POLICIES

In recent decades, agriculture has lost its relative importance in the Swiss economy – though not in society or politics – and preservation in its current form has been due largely to governmental intervention and support. While the average for manufactured products is 2.3 percent, the simple average tariff in Switzerland on imports of agricultural products ranges from 28.6 percent to 36.2 percent. Due to high tariffs on certain agricultural products, preferential tariff rates for other countries, and negative public perception of agricultural products derived from biotechnology, Switzerland is a relatively difficult market in which few U.S. agricultural products successfully compete. High tariffs and quotas are a direct cause of the modest levels of U.S. wheat, corn, and soybean exports. The U.S. share of the Swiss agricultural import market in 2004 was 3 percent. Imports of nearly all agriculture products, no matter the country of origin, are subject to import duties and variable import quotas.

Agricultural tariff-rate quotas present problems for U.S. exporters, as Swiss regulations often allocate quotas to importers that have incentives to purchase domestic products. This practice has increased protection for domestic producers and in some cases, such as potato products, has effectively blocked U.S. exports. Public resistance to agricultural products derived from biotechnology or the use of growth hormones remains strong, and, partially as a result, U.S. agricultural exports to Switzerland during 2004 dropped by 29 percent by volume and by 5.9 percent by value.

FOREIGN TRADE BARRIERS

STANDARDS, TESTING, LABELING AND CERTIFICATION

Switzerland has taken a case-by-case approach to agricultural products derived from biotechnology since voters rejected a moratorium on biotechnology research and products in 1998. Agricultural biotechnology products need approval for consumer marketing through certification by the Federal Office of Public Health, and the manufacturer of such products must submit detailed information concerning the product development process. The Swiss authorities must review the product for toxicity, resistance to antibiotics, and allergenic characteristics. Agricultural biotechnology products that are substantially equivalent to conventional foods may have an easier path to approval. Swiss certificates for approval of agricultural biotechnology products are valid for five years.

Switzerland has required labeling for foods containing products derived from biotechnology since 1996. In January 2005, the federal government lowered the labeling threshold for agricultural products derived from biotechnology from 1.0 percent to 0.9 percent in order to harmonize its regulations with those of the EU. A notable exception to the labeling requirement is the use of substances such as soy oil in the production process. According to Swiss officials, these ingredients do not require a label because testing cannot show they are derived from bio-engineered commodities.

The animal feed industry has succeeded in establishing a small market for products derived from biotechnology. However, the planting of seed crops derived from biotechnology faces difficult environmental approval hurdles. Despite opposition by the Swiss government, voters adopted a popular initiative “Food from GMO-free Agriculture” on November 27, 2005 that introduces a five year moratorium on commercial planting of crops derived from biotechnology. Swiss authorities have noted that requests for the commercial planting of crops derived from biotechnology can be submitted and would be processed during the moratorium period – there were no such requests pending at the time of the national ballot vote. The initiative should have no impact on trade in agricultural products derived from biotechnology because the existing legislation permits their importation. The government has stated that the five-year moratorium did not require implementing legislation and took effect immediately, ending on November 27, 2010. The moratorium does not restrict scientific research in this area – the government also pledged SFr12 million (\$9.1 million) for a national research program to study the uses and possible risks of agricultural products derived from biotechnology.

The most significant barriers for agricultural biotechnology products in Switzerland stem from policies by the major food retailers and Swiss farmers not to purchase such products. Swiss groups opposed to these products in the food chain have been very effective in convincing supermarket purchasing executives and Swiss farm groups to boycott such products.

Since January 2000, imports of fresh meat and eggs produced in a manner not permitted in Switzerland must be clearly labeled as such. Methods not allowed in Switzerland include the use of growth hormones, antibiotics, and other substances in the raising of beef and pork, as well as the production of eggs from chickens kept in certain types of cages.

The Swiss Veterinary Agency continues to refuse to list new U.S. facilities as eligible to export beef to Switzerland and, despite repeated requests, has not produced science-based reasons for this position. Swiss inaction has blocked three plants that the United States requested be listed since early 2002. The Swiss government has made clear that the situation is related to its dissatisfaction with current U.S. regulations that block certain Swiss processed beef exports to the United States due to concerns over mad cow disease and foot-and-mouth disease.

GOVERNMENT PROCUREMENT

Switzerland is a signatory of the WTO Government Procurement Agreement (GPA). On the cantonal and local levels, a law passed by Parliament in 1995 provides for non-discriminatory access to public procurement. According to a July 2002 revised ordinance on public procurement, all private or state-owned companies such as utilities, and transportation, communications, defense, and construction companies that submit tenders for government procurement must make their bids public if the value of the procurement is more than SFr250,000 (\$193,573).

In September 2004, the Swiss government initiated a series of informal consultations to amend the Swiss Federal Law on Public Procurement. Ultimately, this process should simplify the public tender procedure and harmonize the many different cantonal tender procedures. Under the GPA, Swiss cantons are allowed to implement the Agreement independently from the federal government, which sometimes leads to differences among cantons.

In general, quality and technical criteria are as important as price in the evaluation of tenders. Cantons and communes usually prefer local suppliers because they can recover part of their outlays through income taxes. Foreign firms may be required to guarantee technical support and after-sale service if they have no local office or representation.

Notices of Swiss government tenders are published in the Swiss Official Gazette of Commerce (www.shab-online.admin.ch) and on the on-line Swiss government procurement website (www.simap.ch – French, German and Italian versions only). There is no requirement to have a local agent to bid.

SERVICES BARRIERS

Telecommunications

The 1998 Telecommunications Act brought liberalization and privatization to the Swiss telecommunications sector, opening the market to investment and competition from foreign firms. More than 50 Swiss and foreign companies now offer fixed line services. Three different operators, Swisscom, Sunrise (TeleDanmark), and Orange (France Telecom) share the mobile telephone market, and each company also owns third generation mobile telephony licenses (UMTS). Until 2005, SBC Communications' 9.5 percent stake in Sunrise's parent company represented the only significant U.S. presence in the Swiss telecommunications market.

FOREIGN TRADE BARRIERS

In September 2005, U.S. Liberty Global purchased 100 percent of the shares of Cablecom, the largest cable (phone and internet) operator in Switzerland, and second largest internet service provider behind Swisscom – the incumbent state monopoly. Stiff competition between the two operators has already led to a sharp drop in fixed line rates.

Swisscom continues to use litigation to block the Swiss government's efforts to open the market to competition. For example, Swisscom has successfully fought efforts by the Competition Commission and the Federal Communications Commission (ComCom) to unbundle the local loop and provide leased lines at cost-oriented prices. In response, the government is in the process of creating additional legal authority for the regulator to implement these initiatives.

In October 2004, the lower house of Parliament began work on amending the Telecom Act with language that will give the regulator explicit authority to force Swisscom to unbundle its local loop, effectively fixing the "flaw" cited by the federal court. The reform will cover only fixed line services and will not extend to other technologies, such as mobile and WiFi. The bill also requires that broadband access be offered to Swisscom competitors at cost-oriented prices over a period of six years, after which all operators are expected to afford the broadband investment themselves. In 2005, Swisscom lowered its interconnection prices by 7 percent and announced a further 5 percent drop for 2006.

In October 2004, ComCom opened an investigation of Swisscom's broadband access pricing on the ground it might give preferential rates to its internet subsidiary "Bluewin" in comparison with its competitors. This is not the first time the competition watchdog has investigated Swisscom's broadband practices. In 2003, it ordered Switzerland's biggest telecommunications company to stop giving preferential discounts to Bluewin. Because of Swisscom's monopoly on the last mile, competitors have no choice but to deal with Swisscom if they desire to enter the Swiss market.

Further complaints have been raised that Switzerland has some of the highest fixed-to-mobile termination rates among developed countries, despite its WTO obligations to ensure that such interconnection rates with a major supplier are cost-oriented. The Competition Commission criticized termination rates, which prompted Swisscom Mobile to lower its rates.

Audiovisual Services

Switzerland has no limitations on the amount of non-Swiss or non-European origin programming that can be broadcast, but film distributors and cinema companies must maintain, through self-regulatory solutions, an appropriate diversity – not currently defined – in the products offered within a region. The government may levy a nominal development tax on movie theater tickets if the Swiss government determines the appropriate diversity is not being met. The development tax receipts will be used to finance new theaters that could offer greater diversity in the films being shown within a region. Switzerland is a signatory of the October 2005 UNESCO Convention on Cultural Diversity.

Postal Services

The Postal Act divides the Swiss postal market into two segments – universal services and competitive services. Competitive services, which include express delivery, are unrestricted. Universal services are subsequently divided into reserved and non-reserved services. Only Swiss Post is required to provide universal service. Swiss Post is the exclusive provider of reserved services (monopoly), while it competes with private postal operators for the provision of non-reserved services. Private postal operators are allowed to provide specific non-reserved services (shipment and handling of out-bound international mail, and of addressed packages of up to 20 kg) subject to a license, provided they can ensure regular and professional shipment of mail and parcels and reach a turnover, subject to value-added tax, of at least SFr100,000. PostReg, the regulatory authority, exercises market supervision, ensures the functioning and fair competition in the postal market, and enables the proper implementation of applicable regulations. Postal restrictions on parcel deliveries were lifted in 2004, and letters sent abroad or for which the delivery costs were more than SFr5 (\$4) could also be sent by other companies.

In September 2004, the Swiss government decided to reduce Swiss Post's monopoly from the current 350-gram threshold to 100 grams by April 2006. The government's decision to liberalize the market further was based on an independent study which confirmed that a further liberalization of letter delivery services would not disrupt the country's mail distribution, a key issue for voters. Efforts by the Swiss business community to lower Swiss Post's monopoly to 50 grams or grant unlimited access to competitors failed to reach a consensus in the Swiss parliament. The government is expected to publish a report by early 2006 on ways to liberalize further the letter delivery service. Swiss trade unions have warned that any further opening of the market should not go beyond what was approved by parliament three years ago.

In July 2004, PostReg criticized Swiss Post for failing to comply with legal book-keeping requirements and accused the company of largely understating its annual profit. Swiss Post had published a 2004 profit for its universal service of SFr522 million (\$408 million), but PostReg said the figure should have been at least SFr776 million (\$607 million). Swiss Post so far rejected the criticisms of improper bookkeeping and demanded an independent inquiry. Concerns exist that the company might have understated its profit in order to prevent a further liberalization of the postal market.

Insurance

With the highest per capita insurance expenditure in the world, Switzerland's insurance market is extremely appealing to foreign competitors. Out of 198 insurance companies currently operating in the Swiss market, at least 40 are foreign subsidiaries. Of the 198 companies, 26 offer life insurance, 117 offer non-life insurance, and approximately 55 offer reinsurance. Foreign companies offering only reinsurance are not subject to oversight by the supervisory body, the Federal Office of Private Insurance (FOPI).

However, barriers to foreign insurance entry still persist. Foreign insurers attempting to do business in Switzerland are required to establish a subsidiary or a branch and cannot sell their entire product line cross-border or through a representative office. Foreign insurers operating in

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Switzerland are limited to those types of insurance for which they are licensed in their home countries. The manager of the foreign-owned branch must be resident in Switzerland and the majority of the board of directors of the Swiss subsidiary must have citizenship in the European Free Trade Association (Switzerland, Norway, Iceland and Liechtenstein). Public monopolies exist for fire and natural damage insurance in 19 cantons, and for the insurance of workplace accidents in certain industries. Private insurance firms must establish a fund – amounting to between 20 percent and 50 percent of their minimum capital requirement – available at short notice to cover potential losses. A new insurance law took effect on January 1, 2006, that increases the solvency requirements of all insurance companies operating in Switzerland. As part of a bilateral agreement with the European Union, EU non-life insurers are not required to deposit a certain percentage of their assets with the Swiss National Bank (SNB), but non-EU life-insurers are required to do so.

INVESTMENT BARRIERS

Switzerland welcomes foreign investment and accords national treatment. The federal government's approach is to create and maintain general conditions that are favorable both to Swiss and foreign investors. Swiss banking laws encourage the formation of abundant pools of capital from overseas investors. Some cantons have income tax incentive programs to encourage foreign investment.

The major laws governing foreign investment in Switzerland are the Swiss Code of Obligations, the Lex Friedrich/Koller, the Securities Law, and the Cartel Law. There is no screening of foreign investment – except land ownership and national security establishments – nor are there any sectoral or geographical preferences or restrictions. Cantons have been granted extensive decision making powers when allowing foreigners to buy land. Investment areas in which restrictions related to national security apply include hydroelectric and nuclear power, operation of oil pipelines, transportation of explosive materials, operation of airlines, and marine navigation.

ANTICOMPETITIVE PRACTICES

The Swiss economy has long been characterized by a high degree of cartelization, primarily among domestically-oriented firms and industries. In June 2003, the Swiss parliament adopted a revised competition bill, which took effect on April 1, 2004. The most significant improvement is authority to sanction anticompetitive behavior without prior warning, with a maximum fine of ten percent of a firm's total combined revenue for the past three years. Companies that cooperate with regulators are eligible for a reduced fine.

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Electricity

Electricity production is competitive, but local public monopolies dominate electricity transmission and distribution within Switzerland. Several cantons have attempted to prevent other providers from serving their areas, but those efforts were ruled illegal under the Cartel Law. Local communities as a result have tried to bypass the federal court ruling by cementing their dominant position through cantonal legislative changes or “gentlemen’s agreements” with large customers.

During a referendum initiated by Swiss labor unions in 2002, the population rejected a bill aimed at permitting third party access throughout the grid. But experts argue that lower energy power prices in neighboring countries will at some point force Switzerland to adapt. The Swiss government has recently proposed another electricity bill to liberalize the market. The first phase – scheduled to start in 2007 – will allow commercial users to choose their electricity supplier. The bill provides for the unbundling of transmission from commercial activities, the merger of transmission operators into a single system known as “Swissgrid,” and establishes an independent regulatory agency for the electricity sector. A second phase will provide for full market liberalization in 2012.

TAIWAN

TRADE SUMMARY

The U.S. goods trade deficit with Taiwan was \$12.8 billion in 2005, a decrease of \$91 million from \$12.9 billion in 2004. U.S. goods exports in 2005 were \$22.0 billion, up 1.4 percent from the previous year. Corresponding U.S. imports from Taiwan were \$34.8 billion, up 0.6 percent. Taiwan is currently the 10th largest export market for U.S. goods.

U.S. exports of private commercial services (i.e., excluding military and government) to Taiwan were \$5.5 billion in 2004 (latest data available), and U.S. imports were \$5.7 billion. Sales of services in Taiwan by majority U.S.-owned affiliates were \$9.1 billion in 2003 (latest data available), while sales of services in the United States by majority Taiwan-owned firms were \$456 million.

The stock of U.S. foreign direct investment (FDI) in Taiwan in 2004 was not available, \$12.1 billion in 2003. U.S. FDI in Taiwan is concentrated largely in the finance, manufacturing, and banking sectors.

IMPORT POLICIES

Tariffs

Taiwan promulgated a comprehensive tariff revision schedule on January 1, 2004, in compliance with Taiwan's accession commitments to the WTO and Taiwan's Free Trade Agreement with Panama. Tariffs on pharmaceuticals, pulp/paper, iron/steel, construction equipment, agricultural equipment, medical equipment, furniture, and toys were eliminated starting on January 1, 2004. As a result, the average nominal tariff rate on imported goods in 2005 was approximately 5.67 percent and is expected to fall to 5.5 percent by 2007. To comply with its WTO commitments, Taiwan lifted tariff-rate quotas (TRQs) on certain items including chicken meat, pork bellies, and poultry and pork variety meats, on January 1, 2005. In addition, Taiwan voluntarily lifted the sugar TRQ effective January 1, 2005 to meet Taiwan's domestic needs. However, U.S. industry continues to request that Taiwan lower tariffs on imports of many goods, including large motorcycles, wine, canned soups, cookies (sweet biscuits), savory snack foods, vegetable juices, potatoes and potato products, table grapes, apples, fresh vegetables, and citrus products.

Upon Taiwan's accession to the WTO in January 2002, Taiwan implemented TRQs on small passenger cars, three categories of fish and fish products, and a number of other agricultural products. On January 1, 2004, in accordance with its WTO accession commitments, Taiwan made additional tariff cuts and increased TRQ amounts on these products.

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Taiwan has notified the WTO that it maintains Special Safeguards (SSGs) for a number of agricultural products covered by TRQs. SSGs, permitted under Article 5 of the Agreement on Agriculture, allows Taiwan to impose additional duties when import quantities exceed SSG trigger volumes or import prices fall below SSG trigger prices. As Taiwan has not imported many of these products previously, SSG trigger volumes are relatively low. In 2005, Taiwan did not impose any safeguard provisions and none of the imports of subject products reached the safeguard ceiling. SSGs have been previously triggered on several products, including chicken legs and wings, and several types of offal. Products generally continue to be imported in spite of the safeguard tariff.

To meet its WTO commitments, Taiwan has eliminated 99.27 percent of its import controls on 10,921 official import categories. Currently, there are 80 product categories requiring import permits from the Board of Foreign Trade (BOFT) including 56 categories that are prohibited and 24 that can only be imported under special conditions. Most of the permit-required categories are related to public sanitation and national defense concerns and include ammunition and some agricultural products. In addition, Taiwan maintains a lengthy list of products that are banned if made in China, including chocolate confectionery and meters for medical equipment. However, the Ministry of Economic Affairs recently informed the American Institute in Taiwan that imports of certain unfilled chocolate from China will be allowed if imported before June 1, 2006.

Agricultural and Fish Products

Prior to its WTO accession, Taiwan banned or restricted imports of 42 agricultural and fish items. In January 2002, Taiwan liberalized imports of 18 of these agricultural and fish categories and implemented TRQs on the remaining 24 items. TRQs on a number of products of interest to the United States (chicken meat, pork bellies and offal, and poultry offal) were eliminated on January 1, 2005.

Rice

Before Taiwan's WTO accession, imports of rice were banned. During 2002, rice imports were subject to an absolute quota that covered both public and private sector imports. In 2003, Taiwan changed its rice import regime to a tariff-rate quota system without consultation with its trade partners. In January 2003, the United States, Australia, and Thailand formally objected to Taiwan's proposed rice import system at the WTO. Since then, the United States has also raised concerns bilaterally regarding Taiwan's implementation of its rice import system, including cancellation of mark-up price reductions for several private-sector tenders and the use of a "ceiling price" for public-sector tenders. Despite these difficulties, the United States has supplied a majority of Taiwan's imported rice every year since accession. In 2004, Taiwan's implementation of its import commitments improved significantly, but the price ceiling issue resurfaced in 2005. Also, during 2004 and 2005, the United States and Taiwan made substantial progress in resolving outstanding differences on Taiwan's rice procurement arrangements. However, certain rice suppliers to the Taiwan market other than the United States have not agreed to proposed modifications to Taiwan's rice import system.

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As a result, Taiwan will continue its current system while working toward final resolution of the rice import issue.

Tobacco and Alcohol Products

As a condition of Taiwan's WTO accession, a new tobacco and alcohol management and tax system went into effect on January 1, 2002. In place of the previous tax on imports administered by the former monopoly authority, the Taiwan Tobacco and Wine Monopoly Bureau (TTWMB), Taiwan agreed to impose an excise tax and to eliminate tariffs on imports of most spirits. Taiwan also liberalized private alcohol production upon its accession to the WTO and private cigarette manufacturing in 2004. TTWMB became a state-owned corporation, Taiwan Tobacco and Liquor Corporation (TTLC), in July 2002. However, primarily due to resistance by organized labor, the privatization of the TTLC has been repeatedly postponed and there is no target date for implementing privatization.

Wood Products

Taiwan has revised its building codes in line with international standards. However, Taiwan has not yet completed a companion fire code. This delay means that while a wood frame structure may be built, approval by fire inspection authorities is contingent on review and comment by a special committee on details, such as design and usage – making insurance and financing difficult to obtain even if fire inspection authorities approve plans. U.S. wood products companies have raised concerns that this practice is restrictive and does not encourage wood use in construction. The continued use of a special committee rather than finalizing a fire code unnecessarily delays construction of wood structures and raises the cost of using wood materials significantly beyond that of other materials such as concrete and steel.

Automobiles and Motorcycles

Local content requirements in the automobile and motorcycle industries were lifted as part of Taiwan's WTO accession. The importation of motorcycles with engines larger than 150cc was liberalized in July 2002 as part of Taiwan's WTO commitments. In mid-2003, Taiwan agreed to set emissions standards for motorcycles over 700cc in line with international standards, a step the U.S. motorcycle industry supported. Small motorcycles (below 250cc) are prohibited on expressways. Larger motorcycles are restricted from most expressways but are allowed on two national highways. The Ministry of Transportation and Communications (MOTC) has entrusted the Institute of Transportation (IOT) with conducting an evaluation to determine whether to lift the restriction on large motorcycles on expressways. IOT is scheduled to announce the result in June 2006. The U.S. remains concerned with Taiwan's tariffs and other taxes on large motorcycles as well as Taiwan's restrictions on motorcycle access to highways.

STANDARDS, TESTING, LABELING AND CERTIFICATION

As of October 31, 2005, the Bureau of Standards, Metrology & Inspection (BSMI) had 13,981 separate existing standards. The rate of harmonization with international standards (both identical and modified) was 72 percent, up from 69 percent on December 31, 2004.

Industrial and Home Appliance Products

Industrial and home appliance products (such as air-conditioning and refrigeration equipment) are subject to safety and Electro-Magnetic Compatibility (EMC) testing requirements before clearing customs. The manufacturers or importers can choose one of two testing methods - "batch-by-batch inspection" (BBI) with Type Approval, or "registration of product certification" (RPC). All safety testing for end products must be done in Taiwan, by Taiwan-accredited laboratories. Taiwan accepts EMC testing by National Institute of Standards and Technology-accredited laboratories if they are in the United States only for information technology equipment based on the EMC Mutual Recognition Agreement (MRA). For those products that adhere to the ISO 9000 quality management system, an alternative factory inspection module was introduced. The manufacturers or importers may choose the method most appropriate to them when applying for registration under the RPC scheme.

Several new standards were announced in 2005 for electronic and household appliances and toys. The revised Chinese National Standards (CNS) 12574 on household pressure-cooking pots was published on September 27, 2004. This revised standard was used to conduct inspections of such products beginning in May 2005. Starting August 1, 2005, 18 additional types of toys were required to pass inspection before entering the market. This makes a total of 38 types of toys that require inspection. In July 2005, the Ministry of Economic Affairs proposed that television receivers must include the capability to receive over-the-air digital television (DTV) broadcast signals, in addition to the existing EMC and safety requirements for television receivers that are already subject to inspection. The DTV-receiving capability schedule will be based on the size of the screen, with larger televisions required to comply as of January 1, 2006, and smaller televisions by January 1, 2008.

Sanitary and Phytosanitary Measures

As a member of the WTO, Taiwan is bound by the WTO Agreement on the Application of Sanitary and Phytosanitary Measures (including notification of such measures). In 1998, Taiwan agreed to accept meat and poultry imports from plants approved by the USDA Food Safety Inspection Service. In 1999 and 2000, Taiwan agreed to accept *Codex Alimentarius* or U.S. pesticide residue standards for some chemicals used on imported fruits and vegetables. However, the United States remains concerned that some Taiwan plant and animal quarantine measures are not always based on sound science and are more trade restrictive than necessary.

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Alcoholic Beverages

On July 1, 2004, the Ministry of Finance eliminated ingredient-labeling requirements for alcoholic beverages. However, product labels must include a warning label which states that excessive drinking is harmful to health. Beginning January 1, 2006, Taiwan will implement new “Regulations Governing the Inspection of Imported Alcohol” for wine, fruit wine, beer, and brewed cereal beverages; and on July 1, 2006 for fermented beverages with the exception of grape wine; and on July 1, 2006 for distilled spirits and grape wine. Importers of alcoholic beverages can submit documentation of sanitary inspection or safety assurance issued by officials in charge of alcohol product inspection or professional alcohol associations of exporting countries to substitute for product inspection upon customs clearance.

Agricultural Biotechnology Products

Taiwan authorities generally have taken a cautious, but fairly reasonable approach to trade in agricultural biotechnology products. Risk assessment documentation on agricultural biotechnology corn and soybeans was required to be submitted to the Department of Health (DOH) before April 30, 2002, and mandatory labeling on certain corn and soybean products commenced in 2003. In October 2003, DOH announced its intention to require registration of agricultural biotechnology products other than corn and soybeans in 2004, but announced a process for life science companies to obtain interim approval for those products currently commercialized. No disruptions to trade have resulted from Taiwan’s biotechnology regulations. However, with a number of products entering the regulatory approval pipeline and a lack of investment in a strong domestic regulatory infrastructure, delays in approvals have become more frequent.

Labeling of Biotechnology Food Products

Taiwan requires labels on foods containing biotechnology corn or soybeans. All food products containing 5 percent or more bio-engineered soybean or corn ingredients by weight must be labeled as “Genetically Modified (GM)” or “Containing Genetically Modified.”

Medical Devices

Registration and approval procedures for medical device imports are complex and time-consuming, and have been the subject of longstanding complaints by U.S. firms. The registration process requires extensive documentation, sometime arbitrary demands for additional information and redundant testing. Changes in the registration requirements mean manufacturers must register Class 1 (lowest classification of risk) medical devices for the first time and re-register previously approved products. In most cases, this requires companies to submit additional documentation, even when products are based on previously approved devices, are identical products made in different quality system documentation (QSD) manufacturing sites, or even when the product’s outer packaging changes. The Department of Health (DOH) narrowly avoided a crisis in June 2005, when

it extended the deadline for registration by six months and committed additional resources to processing the flood of applications. As of the beginning of 2006, most importers report that their products were coming into Taiwan without substantive delays. Regulations are vague regarding when local clinical trials are required for the review process or whether industry is allowed to provide additional input in response to questions posed by DOH officials reviewing the clinical trial submissions. Taiwan has identified both the medical device and pharmaceutical sectors as priorities for local development, resulting in Taiwan agencies often favoring the interests of local companies over foreign firms.

Pharmaceuticals

Taiwan's lengthy pharmaceutical registration process slows market entry for new drugs that have already received regulatory approval in advanced economy markets and imposes unnecessary costs on drugs that have been approved in Taiwan. Product registration requires submission of plant master files, validation documentation, as well as local clinical trials. Following extensive negotiations, Taiwan agreed in August 2003 to replace submission of full-scale validation documentation with an overview template/certificate of pharmaceutical products (CPP) issued by the relevant authority from the source country. DOH retains the right to conduct overseas site inspections based on risk factors.

Despite intensive consultations, U.S. industry remains concerned that these inspections will unfairly target manufacturers that provide abridged data. Discussions between the United States and Taiwan to resolve remaining issues, especially requirements for computerized validation data, have led to the development of mutually agreeable standards.

Taiwan uses various methods to lower assigned prices on innovative drugs, including through "reference pricing" and periodic lowering of assigned prices without a transparent process. In addition, Taiwan continues to restrict consumer choice and limit U.S. market access through disproportionate reimbursement of domestically manufactured generic drugs. Article 49 of Taiwan's National Health Insurance law mandates reimbursement of healthcare providers at actual transaction costs, but this law is not enforced. Discussions between the United States and Taiwan on this issue are ongoing.

In July 2002, Taiwan introduced a "global budget" in selected locations in which hospital reimbursements are capped by the National Health Insurance system. The goal is to increase efficiency and encourage cost-cutting measures. In practice, this has led to increased pressure on pharmaceutical suppliers to provide discounted products. Despite reports of negative effects on patient care, DOH has announced plans to extend global budgeting to all medical centers. Although these plans have been delayed by hospital resistance, universal global budgeting will likely be implemented in January 2006.

On September 1, 2005, the Bureau of National Health Insurance (BNHI) introduced guidelines to discourage improper use of pharmaceuticals. For instance, duplication of anti-acid prescriptions will no longer be reimbursed. In an effort to cut costs, BNHI stopped reimbursing for some over-the-counter medicines in July 2005.

Other issues

Taiwan initially reopened the market to U.S. beef in April 2005, after banning imports of U.S. beef in December 2003 following the detection of the first positive case in the state of Washington. Taiwan reimposed its import suspension on U.S. beef in June 2005, after the announcement of a second case of Bovine Spongiform Encephalopathy (BSE) in the United States. On January 25, 2006, Taiwan lifted its ban on U.S. boneless beef and beef products from cattle less than 30 months of age. Non-ruminant products for feed use, such as tallow, lard, poultry and porcine meal remain banned due to BSE concerns. Limited exceptions are only approved after a very slow case-by-case review or plant clearance process.

GOVERNMENT PROCUREMENT

Taiwan committed to accede to the WTO Agreement on Government Procurement (GPA) as part of its WTO accession. While Taiwan has applied to accede to the GPA, its accession has not yet been completed due to differences regarding nomenclature issues. To prepare for accession, Taiwan implemented a new Government Procurement Law in mid-1999. This was an important first step toward establishing a transparent and predictable environment for Taiwan's multi-billion dollar public procurement market.

In August 2001, Taiwan and the United States signed a Memorandum of Understanding (MOU) on government procurement. The MOU calls for Taiwan to implement certain procedural commitments immediately, while others will be implemented upon accession to the GPA. U.S. participation in Taiwan's government procurement projects is discouraged by clauses in some contracts that exclude foreign tenders, as well as by Taiwan's refusal to implement liability caps and exclusions for consequential damages. The Public Construction Commission often requests U.S. firms to provide relevant U.S. practices and international cases for reference. The United States continues to encourage Taiwan to abide by the provisions of the GPA in spite of the difficulties in accession.

EXPORT SUBSIDIES

Taiwan provides incentives to industrial firms in export processing zones and to firms in designated "emerging industries." Some of these programs may have the effect of subsidizing exports. Taiwan has notified the WTO of these programs and, as part of its WTO accession, committed to amend or abolish any subsidy programs inconsistent with WTO rules. Amendments of relevant laws, such as the Statute for Establishment and Management of Economic Processing Zones and the Statute for Establishment of Scientific Industrial Parks, to eliminate improper subsidies, went into effect upon Taiwan's WTO accession. The United States continues to monitor Taiwan's compliance

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with the commitments it undertook as part of its WTO accession, including those obligations associated with the Agreement on Subsidies and Countervailing Measures.

INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

IPR protection continues to be an important issue in the U.S.-Taiwan trade relationship. The United States recognizes Taiwan's continuing efforts to take measures to improve protection and enforcement of IPR in 2005, including intensifying raids against manufacturers and retailers. The U.S. International Intellectual Property Alliance (IIPA) estimates that losses due to IPR copyright piracy in Taiwan cost U.S. industry \$377 million in 2005. The U.S. government also continues to be concerned with the prevalence of counterfeit pharmaceuticals in Taiwan, despite several large raids against manufacturers and the passage of amendments strengthening the pharmaceutical law. Another area of concern is inadequate protection for the packaging, configuration, and outward appearance of products – known as trade dress. U.S. industry has also complained about delays in court cases and the Taiwan judiciary's difficulty in handling technical cases. Generally, U.S. rights holders find that court procedures themselves can constitute barriers to enforcement, and that penalties for intellectual property violations are inadequate to deter violators.

In December 2004, Taiwan was moved from the U.S. Special 301 "Priority Watch List" to the "Watch List" after an out-of-cycle review determined that Taiwan had made sufficient progress to warrant an improved status. In addition, soon after the results of the out-of-cycle review were announced in January 2005, Taiwan's legislature approved a bill to prevent unfair commercial use of pharmaceutical test data. Despite these improvements, the United States will continue to monitor Taiwan authorities' development of implementing regulations for the protection of pharmaceutical test data. In addition, Taiwan needs to take further effective actions against piracy of copyrighted works over the Internet and to continue the strengthening of enforcement efforts so that piracy and counterfeiting are effectively reduced. The United States also will continue to follow with interest Taiwan Customs' efforts to stop exports of counterfeit materials to ensure that these efforts are as effective as, or more effective than, Taiwan's recently abolished Export Monitoring System.

To improve Taiwan's ability to protect IPR, the government formulated a three-year (2003-2005) IPR action plan. Measures included establishing the Integrated Enforcement Task Force (IETF) with a force of 220 special police officers in January 2003; opening three warehouses for storing counterfeiting seizures; raising informant rewards to up to approximately \$310,000 per counterfeiting seizure; strengthening border control inspection for optical media exports; and increasing day and night inspections on optical media production facilities, night markets, and retail shops. Counterfeit goods seized by the U.S. Customs Service from shipments of Taiwan origin dropped from \$26.5 million in FY2002 to \$767,671 in the first half of FY2005. The Business Software Alliance (BSA) also announced that the software piracy rate in Taiwan has decreased steadily from 72 percent in 1994 to 43 percent in 2002, although this rate remained unchanged in 2003 and 2004.

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Trademark counterfeiting, particularly of clothing and luxury goods, is a growing concern. Much of the counterfeit product is allegedly smuggled from China. Rights holders state that Taiwan is both a transshipment point and a market for this counterfeit material. Taiwan Customs makes regular seizures of counterfeit apparel and handbags, but rights holders complain that investigation and prosecution remain hampered by an overworked and disinterested bureaucracy and that sentences are inadequate to deter trademark counterfeiters.

Internet piracy and illegal peer-to-peer downloading are serious concerns for IP enforcement in Taiwan and the sale of counterfeit goods over the Internet, resulting in part from the increased raids on traditional sales venues, is a growing concern. Infringers use the Internet to market illegal goods and to allow the unauthorized downloading of music, movies, and software from Internet service providers (ISPs). To deter Internet piracy, the Taiwan Intellectual Property Office (TIPO) in May 2005 initiated an implementation plan for strengthening preventive measures against Internet infringement. TIPO created a joint Internet infringement inspection special task force to conduct Internet inspections, and has made efforts to strengthen cooperation with enforcement agencies in other nations to tackle cyber crime. In addition, TIPO is coordinating with ISPs and rights holders' associations to establish a code of conduct for ISPs and is working with the Ministry of Education to enhance Internet management at schools. Efforts to use the legal system to shut down or restrict the activities of such services have met with mixed success. In June 2005, peer-to-peer (P2P) company EzPeer was found not guilty of allowing users to download copyrighted material through their site. However, in September 2005, another popular P2P site, Kuro, was found guilty of the same charge. Rights holders groups have called on Taiwan to further amend the Copyright Law or other regulations to clarify secondary liability of ISPs and other intermediaries. Taiwan's 2001 Optical Media Law and night/day inspections have led to a significant decrease in large-scale factory production of counterfeit optical media products, although the IIPA reports that the organized criminal syndicates that control most of the piracy business in Taiwan are simply moving their operations to "burn to order" and to the Internet.

The United States remains concerned with the growing incidence of counterfeit pharmaceutical products in the Taiwan market. In March 2004, Taiwan revised the pharmaceutical affairs law to increase penalties for pharmaceutical counterfeiting and the Ministry of Justice, the Taiwan Coast Guard, and Taiwan Customs have had some success in intercepting imports of counterfeit pharmaceuticals. Nevertheless, counterfeit products continue to be a threat to public health, Taiwan's DOH enforcement mechanism is not adequate. In January 2005, Taiwan's legislature approved a bill to provide data protection for pharmaceutical products – a TRIPS commitment – and an incentive for innovative pharmaceutical manufacturers to introduce new products into the Taiwan market, but final implementing regulations are still pending. The United States will monitor Taiwan's development of implementing regulations to ensure that commitments made by Taiwan regarding the period of protection are satisfied.

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Taiwan's judiciary continues to experience difficulties in handling technical cases, and U.S. industry has complained about long delays in court cases. Often conflicting or unclear lines of bureaucratic authority stymie IPR enforcement efforts. The United States continues to assist in strengthening the judicial system by holding seminars on criminal enforcement while encouraging Taiwan to set up IP courts with experienced judges.

SERVICES BARRIERS

Financial Services

Taiwan continues to liberalize its financial market beyond its WTO accession commitments. In January 2001, the Securities and Futures Exchange Commission (SFEC) lifted the restriction on employment of foreigners by domestic securities firms. Also in January 2001, the SFEC removed the 50 percent foreign ownership limit on listed companies. In June 2003, the SFEC phased out a minimum two-year period for foreign holders of global depository receipts (GDRs) to exchange GDRs for equity stocks after a GDR is issued. In July 2003, the SFEC lifted the ceiling limit of \$3 billion on inward remittances by a qualified foreign institutional investor (QFII). It also abolished the requirement for a QFII to inwardly remit its investment fund within two years after it receives approval. In early October 2003, Taiwan voluntarily abolished the QFII system. The SFEC was renamed as the Securities and Futures Bureau (SFB) in July 2004.

Foreign portfolio investors are required to complete registration rather than seek advance approval. Since December 2003, the registration can be done through the Internet. In late 2003, Taiwan allowed foreign portfolio investors to trade in the futures and money markets as a part of financial management prior to actual portfolio investment. However, futures, money market funds and bank deposits are subject to a limit of 30 percent of total inward remittances. All offshore foreign portfolio investors may trade in Taiwan's stock market regardless of their size, except for investments in hedge funds and investors from the People's Republic of China. However, foreign individual investors are still subject to an investment limit. Onshore foreign individuals and institutional investors are also subject to annual inward/outward limits.

Morgan Stanley Capital International (MSCI) raised the weight for Taiwan stocks in its index over the past year, attracting a large volume of foreign investment funds to flow into Taiwan in 2005.

In addition to liberalization, Taiwan plans to set up a securities market international board where both listing and trading will be denominated in U.S. dollars. The planned international board is designed to attract foreign companies to list there as well as encourage foreign portfolio investors to trade on the board.

Taiwan continues to work towards fulfilling its May 1997 commitment to liberalize insurance premium rates and policy clauses. It voluntarily opened the reinsurance market. In November 2001, Taiwan permitted life insurance companies to sell investment-linked products. Taiwan began to allow life insurance companies to set their

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own premium rates in January 2002, if the companies had their own actuaries to determine such rates. Taiwan adopted a three-stage premium rate liberalization program for non-life insurance. Effective January 1, 2002, insurance firms were allowed to set premium rates for large face-value fire insurance policies and fire insurance policies sold to multinational corporations. All non-life insurance companies were permitted to set loading expenses (including commissions) for all insurance products. The second stage of premium liberalization began in April 2005. After that date, non-life insurance firms meeting government-set requirements were not required to obtain prior approval for pure premiums except for car and fire insurance. For car and fire insurance, they were allowed to set pure premiums within a range between the government-approved benchmark rate and 10 percent below the benchmark. Taiwan may advance the target date for total liberalization to 2006 from January 2008 when the insurance policy review procedure is currently scheduled to be deregulated.

Taiwan adopted a transparent approval procedure for insurance policies in January 2001. Prior approval is not required for products whose policy clauses are identical or very similar either to the standard versions published by the government or to the existing products of other companies. New products are subject to prior approval. Taiwan's Insurance Bureau (formerly the Department of Insurance) adopted a negative list system in January 2005. Under the new system, new products subject to prior approval from the Bureau will be sharply reduced. The processing time will be cut from 90 days to 75 days for life insurance products and 60 days for non-life insurance products. The Insurance Bureau plans to further deregulate the insurance policy review procedure in 2006. Insurance companies with a rating above a set level will be permitted to determine their own premium rates, and will not need to seek approval for 90 percent of their new products.

Taiwan's Insurance Bureau has allowed competition in Taiwan's reinsurance market, and the Central Reinsurance Corporation Statute was revoked in June 2004. The Central Reinsurance Corporation, the only local reinsurance firm in Taiwan, was privatized in July 2002. In August 2002, the Insurance Bureau lowered the capital requirement for entering the reinsurance market. In response to the liberalization, the Swiss Reinsurance Co. became the first foreign reinsurance firm to set up a branch in Taiwan in early 2004.

Telecommunications Services

Following the issuance of licenses to three fixed-line telecommunications service providers in 2000, the Directorate General of Telecommunications (DGT) again opened applications for integrated network licenses in September 2004. The capital requirement for integrated network services was reduced to NT\$16 billion from NT\$40 billion and system capacity requirements were lowered from one million to 400,000 subscriber lines. Since that time, there has been only one bidder (in October 2005) for a license to provide integrated network services. DGT also opened the local, long-distance and international call businesses in March 2005. A new formula based on local population will be used to calculate the capital requirements for each of the new service licenses. For instance,

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NT\$1.2 billion may be required for a local call license in Taipei City and NT\$2 billion for long-distance and international service licenses.

Existing fixed-line operators still face serious difficulties in negotiating reasonable inter-connection arrangements at technically feasible points in the network of the dominant carrier, Chunghwa Telecom (CHT). Despite its announcement in May 2004 that it would share the local loop with the three private providers, CHT set two limitations: (1) non-CHT service provider's access to CHT's local loop can only be initiated by end users, and (2) only voice service in three metropolitan areas is open to non-CHT operators. Taiwan's Premier announced in November 2003, that the government would invest a total of NT\$35 billion in the next five years to help local governments resolve "last mile" problems for telecommunications end-users. This plan, part of a number of telecommunications-related investment proposals called "Mobile Taiwan," will also include the construction of a second broadband network around Taiwan to be jointly used by telecommunications service companies. These new investment projects are expected to help break the monopoly of the telecommunications network by formerly state-owned CHT.

Until 2005, Taiwan's telecommunications regulator (DGT) and the largest telecommunications operator (CHT) were both under the control of the Ministry of Transportation and Communication (MOTC), creating an obvious conflict of interest. Privatizing CHT and establishing an independent regulator were two of Taiwan's WTO accession commitments. In August 2005, MOTC officially privatized CHT by selling an additional 17 percent of its CHT stock, 3 percent domestically and 14 percent on the New York Stock Exchange. These sales reduced the percentage of CHT stock in government hands to less than 50 percent. However, CHT still retains close ties to the government. In November 2005, Taiwan's Premier announced a CHT rate cut on the floor of the Legislative Yuan, calling into question CHT's independence. The Legislative Yuan in October 2005 finally approved the creation of an independent regulatory body, called the National Communications Commission (NCC) after heated political debate. The political compromise necessary to pass the legislation raises concerns that the NCC could be subject to political pressure. The new body will have 13 commissioners selected by political parties and will be staffed by employees of the former DGT and Government Information Office. It is expected to begin operations by the beginning of 2006, but may have difficulty establishing its legitimacy as an independent regulator as a result of the political controversy surrounding the naming of commissioners.

In August 2003, DGT amended regulations to open Taiwan's mobile virtual network operator (MVNO) market and began licensing in September 2003. The MVNO market opening offers an alternative third-generation (3G) wireless service to local consumers and allows service providers to operate without a 3G license by partnering with existing 3G operators. Cellular carriers KG Telecom and Far EasTone merged in October 2003. The merger has created a mobile service market equally divided between FarEasTone, CHT and Taiwan Cellular.

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In November 2003, the DGT announced the regulations governing number-portability service, enabling subscribers to retain their existing telephone numbers when switching from their original Type I enterprise to another Type I enterprise engaging in the same business. Actual implementation of the number-portability service started on October 15, 2005. In November 2004, DGT began to solicit comments for a proposal to facilitate development in the voice over Internet protocol (VoIP) services. DGT is expected to open VoIP to telecommunications operators in November 2005. The United States continues to monitor Taiwan's progress in the telecommunications sector.

INVESTMENT BARRIERS

Taiwan continues to relax investment restrictions in a host of areas, but foreign investment remains prohibited in a handful of industries such as agriculture, public utilities, and postal services. Taiwan dropped oil exploration from the negative list of industries in May 2004. Foreign investors in the telecommunications sector are subject to a 60 percent ownership limit, with the limit on direct foreign investment raised from 20 percent to 49 percent in 2002. Foreign investors can own minority stakes in cable and satellite broadcasters, but are prohibited from owning terrestrial broadcasters. In February 2003, Taiwan lifted its ban on foreign investment in liquor production, although prior approval is required. Similarly, in January 2004, foreign investment restrictions on cigarette production were removed, although prior approval is required. The 50 percent foreign ownership limit on air cargo forwarders and air cargo terminals was eliminated when Taiwan became a WTO member. The limit on foreign ownership of power plants has been removed, while foreign investment in electricity transmission and distribution remains subject to a 50 percent ownership limit and approval by the Executive Yuan. In October 2003, Taiwan set a foreign ownership limit of 49 percent on high-speed railway transportation.

ANTICOMPETITIVE PRACTICES

In the cable television market, U.S. program providers contend that Taiwan's three dominant multi-system operators (MSOs) frequently collude to inhibit fair competition. Control by the MSOs of upstream program distribution deterred U.S. program providers from negotiating reasonable program fees. In December 2003, Taiwan's legislature passed a new broadcasting law combining the Radio and Television Broadcasting Law, the Cable Television Broadcasting Law, and the Satellite Television Broadcasting Law. Following passage of the law, Taiwan officials are working to eliminate political interference in the television broadcasting industry by monitoring public releases of state-owned and party-owned equity shares in broadcast media.

ELECTRONIC COMMERCE

Taiwan's approach to electronic commerce and related issues is still evolving. According to the Institute for Information Industry, over 90 percent of Taiwan's companies have corporate networks and a network infrastructure, while 61 percent of the 5.2 million

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household computer users link their computer to networks, mainly by broadband digital subscriber line (DSL). A law protecting personal on-line data was approved in 2001.

The Electronic Signature Law, passed by the Legislative Yuan in late October 2001, adopts the principles of the United Nations Commission on International Trade Law's Model Law on Electronic Commerce and recognizes the legal validity of electronic contracts, records, and signatures. Taiwan has passed several laws and regulations governing electronic commerce since 2003. In May 2005, the Ministry of Finance announced a guideline to impose a business tax on Internet vendors who sell products for profit and have monthly sales over NT\$60,000. In addition to a business tax, the authorities discussed a proposal to assess import duties for software sold and downloaded over the Internet.

If implemented, such a policy would appear to run counter to the Doha Declaration that WTO Members would maintain their current practice of not imposing customs duties on electronic transmissions. Meanwhile, Taiwan has refused to join the United States at APEC in advocating for a permanent moratorium on taxation of Internet transactions.

THAILAND

TRADE SUMMARY

The U.S. goods trade deficit with Thailand was \$12.7 billion in 2005, an increase of \$1.4 billion from \$11.2 billion in 2004. U.S. goods exports in 2005 were \$7.2 billion, up 13.6 percent from the previous year. Corresponding U.S. imports from Thailand were \$19.9 billion, up 13.2 percent. Thailand is currently the 23rd largest export market for U.S. goods.

U.S. exports of private commercial services (i.e., excluding military and government) to Thailand were \$1.1 billion in 2004 (latest data available), and U.S. imports were \$903 million. Sales of services in Thailand by majority U.S.-owned affiliates were \$2.6 billion in 2003 (latest data available), while sales of services in the United States by majority Thailand-owned firms were \$3 million.

The stock of U.S. foreign direct investment (FDI) in Thailand in 2004 was \$7.7 billion, up from \$7.1 billion in 2003. U.S. FDI in Thailand is concentrated largely in the manufacturing, professional, scientific, and technical services, and mining sectors.

FREE TRADE AGREEMENT (FTA) NEGOTIATIONS

The U.S. government began FTA negotiations with Thailand in June 2004, and has conducted seven rounds of discussions. Having concluded an FTA with Singapore in May 2003, the United States is seeking to advance President Bush's Enterprise for ASEAN Initiative (EAI), which is aimed at enhancing U.S. relations with ASEAN countries, and to address concerns about Thailand's trade and investment regime. While the two sides have made progress in many areas of the negotiations, much work remains. The U.S. Government had hoped to conclude the talks by the spring, but in February, the Thai Government called snap elections for April 2 and it has been in caretaker mode since then. The United States and Thailand will jointly determine how best to proceed once a new government is in place.

IMPORT POLICIES

Thailand's high tariffs remain a major impediment to market access in many sectors. The country's average applied Most Favored Nation (MFN) tariff rate is 11.46 percent (the average applied MFN tariff rate in the agricultural sector is 24.32 percent, while in the industrial sector the average applied tariff rate is 9.48 percent). The highest tariff rates apply to imports competing with locally produced goods, including agricultural products, automobiles and auto parts, alcoholic beverages, fabrics, paper and paperboard products, restaurant equipment, and some electrical appliances.

In some cases, tariffs on unfinished and intermediate products are higher than on related finished products. In the aftermath of the 1997-98 financial crisis, the Thai government

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increased duties, surcharges, and excise taxes on a range of "luxury" imports, including wine, passenger cars, and wool carpets. Some tariff increases have occurred in conjunction with elimination of other trade restructuring measures; for example, tariffs on completely knocked down (CKD) automobile kits increased from 20 percent to 33 percent (later reduced to 30 percent) when local content requirements were eliminated in the automotive industry in December 1999. Thailand also imposes a 60 percent duty on motorcycles. When import duties, excise taxes, and other surcharges are calculated, the price of a motorcycle in Thailand is close to double its selling price in the United States. Thailand also does not permit the importation of bulk spirits at bottle strength for local bottling, thus limiting the access of imported spirits to the market.

The Thai government is behind in its schedule to implement its WTO and ASEAN Free Trade Area (AFTA) tariff reduction commitments and rationalizing its complicated tariff regime, which currently has 46 rates. Nonetheless, it has continued to lower selected import duties in line with WTO and AFTA commitments, mostly on raw materials and inputs not produced locally. In 2005, the government reviewed the entire tariff structure, which includes 5,505 items. Tariffs in the electronics sector, which make up about one fourth of total tariff items, will be the first group for which tariff reductions will be announced. The government is expecting to complete the tariff restructuring by the end of 2006, as 80 percent of AFTA tariff lines are scheduled to be brought down to zero by January 2007.

Taxation

Thailand's tax administration generally is complicated and non-transparent. Excise taxes are high on some items, such as unleaded gasoline, beer, wine, and distilled spirits. When import duties, excise taxes, and other surcharges are calculated, the cumulative tax burden on most imported whiskey is approximately 169 percent. In March 1999, as part of an economic stimulus package, the value-added tax (VAT) was temporarily reduced from 10 percent to 7 percent and the excise tax on fuel oil was reduced from 17.5 percent to 5 percent. The Thai government frequently has announced its intention to restore the VAT to 10 percent, but continues to delay the decision. The most recent effort to restore the VAT to 10 percent was scheduled to take place on October 1, 2005; that commitment has been delayed until September 30, 2007.

Agriculture and Food Products

High duties on agriculture and food products and arbitrary management of import licenses and application of sanitary and phytosanitary (SPS) measures (see section below on Standards, Testing, Labeling, and Certification) remain the primary impediments to U.S. exports of high-value fresh and processed foods. Under its WTO Uruguay Round agriculture obligations, Thailand committed to reduce its import duties, but agriculture is scheduled to be among the last sectors rationalized under the Thai government's tariff restructuring plan.

Duties on imported consumer-ready food products typically range between 30 percent and 50 percent – the highest in the ASEAN region – with some as high as 90 percent (e.g., coffee). Tariffs on meats, fresh fruits (including citrus fruit and table grapes) and vegetables, fresh cheese and pulses (e.g., dry peas, lentils, and chickpeas) are similarly high, even for products for which there is little domestic production. Frozen french fries, for example, are not produced in Thailand, yet there is a tariff of 30 percent. When import duties, excise taxes, and other surcharges are calculated, imported wines face a total tax of nearly 400 percent. The excise tax on wine (made of grapes) is 60 percent of value or 100 baht per liter of pure alcohol, whichever is higher. Fermented spirits made from fruits other than grapes, e.g., mangosteen, are subject to an excise tax of 25 percent of value or 70 baht per liter of pure alcohol, whichever is higher.

With the exception of wine and spirits, Thailand no longer applies specific duties for most agricultural and food products, and *ad valorem* rates are declining in accordance with Thailand's WTO commitments. Nevertheless, import duties on some agricultural and processed food goods have an average tariff rate of 25.4 percent. Moreover, bound duties on many high-value fresh and processed food products will remain high, from 30 to 40 percent, even after reductions under WTO commitments. Tariffs on apples are 10 percent, while duties on pears and cherries remain as high as 60 percent. U.S. fruit growers estimate lost sales of up to \$25 million annually from the combined effect of Thailand's high tariffs, surcharges, and a customs reference price system that often disregards the declared transaction price of these products (see "Customs Barriers" section below).

Thailand's overall import policy is directed at protecting domestic producers, and the government has implemented non-transparent price controls on some products and maintains significant quantitative restrictions that impede market access. The United States is concerned that access to tariff-rate quotas for agricultural products is often managed in an arbitrary and non-transparent manner. Although Thailand has been relatively open to imports of feed ingredients, including corn, soybeans, and soymeal, in recent years, the Thai government applies burdensome requirements associated with the issuance of import permits for feed ingredients. For example, tariff rates on corn imports have been liberalized, but the benefit of this tariff reduction has been offset by a Thai government requirement that corn imports arrive between March and June, a seasonal limitation not provided for in Thailand's WTO schedule. This requirement places U.S. suppliers at a disadvantage, in favor of corn from the southern hemisphere. Corn is also subject to a tariff-rate quota (TRQ): in-quota corn imports (54,440 mt) are subject to a 20 percent tariff rate, while out-of-quota corn imports are subject to a 73.8 percent tariff. There are unlimited import quotas for soybeans, for which the import duty is five percent. However, Thailand requires that importers purchase a certain amount of domestically-produced product before being granted licenses for imported products. Importers of skim milk powder report that import quota allocations are often released late, which sometimes causes interruptions in trade flows.

In addition, the Thai government requires import license fees for meat products of approximately \$114 per ton on beef and pork, \$227 per ton for poultry, and \$114 per ton

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on offal that do not appear to reflect the costs of import administration. SPS standards for certain agricultural products also often appear to be applied arbitrarily and without prior notification. The Thai government is in the process of implementing a long-dormant requirement of inspecting individual slaughterhouse or farm facilities that export animals and animal products into Thailand. Efforts have been made to negotiate a system audit, as opposed to a plant by plant audit as is desired by the Thai government. U.S. agricultural exports, including fish and forestry products, to Thailand, which dropped dramatically in the aftermath of the 1997 financial crisis to \$440 million in 1998, have recovered and reached \$765 million in 2004. According to U.S. industry estimates, potential exports to Thailand could reach as much as \$1.5 billion annually if Thailand's tariffs and other trade-distorting measures are substantially reduced or eliminated and the economy recovers to pre-crisis levels.

Automotive Sector

Thailand's import duties and taxes in this sector are among the highest in the ASEAN. In response to the financial crisis, the Thai government in October 1997 raised tariffs on Completely Built Up (CBU) passenger cars and sport utility vehicles to 80 percent, up from 42 percent and 68 percent, respectively. Thailand signed an FTA with Japan in August 2005 that will phase in over four years a reduction of tariffs to 60 percent on Japanese vehicles with engines greater than 3000 cc. Current tariff rates on parts and components range from 10 percent to 30 percent. However, tariffs on CBU pick-up trucks have been reduced from 60 percent to 40 percent.

Excise taxes in Thailand are based on engine displacement. In July 2004, Thailand revised its excise tax structure and simplified the previous system. Thailand's taxes on passenger vehicles range from 30 percent to 50 percent, while pickup trucks are taxed at a rate of three percent. Customs valuation issues have been particularly acute in the automotive sector (see "Customs Barriers" section below).

Textiles

Thailand's tariff rates for U.S. textile exports are high, ranging from 20 percent to 30 percent for most fabrics and 30 percent for most clothing and other made-up textile products. In addition, Thailand applies specific duties on more than one-third of all textile tariff lines, which make effective rates even higher. Furthermore, on the APEC website, Thailand's applied tariffs for certain clothing are incorrectly listed as 60 percent. Thailand has not yet addressed U.S. concerns that these higher published tariffs could be misleading and discourage potential U.S. exporters.

Quantitative Restrictions and Import Licensing

Thailand is still in the process of changing its import licensing procedures. Import licenses are required for at least 26 categories of items, including many raw materials, petroleum, industrial materials, textiles, pharmaceuticals, and agricultural items.

Imports of used motorcycles and parts and gaming machines are prohibited. Imports of other products must meet burdensome regulatory requirements, including extra fees and certificate-of-origin requirements. Thailand does not have specific measures of general application relating to non-preferential rules of origin.

Imports of food, pharmaceuticals, certain minerals, arms and ammunition, and art objects require special permits from relevant ministries. Thailand requires that detailed and often proprietary business information about the manufacturing process and composition of food be provided in applications for food product registration.

Customs Barriers

Thailand made no significant changes to its customs practices in 2005. During 2003-2004, Thailand took some steps to improve its customs practices, building on discussions held under the U.S.-Thailand Trade and Investment Framework Agreement (TIFA). While the international business community maintains that some positive customs policy changes are slow in filtering down through the bureaucracy, most acknowledge the progress to date and recognize that the Thai government is committed to improving its customs procedures and facilitating trade.

As part of its effort to improve the transparency and efficiency of customs procedures, Thailand implemented in 2003 a *de minimis* threshold, exempting goods valued at 1,000 baht or less from formal entry procedures and has increased the low-value informal clearance threshold to 40,000 baht (\$1000) from 20,000 baht (\$500). Thailand also has taken action to expand customs clearance working hours, to increase the use of electronic and paperless customs procedures, and to create an English-language version of the Customs Department website.

The Thai government needs to make further progress to enhance the transparency and efficiency of its customs regime. In July 2003, Thailand formally notified the WTO of legislation passed in 2000 implementing the WTO Customs Valuation Agreement. Meanwhile, Thailand has drafted, but not yet submitted to Parliament, legislation limiting the discretion of the Customs Director General to arbitrarily increase the customs value of imports (though in practice, the Director General has not made use of that discretion). Some industry representatives continue to report inconsistent application of the WTO transaction valuation methodology and continued use of arbitrary values.

As is the case with some Thai agencies, Customs has an incentives program rewarding officials for identifying violators based on a percentage of the recovered revenues. This practice encourages revenue maximization rather than compliance with legal requirements. Although Thailand has taken steps to streamline its customs appeals procedures, some businesses contend that the process is still too lengthy and not yet fully transparent. Corruption in the Customs Department reportedly remains a serious problem.

STANDARDS, TESTING, LABELING AND CERTIFICATION

Thailand's Food and Drug Administration (TFDA) imposes standards, testing, and labeling requirements, and requires certification permits for the importation of all food and pharmaceutical products, as well as certain medical devices. Many U.S. companies consider the cost, duration, and complexity of the permitting processes to be overly burdensome and are concerned about the periodic demands for disclosure of proprietary information. TFDA has streamlined its procedures somewhat, but U.S. companies still report delays of up to a year. All processed foods must be accompanied by a detailed list of ingredients and a manufacturing process description, disclosure of which could jeopardize an applicant's trade secrets. A labeling regime for genetically modified foods, modeled on the Japanese system, was put into effect in May 2003. The TFDA has introduced new regulations on food safety testing, known as Ministerial Decree 11, requiring that many imported food products undergo testing and certification for a number of chemical additives. U.S. food exporters report that these new rules are burdensome and unclear, and no risk assessment substantiating the need for this testing has been provided.

The Thailand Industrial Standards Institute (TISI) is the national standards organization under the Ministry of Industry. TISI is empowered to provide product certifications according to established Thai standards and is an accredited body for ISO and HACCP certifications in Thailand. The Thai government requires the certification of 60 products in ten sectors, including agriculture, construction materials, consumer goods, electrical appliances and accessories, PVC pipe, medical equipment, LPG gas containers, surface coatings, and vehicles.

U.S. private sector representatives have raised concerns about a number of measures proposed or implemented as a result of TISI actions. These measures include a technical regulation proposed by TISI on radio disturbance limits for personal computers and another technical regulation issued by TISI requiring all uninterruptible power systems to meet certain testing standards.

Thailand bars large-displacement motorcycle traffic from its tollways, including large motorcycles that are engineered to be ridden safely at highway speeds. In 2000, Thailand adopted motorcycle emissions regulations that are an amalgamation of standards and tests used elsewhere in the world, resulting in standards that reportedly are among the most stringent in the world. U.S. industry contends that enforcement of these standards has been non-transparent and that even producers utilizing advanced low-emission technology have difficulty meeting these standards.

GOVERNMENT PROCUREMENT

Thailand is not a signatory to the WTO Agreement on Government Procurement; although in the past Thai officials have indicated support for a WTO Agreement on Transparency in Government Procurement. A specific set of rules, commonly referred to as the Prime Minister's Procurement Regulations, governs public-sector procurement for

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ministries and state-owned enterprises. While these regulations require that non-discriminatory treatment and open competition be accorded to all potential bidders, different state enterprises typically have their own individual procurement policies and practices. Preferential treatment is provided to domestic suppliers (including subsidiaries of U.S. firms registered as Thai companies), which receive an automatic 15 percent price advantage over foreign bidders in initial bid round evaluations.

A "Buy Thai" directive from the Prime Minister's office issued in 2001 has raised additional concerns about Thai government procurement policies. Reversing a long-standing non-discriminatory government procurement policy, "Buy Thai" impeded market access of foreign suppliers in selected sectors during 2001-02, notably personal computers. While Thailand officially denies that the "Buy Thai" policy discriminates against foreign producers, specific language used in government instructions on some procurement tenders explicitly excludes foreign-made, non-Thai products from the bidding process.

A procuring government agency or state enterprise reserves the right to accept or reject any or all bids at any time and may also modify the technical requirements during the bidding process. The latter provision allows considerable leeway to government agencies and state-owned enterprises in managing tenders, while denying bidders any recourse to challenge procedures. Allegations that changes are made for special considerations frequently surface, including charges of bias on major procurements. Despite the official commitment to transparency in government procurement, U.S. companies and Thai media regularly report allegations of irregularities. Private sector representatives have expressed concern regarding a Thai government decision to no longer include arbitration clauses in concessions and government contracts.

Regulations promulgated in May 2000 formalized a Thai government practice requiring a countertrade transaction on government procurement contracts valued at more than 300 million baht, or \$7.7 million, on a case-by-case basis. A counter-purchase of Thai commodities valued at not less than 50 percent of the value of the principal contract may be required. As part of a countertrade deal, the Thai government also may specify markets into which commodities may not be sold; these are usually markets where Thai commodities already enjoy significant access. From 1994 through September 2005, 292 countertrade agreements were signed, resulting in exports valued at 67 billion baht, or approximately \$1.7 billion.

EXPORT SUBSIDIES

Thailand maintains programs to support trade in certain manufactured products and processed agricultural products, which may constitute export subsidies. These include various tax benefits, import duty reductions, credit at below-market rates on some government-to-government sales of Thai rice (established on a case-by-case basis), and preferential financing for exporters. Low interest loans provided under the Export Market Diversification Promotion Program for exporters targeting new markets ended in December 2003.

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INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

Widespread commercial intellectual property counterfeiting and piracy continue at high levels, despite the promise that accompanied the recent restructuring of IPR enforcement agencies.

U.S. copyright industries reported an estimated annual trade loss of more than \$175 million in 2004 from IPR infringement in Thailand. An increasing volume of pirated and counterfeited products manufactured in Thailand are exported. Thailand has been on the U.S. Special 301 "Watch List" since November 1994.

The United States and Thailand held extensive consultations on IPR issues under the TIFA. In June 2003, the United States provided Thailand with a proposed IPR Action Plan. This plan included detailed proposals for action to be taken on enforcement, legislative/regulatory, and judicial issues. Key among these were: (1) revisions to the optical disk legislation then pending before Parliament and expeditious passage of this legislation; (2) a clear improvement in Thailand's IPR enforcement record through sustained, aggressive, and coordinated enforcement efforts; and (3) improvements in the draft Copyright Act amendments under consideration and passage of these amendments. After the FTA negotiations were underway, Thailand enacted optical disk legislation that lacked many key elements, and U.S. officials continue to press Thailand to address these deficiencies. The Copyright Act amendments have not been enacted and lack of sustained, aggressive, and coordinated enforcement remains a substantial problem.

The implementing regulations for the Trade Secrets Act, which was passed in March 2002, have yet to be adopted. The Thai Food and Drug Administration (FDA) and Department of Agriculture have drafted regulations to implement the Act, and public comments have been solicited. Although the draft regulations are now ready for signature by the Minister of Public Health, it is likely they will not be acted upon until the completion of the bilateral FTA negotiations.

The latest available draft of the Trade Secrets Act allows a government agency to disclose trade secrets to protect any "public interest" not having a commercial interest, provided the agency takes "regular measures to protect such trade secrets from unfair commercial use." The U.S. Government has raised concerns that this language would provide authorities with overly broad authority that could deny the protection of approval-related data against unfair commercial use.

A further piece of legislation related to the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS), the Geographic Indications Act, was passed by the Thai Parliament in September 2003 and went into effect in April 2004. Private sector representatives have expressed concern about the implementation and enforcement of the Plant Variety Protection Act, noting the wide availability of pirated or counterfeit seeds and other products in Thailand.

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Thailand's IPR enforcement efforts have been inconsistent. Although conviction rates are high, corruption and a cultural climate of leniency can complicate prosecution of cases. The frequency of raids compromised by leaks from police sources remains a concern. Pirates, including those associated with transnational crime syndicates, have responded to intensified levels of enforcement with intimidation against rights holders' representatives and enforcement authorities. In 2003, the Ministry of Commerce took the lead in promoting interagency cooperation on IPR enforcement issues, concluding two Memorandums of Understanding between enforcement agencies (Thai police and the Thai Customs Department) and rights holders to better coordinate operations. While these agreements prompted improved retail enforcement leading up to and during the October 2003 APEC Leaders Meeting in Bangkok, retail piracy returned soon thereafter. Despite several attempts throughout 2004, including a new MOU signed between the same parties in June, 2004 the Thai government has yet successfully to sustain enforcement actions against retailers, distributors, and manufacturers of pirated and counterfeit goods. In June 2005, another MOU was concluded that provided for support by rights holders for rewards payments to enforcement officials.

The Thai Parliament passed legislation in the fall of 2003 to fully authorize the establishment of the Department of Special Investigations (DSI). In its work on IPR enforcement, DSI should focus on major infringing production, warehousing and trafficking operations, as well as those activities associated with organized crime. However, DSI is not yet adequately staffed to carry out these responsibilities. In December 2003, the Thai Cabinet approved, in principle, draft amendments to the Anti-Money Laundering Act, one of which makes IPR crimes a criminal offense. This amendment would allow police and other law enforcement officials to seize and investigate funds and suspected bank accounts. However, in July 2004, the Council of State, which reviews pending legislation, rejected the inclusion of IPR crimes as a criminal offense, citing concerns that IPR violations are "commercial disputes."

The Thai government established a specialized intellectual property court in 1997, which has improved judicial procedures and imposed tougher penalties. Criminal cases generally are disposed of within 6 months to 12 months from the time of a raid to the rendering of a conviction. However, Thai officials generally lack sufficient resources to undertake enforcement actions apart from those initiated by rights holders. Effective prosecutions can be labor-intensive for rights holders, who often investigate, participate in raids, and assist in the preparation of documentation for prosecution.

Patents

Amendments to Thailand's patent regime designed to meet TRIPS obligations entered into effect in September 1999. Thailand's patent office, however, lacks sufficient resources to keep up with the volume of applications, and patent examinations can take more than five years. The Department of Intellectual Property is seeking to contract out some aspects of patent search for novelty and preparation of applications to academic institutions in order to speed up the registration process. In 2005, Thailand began preparations to accede to the Paris Convention and the Patent Cooperation Treaty.

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Copyrights

Thailand's copyright law, intended to bring Thailand into conformity with international standards under TRIPS and the Berne Convention, became effective in March 1995. Despite efforts by Thai police at the retail, distribution, and production levels and by corporate end users, piracy remains a serious concern.

The copyright law is ambiguous regarding decompilation, and regulations for enforcement procedures leave loopholes that frustrate effective enforcement.

The Thai government is in the process of amending the Copyright Law in order to conform with two 1996 World Intellectual Property Organization (WIPO) treaties, the WIPO Copyright Treaty and the WIPO Performances and Phonograms Treaty. These treaties, commonly known as the WIPO Internet treaties, entered into force in 2002. The draft amendments to the Copyright Law have been approved by the Cabinet, but further changes are expected to result from the ongoing FTA negotiations.

Cable piracy continues to be a major problem throughout Thailand, as pirate providers expand their reach in the provinces. In December 2003, the Thai government initiated a new policy offering amnesty to operators who agree to cease infringing actions under threat of legal action. This policy is intended as a temporary measure pending the establishment of the National Broadcasting Commission and new regulations for cable operators. Since December 2003, the Thai government, however, has missed several deadlines to initiate enforcement operations.

U.S. copyright industries continue to express serious concerns over the rapid and unchecked growth of optical media piracy in Thailand. In October 2004, the Thai Parliament passed the Optical Disk Manufacturing Control bill, in the drafting stage since 1999. This legislation is designed to enhance the authority and capabilities of the Thai government to act against operators of illicit optical disk factories and to control the production materials and machines of legal producers. U.S. copyright industries are concerned that the optical disk legislation is deficient in several respects, including that penalties are not high enough to deter pirates and do not enhance the government's enforcement and oversight powers sufficiently. The legislation went into effect in August 2005.

Book publishers are concerned that the existing copyright law is being interpreted in a manner that is allowing extensive book piracy, especially in the form of illegal photocopying, to go unchecked. According to one industry group, annual losses are estimated to be approximately \$30 million.

Trademarks

The Thai government amended its trademark law in 1992, increasing penalties for infringement and extending protection to service, certification, and collective marks. The Thai government also streamlined trademark application procedures, addressing issues raised by the U.S. Government in the 1998 IPR action plan. Additional amendments designed to bring Thailand's trademark law into compliance with the TRIPS Agreement were enacted in June 2000, broadening the legal definition of a mark. While these developments have created a viable legal framework and have led to some improvements in enforcement, especially for clothing, accessories, and plush toys, trademark infringement remains a serious problem.

U.S. companies with an established presence in Thailand and a record of sustained cooperation with Thai law enforcement officials have had some success in defending trademarks, but the process remains time-consuming and costly. Penalties for proven trademark violations are insufficient to have a deterrent effect.

SERVICES BARRIERS

Telecommunications Services

Thailand made substantial progress toward reforming the regulatory regime for the telecommunications sector during 2005, but several controversial issues remain unresolved and significant obstacles to foreign investment in the sector remain in place. While Thailand is expected to fulfill its 1997 commitment under the WTO to liberalize basic telecommunications services by January 2006, new technologies such as mobile telephony and broadband internet services have transformed the telecommunications sector in the intervening period. At this stage, the net positive impact of liberalizing the market in fixed-line services, facsimile, telex, and telegraph services as promised will be marginal.

The seven-member National Telecommunications Commission (NTC), the independent regulator mandated by the 1997 constitution responsible for licensing, spectrum management, and supervision of telecommunications operators, began its operations on November 1, 2004. The Thai Senate chose the commissioners amid much controversy over political interference in their selection in August 2004, and the King of Thailand appointed the Commission on October 1, 2004. The NTC's secretariat was formed from the former Post and Telecommunications Department (PTD) on November 1, 2004. The creation of the NTC follows reorganization with respect to ministerial oversight of the telecommunications sector in 2002. While the new Ministry of Information and Communication Technology (MICT) is responsible for overall telecommunications policy, including such major initiatives as privatization of state-owned telecommunications firms, the initiative for liberalization of the sector clearly rests with the industry regulator, the NTC.

FOREIGN TRADE BARRIERS

In its first year, the NTC formulated the Telecom Master Plan for 2005-2007, published in the Royal Gazette on August 3, 2005. It has established licensing criteria for the three types of telecommunications licenses it may issue: Type I (without network), Type II (with or without network for specific groups or users), and Type III (with network for public telecommunication services). The NTC has also set criteria for allocation of telephone numbers, and has set temporary measures for radio and frequency allocation. It has also issued six type I and Type III telecommunication licenses to TOT Pcl (TOT) and CAT Telecom Pcl (CAT Telecom) on August 4, 2005. The licenses granted cover the existing telecommunications services operated by the two incumbent operators. (For regulation of internet service providers, see comment under electronic commerce.)

The NTC has also begun to move forward with the licensing process for satellite services. Hearings began in November 2005, and the NTC expects to issue licenses in 2006. The three types of licenses will be: Type I for Satellite Operators (the licensing principles for Type III telecommunications licenses will apply); Type II for Earth-station Operators (the licensing principles for Type II telecommunications licenses will apply); and Type III for Satellite Service Re-Sellers (the licensing principles for Type I telecommunication licenses will apply).

The NTC is planning to address other pending issues. It held hearings on third-generation (3G) mobile telephone services in November 2005, and it plans to set licensing criteria and issue the licenses during the first half of 2006. It is still not known whether there will be an auction for the licenses or the licenses will be administratively allocated. Because so many different existing networks are governed by different rules, the NTC must also determine the regime for payment of interconnection charges when issuing 3G licenses. By law, allocation of frequencies requires participation by both the NTC and a National Broadcast Commission, which is still not yet operational. It remains unclear how frequencies will be allocated and whether allocation will await the formation of the NBC.

The RTG has allowed foreign participation in the telecommunications sector since 1989, but state-owned enterprises, now corporatized at TOT and CAT Telecom, have continued to control large segments of the market, particularly in fixed-line and international long-distance services. With the growth of new markets such as mobile phone and satellite services in recent years, however, the role of private companies in this dynamic sector has grown accordingly. The market in mobile services, for example, is dominated by three private operators, whose shares are listed on the Stock Exchange of Thailand: Advanced Information Service (AIS), Total Access Communication (TAC) and TA Orange (a subsidiary of the True Corporation). All three operators have pursued linkages with foreign telecommunications firms. Singapore Telecom holds approximately a 20 percent stake in AIS, and in October 2005, Norway's Telenor AS bought out both TAC and its parent company UCOM. Some analysts have suggested that this buyout of UCOM and TAC, which is currently being reviewed by the NTC, was structured in a way intended to get around the spirit, if not the letter, of restrictions on foreign investment in Thailand's telecommunications sector.

FOREIGN TRADE BARRIERS

In November 2001, the RTG enacted a Telecommunications Business Law that lowered the permitted percentage of foreign ownership in telecommunications companies from 49 percent to 25 percent. The government of Prime Minister Thaksin Shinawatra publicly pledged to amend the law to return the foreign ownership limit to 49 percent, and in November 2005, such an amendment was finally approved. The amendment also abolishes the requirement that the executive board of a telecommunications company must be 75 percent Thai.

Thailand's telecommunications operators have historically operated as state-owned enterprises, and the legacy of state-ownership continues to affect the business environment in the sector.

The two outstanding issues are concession conversion and privatization. Beginning in the mid 1980s, the RTG introduced competition into the telecommunications sector to increase capacity so as to meet the booming economy's demand for telecommunication services. The state-owned telecommunications companies, now TOT and CAT Telecom, granted several concessions to private companies on a build-transfer-operate (BTO) contract basis. Under the BTO contracts, the private contracting party established telecommunications networks at their own expense. Upon completion of the concession period, all assets are to be transferred to the concession grantor. Revenue sharing payments for each concession have differed. A dual structure in the sector resulted, where the concessionaires both compete with TOT and CAT Telecom while at the same time abiding by their contracts and making revenue sharing payments to them. While early plans for reform of the sector called for concession conversion, the NTC decided not to interfere in the concessions but to begin issuing licenses to provide telecommunications services. Concessions are thus expected to expire gradually as the private operators migrate subscribers for mobile services from 2G to 3G services, which will bring their operations under the purview of the NTC and free them from the revenue sharing payments.

The RTG is also planning to partially privatize TOT (in May 2006) and CAT Telecom (still not scheduled). Regulatory uncertainty on such issues as interconnection charges complicates the task of determining their market value, however. Additionally, the loss of revenue from the unwinding of the concessions raises the question of whether investors will find their shares to be attractive investments.

Postal and Express Delivery Services

The Thailand Post Company, Ltd., is a state enterprise that has been corporatized. The Postal Committee is the regulator of postal services in Thailand. The provisions of the Postal Act B.E. 2477 (1934) cover basic postal (letters and postcards) and personal information. Any enterprise providing express delivery services not related to personal information as provided by the Act (such as parcel post) fall outside the purview of the Postal Committee. As a result of the postal services monopoly, other express delivery service providers are currently assessed a charge of Bht. 37 per piece, approximately \$1 U.S. dollar, consisting of both postage and the fine for violating the postal service

FOREIGN TRADE BARRIERS

monopoly. The Telecommunications Ministry is working to solve the problem of monopoly rights by drafting a bill to eliminate the monopoly. The bill envisions dividing postal services into universal service and specific services. It is unclear, however, whether express delivery service providers will wish to be included in the scope of the law as postal service providers because of the accompanying licensing obligations.

Legal Services

Current Thai law prohibits foreign equity participation in Thai law firms in excess of 49 percent, and foreign nationals are prohibited from practicing law in Thailand. However, under the U.S.-Thailand Treaty of Amity and Economic Relations (AER Treaty), U.S. investments are exempted from the general restriction on foreign equity participation in law firms. U.S. investors may own law firms in Thailand; however, U.S. citizens and other foreign nationals (with the exception of "grandfathered" non-citizens) may not provide legal services. In certain circumstances, foreign attorneys may act in a consultative capacity.

Financial Services

After the 1997-98 financial crisis, the Thai government liberalized foreign firms' access to the financial sector. Significant restrictions remain on foreign participation in the sector, however. While foreigners have been allowed to engage in brokerage services since 1997, for example, foreign firms are allowed to own shares greater than 49 percent of Thai securities firms only on a case-by-case basis.

Foreigners are permitted to hold a maximum of 25 percent of the equity in Thai banks. Within the "Financial Sector Master Plan" drafted by the Bank of Thailand and approved by parliament, this percentage may be increased to 49 percent at such time as the Central Bank deems appropriate. The Master Plan requires all Thai deposit-taking institutions to become either a retail or commercial bank with differing minimum capital requirements. The Bank of Thailand has indicated that no new banking licenses will be issued until "economic conditions" permit greater competition in the Thai banking market.

Foreign banks currently operating in Thailand are disadvantaged in their ability to compete. Most notably, they are limited to one branch, and are not permitted to operate off-site ATM machines, which are considered as branches. Foreign banks must maintain minimum capital funds of 125 million baht (\$3.1 million) invested in government or state-enterprise securities or deposited directly with the Bank of Thailand. Expatriate management personnel are limited to six professionals in full branches and to two professionals in Bangkok International Banking Facility operations, although exceptions are often granted.

Charged with helping to restructure the financial sectors' non-performing loans, the government-owned Thai Asset Management Corporation (TAMC) gives priority to Thai nationals when contracting for management, technical, and advisory services. Foreigners may be hired, however, in the absence of qualified Thai nationals.

FOREIGN TRADE BARRIERS

Construction, Architecture, and Engineering

Foreigners are prohibited from working as engineers or architects, but in practice, they can work as consultants in these fields. Construction firms must also be registered in Thailand (i.e., establish a commercial presence). Under the U.S.-Thailand AER Treaty, American firms may establish companies in Thailand that provide construction, architectural, and engineering services. The Thai government regulates the billing rates of foreign construction, architectural, and engineering firms. Current practice places a ceiling on billing for these services by foreign firms.

Accounting Services

Foreigners cannot be licensed as Certified Public Accountants and therefore cannot provide accounting services in Thailand. Foreign accountants may only serve as business consultants.

Transport Services, including Express Delivery Services

The passage of the Multimodal Transport Act of July 2005 has resulted in a new barrier to trade in the transport services sector. While the full impact of the law remains unclear, it introduces uncertainty into the treatment of operations of foreign shipping companies. The law was scheduled to become effective in October 2005, but the implementing regulations drafted by the Ministry of Transport are not yet finalized. While the text of the law itself appears to require foreign shipping companies performing multimodal services in Thailand to either incorporate in Thailand or appoint a Thai agent (as opposed to operating out of their branch offices in Thailand as they have previously). In view of the severe penalties for non-compliance (including a retroactive fine of Baht 50,000 per contract), international shipping firms have pre-emptively sought to avoid exposure by either incorporating in Thailand or appointing an agent, and passing the attendant costs on to consumers. The current draft ministerial regulations implementing the law provide that the law shall not apply to foreign shipping companies transporting goods under bills of lading governed by international convention. The United States believes this implementing regulation, if adopted, would resolve the restrictions on the branch office created by the new law.

The 49 percent limit on foreign ownership in land transport (trucking) hampers investment in the growth of express delivery services. Express delivery firms prefer to have the option of controlling items throughout the supply of the service, including both air and ground-based operations in order to speed the movement of goods. (See also comment under postal and express delivery services.)

In 2005, there has been considerable progress toward liberalization of air transport services. Building on the bilateral Open Skies Agreement of 2003 between the Kingdom of Thailand and the United States, which covered cargo services, the two countries signed a comprehensive Open Skies Agreement in September 2005 that includes passenger air

travel. The agreement provides for a phase-in period until 2010 with respect to full passenger pricing liberalization and full fifth freedom passenger traffic rights.

Healthcare Services

Thai government policy is highly restrictive in the healthcare services sector (e.g., hospital, dental, physician services), particularly regarding the lack of transparency relating to hospitals and the possibility of foreign ownership, administration, and equity shares in treatment facilities.

Advertising

Thai law prohibits advertising on pay television. Television is the most popular media for advertising. There are no regulations on foreign participation in advertising.

INVESTMENT BARRIERS

The Alien Business Act lays out the overall framework governing foreign investment and employment in Thailand. Although the Act prohibits foreign investment in most sectors, Thailand makes an exception for U.S. investors pursuant to the AER Treaty. Under the AER Treaty, Thailand may discriminate against U.S. investors only in the following sectors: communications, transportation, fiduciary functions, banking involving depository functions, the exploitation of land or other natural resources, and domestic trade in indigenous agricultural products. Moreover, Thailand's obligation to accord national treatment to U.S. investors in all other sectors does not extend to "the practice of professions, or callings reserved for [Thai] nationals."

The Alien Business Act's prohibitions on foreign investment generally do not affect projects established by Board of Investment promotion privileges or export businesses authorized under the Industrial Estate Authority of Thailand law.

Trade-Related Investment Measures

In 1995, pursuant to the WTO Agreement on Trade-Related Investment Measures (TRIMS), Thailand notified the WTO that it would maintain local-content requirements to promote investment in a variety of sectors, including milk and dairy processing, and the motor vehicle assembly and parts industries. Thailand eliminated the measures in the automotive sector by the January 1, 2000 deadline established by the TRIMS Agreement. In 2001, along with several other developing countries, Thailand received an extension for its milk and dairy processing measures. It eliminated those measures at the end of 2003.

ELECTRONIC COMMERCE

While the Royal Thai Government (RTG) has placed a high priority on the development of electronic commerce and approved an electronic commerce framework in October 2000, it has only partially enacted the laws and implemented the regulations envisioned. Internet penetration among the population age 6 years and up has increased markedly in recent years, reaching 10.4 percent nationwide and 26.9 percent in Bangkok in 2003, according to the National Statistics Office. Rates of household ownership of a computer have likewise been rising, reaching 9.6 percent nationwide and 29.4 percent in Bangkok in 2003, and 13.7 percent nationwide and 33.1 percent in Bangkok in 2005. An undeveloped legal framework nevertheless continues to constrain the development of electronic commerce.

An Electronic Transactions Act entered into force in April 2002, but it is awaiting the Cabinet's issuance and approval of a royal decree to implement the law. In 2002, RTG plans called for enacting four additional bills into law: a cyber-crime bill, a national information infrastructure bill to facilitate universal service, a data protection bill, and an electronic funds transfer bill. The cyber-crime bill was approved by the Cabinet in September 2003. Subsequent review took two years. In November 2005, the bill was sent back to the Cabinet for submission to the House of Representatives. It is currently with the screening committee of the House of Representatives and is scheduled for the first reading during the current parliamentary session. The national information infrastructure bill remains under review at MICT, awaiting the outcome of a restructuring of the ministerial offices to oversee implementation of the law. In view of the broad interest in data protection across many sectors of the economy, the Prime Minister's Office has taken charge of drafting data protection legislation. Similarly, the electronic funds transfer bill has been superceded by the MICT's effort to draft an electronic payments bill, which it has completed. The MICT is currently scheduling hearings on the bill. It is not yet known when any of the above bills will be enacted into law.

Since the newly established National Telecommunications Commission (NTC) began its work in November 2004, a clearer regulatory framework for the operation of Internet Service Providers (ISPs) has emerged. The NTC has established licensing criteria, license fees, and interconnection charges for ISPs. The NTC issued the first Type I telecommunications license (for an operator without its own network) to KSC Commercial Internet Public Company Limited in June 2005.

Responsibility for policy with respect to electronic commerce rests with the MICT. Oversight of the industry, however, remains divided among the MICT and other agencies including the National Electronics and Computer Technology Center, under the Ministry of Science and Technology.

FOREIGN TRADE BARRIERS

OTHER BARRIERS

Several government firms are protected from foreign competition in Thailand. In the pharmaceutical sector, the Government Pharmaceutical Organization is not subject to requirements faced by the private sector on registration. In addition, it can produce and market generic formulations of drugs marketed in foreign countries irrespective of safety monitoring program protection. Thai government requirements limiting government hospitals' procurement and dispensing of drugs not on the national list of essential drugs (NLED) significantly constrain the availability of many imported products.

The Thai government retains authority to set price ceilings for 20 goods and services, including medicines, sound recordings, milk, sugar, fuel oil, and chemical fertilizer. Price control review mechanisms are non-transparent. Price control determinations are sometimes based on outdated assumptions, including exchange rates, and go for long periods without review, even upon repeated petition for review by affected parties. Only sugar currently is subject to a retail price ceiling.

In practice, the Thai government also uses its control of major suppliers of products and services under state monopoly, such as the petroleum, aviation, and telecommunication sectors, to influence prices in the local market.

Thailand has not signed the UN Convention against Corruption, which entered into force on December 14, 2005. Nevertheless, the Thai government has made some efforts to counter official corruption. The Thai Constitution of 1997 contains provisions to address corruption, including enhancement of the status and powers of the Office of the Counter Corruption Commission (OCCC), which is independent from other branches of government. Persons holding high political office and members of their immediate families are required to disclose their assets and liabilities before assuming and upon leaving office. Moreover, a new law regulating the bidding process for government contracts both clarifies actionable anti-corruption offenses and increases penalties for violations. Nonetheless, anti-corruption mechanisms continue to be employed unevenly; there are relatively few prosecutions of government officials for corruption offenses. The lack of transparency in administrative procedures also contributes to perceptions of corruption in Thailand. Prescribed comment periods for new legislation and regulations are sometimes not honored, and implementing regulations can be unclear, causing uncertainty among companies about the interpretation of the provisions.

FOREIGN TRADE BARRIERS

TURKEY

TRADE SUMMARY

The U.S. goods trade deficit with Turkey was \$903 million in 2005, a decrease of \$669 million from \$1.6 billion in 2004. U.S. goods exports in 2005 were \$4.3 billion, up 27.1 percent from the previous year. Corresponding U.S. imports from Turkey were \$5.2 billion, up 4.9 percent. Turkey is currently the 31st largest export market for U.S. goods.

The stock of U.S. foreign direct investment (FDI) in Turkey in 2004 was \$2.2 billion, up from \$2.0 billion in 2003. U.S. FDI in Turkey is concentrated largely in the banking, wholesale, and manufacturing sectors.

IMPORT POLICIES

Tariffs and Quantitative Restrictions

Turkey applies the EU's common external customs tariff to third-country (including the United States) non-agricultural imports and imposes no duty on non-agricultural items from EU and European Free Trade Association (EFTA) countries.

Turkey maintains high tariff rates (25 percent average Most-Favored-Nation rate) on many food and agricultural product imports. The Turkish government often increases tariffs on grains during the domestic harvest. High feed prices harm Turkish livestock industries, particularly for beef and poultry. Duties on fresh fruits range from 61 percent to 149 percent. Processed fruit, fruit juice, and vegetable tariffs range between 41 percent and 138 percent. The Turkish government also levies high duties, excise taxes, and other domestic charges on imported alcoholic beverages that increase wholesale prices by more than 200 percent.

Import Licenses and Other Restrictions

Import licenses are required for products that need after-sales service (e.g., photocopiers, advanced data processing equipment, and diesel generators), distilled spirits, and agricultural products. Lack of transparency in Turkey's import licensing system can result in costly delays, demurrage charges, and other uncertainties that stifle trade for many agricultural products and for distilled spirits. Starting in 2000, the Ministry of Agriculture and Rural Affairs (MARA), Office of Protection and Control, stopped issuing import licenses for rice and corn prior to and during the harvest season. Since 2003, however, MARA has stopped issuing import licenses for rice during the entire year, not just during the domestic harvest. The only method of importation is through a restrictive tariff-rate quota (TRQ) scheme that Turkey institutes each year after the Turkish rice harvest ends and suspends just before the next year's harvest begins.

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Under the TRQs, in order to receive the preferential in-quota tariff rates, importers must purchase substantial quantities of Turkish rice from the Turkish Grain Board and/or Turkish producers and producer associations. As previously mentioned, Turkey ensures that there are no over-quota imports (to which the domestic purchase requirement does not apply) by failing to issue any import licenses. Turkey's failure to grant import licenses at the over-quota rate and its establishment of an onerous domestic purchase requirement governing imports under the TRQ scheme appear to be inconsistent with Turkey's WTO obligations. Thus, the United States requested WTO dispute settlement consultations with Turkey in November 2005.

In some cases, notably for meat and poultry, the Turkish government simply does not issue any licenses, thereby creating a *de facto* ban on imports of these products. Turkey has not allowed livestock for slaughter or meat imports from any foreign country since 1996 and has not established any public health requirements for the entry of meat. Outbreaks of Bovine Spongiform Encephalopathy (BSE) and foot and mouth disease (FMD) in Europe strengthened Turkey's resolve to keep livestock and meat products out of their market. The United States is currently not able to export breeding livestock to Turkey since the EU placed the United States in the third BSE risk category. Turkey's BSE Committee has decided not to import any breeding cattle from category 3 countries (based on the EU system). The United States is also unable to export poultry meat for consumption within Turkey because the Government of Turkey requires its officials to inspect and approve all foreign processing facilities and expects inspection costs to be covered by Turkish importers.

Due to the EU accession process, Turkey is in the process of rewriting its agriculture import regulations in order to harmonize them with the EU. Some new regulations, however, do not appear to be consistent with EU regulations.

Despite liberalization of the spirits and tobacco markets, including a completed privatization of the alcohol operations of the state-owned monopoly and a privatization of the monopoly's tobacco operations, as well as privatization of imports of wine and alcoholic beverages, increases in consumption have been inhibited by inordinately high tariffs (85 percent - 100 percent) and consumption taxes (275 percent), along with the value-added-tax (VAT).

STANDARDS, TESTING, LABELING AND CERTIFICATION

The Turkish government has a poor track record of notifying WTO members of proposed technical regulations and phytosanitary requirements and implementation can appear to be arbitrary. Importers report increasing difficulty in obtaining information on sanitary and phytosanitary certifications. The Turkish government often requires laboratory testing on items not normally subject to testing by trading partners, allegedly without any scientific basis. Although these practices do not stop imports, they can make the process more cumbersome. U.S. imports could increase by an estimated \$10 million to \$25 million if these procedures were regularized.

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U.S. products with the EU certificate of conformity (CE mark), particularly medical devices, are often detained by Turkish customs authorities for inspection. In some cases, U.S. products apparently have been subject to additional tests, despite their CE marks, while EU CE-marked products gain immediate entry to the Turkish market. For importation of distilled spirits, Customs requires that between 2 and 4 bottles per consignment be submitted for unspecified analysis, raising the cost of importing.

GOVERNMENT PROCUREMENT

Turkey is not a signatory of the WTO Government Procurement Agreement. It is, however, an observer to the Committee on Government Procurement. Although Turkey's laws require competitive bidding procedures for tenders, U.S. companies sometimes become frustrated over lengthy and often complicated bidding and negotiating processes.

Turkey's public tender law established an independent board to oversee public tenders. There is a minimum bidding threshold at which foreign companies can participate in state tenders. However, the law provides a price preference of up to 15 percent for domestic bidders that is not available if they form a joint venture with foreign bidders. Turkey did expand the definition of domestic bidder to include corporate entities established under Turkish law, including those established by foreign companies.

Military procurement generally includes an offset requirement in the tender specifications. The offset guidelines were recently modified to encourage foreign direct investment and technology transfer.

EXPORT SUBSIDIES

Turkey employs a number of incentives to promote exports, although programs have been scaled back in recent years to comply with EU directives and WTO commitments. Historically, wheat and sugar have been Turkey's main subsidized commodities. Export subsidies, ranging from 10 percent to 20 percent of export values, are granted to 16 agricultural or processed agricultural products. In 2004, the Turkish Grain Board (TMO) sold domestic wheat at world prices (well below domestic prices) to Turkish flour and pasta manufacturers based upon their exports of flour and pasta. The Turkish Export-Import Bank provides exporters with credits, guarantees, and insurance programs. Certain tax credits also are available to exporters.

INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

Turkey's intellectual property rights regime has improved in recent years, but still contains serious problems. Turkey remained on the Special 301 "Priority Watch List" in 2005 due to concerns about the lack of protection for confidential test data submitted by pharmaceutical companies against unfair commercial use and continued high levels of piracy and counterfeiting of copyright and trademark materials.

FOREIGN TRADE BARRIERS

Turkey is a signatory to a number of international conventions, including the Stockholm Act of the Paris Convention, the Patent Cooperation Treaty, and the Strasbourg Agreement.

Turkey's copyright law provides deterrent penalties for infringement. However it does not prohibit circumvention of technical protection measures, a key feature of the World Intellectual Property Organization (WIPO) "Internet" treaties. Generally, Turkish courts have not imposed deterrent penalties to pirates as provided in the copyright law but have instead applied the Turkish Cinema Law, which has much lower penalties. More recently, however, Turkish courts have issued increasingly deterrent sentences for copyright infringers, but significant backlogs in the courts slow redress. Recently enacted legislation contains several strong anti-piracy provisions, including a ban on street sales of all copyright products and authorization for law enforcement authorities to take action without a complaint by the rights holder. However, the law also reduces potential prison sentences for piracy convictions.

In accordance with the 1995 patent law and Turkey's agreement with the EU, patent protection for pharmaceuticals began on January 1, 1999. Turkey has been accepting patent applications since 1996 in compliance with the TRIPS agreement "mailbox" provisions. The patent law does not, however, contain interim protection for pharmaceuticals in the research and development "pipeline".

Turkey's recently amended Patent Law provides for penalties for infringement of up to three years in prison, or approximately \$32,000 in fines, or both, and closure of the business for up to one year. However, research-based companies in the pharmaceuticals sector are concerned about provisions that delay the initiation of infringement suits until after the patent is approved and published, permit use of a patented invention to generate data needed for the marketing approval of generic pharmaceutical products, and give judges wider discretion over penalties in infringement cases. There is concern that amendments proposed this year to the patent law could lead to weaker enforcement and penalties and dilute basic intellectual and industrial property protections. Turkey does not currently have a system for patent linkage, which could create confusion and possibly allow generic pharmaceutical manufacturers to register a patent-infringing copy of a brand name drug.

The Ministry of Health introduced limited protection for undisclosed test data against unfair commercial use in a regulation issued in January 2005 and revised in June 2005. However, several of the regulation's provisions severely undermine protection for confidential test data. Data protection is limited to original products licensed in a European Customs Union country after January 1, 2001, for which no generic manufacturers had applied for licenses in Turkey as of January 1, 2005. The term of exclusivity is limited to the duration of the drug patent or to six years after the date of licensing in a European Customs Union country, implying a shorter term of protection because of the length of the marketing approval process in Turkey. Research-based companies estimate that due to the prolonged regulatory review, on average the period of data protection is diminished by 20 percent to 25 percent. Trademark holders also

FOREIGN TRADE BARRIERS

contend that there is widespread and often sophisticated counterfeiting of their marks in Turkey especially in apparel, film, cosmetics, detergent, and other products.

SERVICES BARRIERS

Telecommunications Services

In the WTO negotiations on Basic Telecommunications Services, Turkey made commitments to provide market access and national treatment for all services by the end of 2005. In the interim, Turkey committed to provide national treatment for mobile, paging, and private data networks. In the current WTO services negotiations, Turkey has offered to adopt the full WTO Reference Paper on regulatory principles

In November 2005, 55 percent of the government-owned Turk Telecom was sold to a Saudi-Lebanese company (Oger Telekom). Turk Telecom currently provides all voice telephony, most value-added, and other basic telecommunications services. While still new and inexperienced, the Telecommunications Authority (TK) is working to enforce its rulings on interconnection between Turk Telecom's network and the competitive internet service providers and long-distance operators. The TK is targeting the phased opening of wireless communications and some value-added services. U.S. firms complain about a lack of transparency in the licensing process and about the revenue sharing requirement with Turk Telecom.

Other Services Barriers

There are restrictions on establishment in financial services, the petroleum sector, broadcasting, and maritime transportation (see Investment Barriers section). While recent legislation significantly broadened the range of occupations in which foreigners can be employed, restrictions remain for doctors, attorneys, and several other professions.

INVESTMENT BARRIERS

The United States-Turkey Bilateral Investment Treaty (BIT) entered into force in May 1990. Turkey has a liberal investment regime, but private investment has often been hindered by excessive bureaucracy, political and macroeconomic uncertainty, and weaknesses in the judicial system, high tax rates, a weak framework for corporate governance, and frequent changes in the legal and regulatory environment. The current government has been trying to promote foreign investment and foreign direct investment increased in 2005. Almost all areas open to investment by the Turkish private sector are fully open to foreign participation without screening or price approval, although establishment in the financial and petroleum sectors requires special permission. Foreign equity ownership is limited to 25 percent in broadcasting and 49 percent in maritime transportation. Parliament is considering draft legislation easing restrictions on foreign ownership in the media. Once investors have committed to the Turkish market, they have sometimes found their investments undermined by arbitrary legislative action, such as the imposition of production limits.

FOREIGN TRADE BARRIERS

The Turkish government accepts binding international arbitration of investment disputes between foreign investors and the state. A recent law expanded the scope of international arbitration in contracts with the Turkish government. Investors continue to have concerns about the government's recognition and enforcement of arbitral awards against public entities, and at least one American company reports that the judicial system in Turkey has not recognized foreign arbitral awards. Turkey is a party to both the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards and to the ICSID Convention.

Turkish legislation aims to introduce a liberalized energy market, in which private firms will be able to develop projects with the approval of the Energy Market Regulatory Authority, an independent regulatory body. The state electricity utility has been unbundled into production, transmission, distribution, and trading companies, but little progress has been made in privatizing power generation and distribution. The privatization of electricity distribution is planned, but still awaits new legislation. Targeted liberalization of the natural gas sector has also faced delays. The state pipeline company, BOTAS, will remain dominant, but legislation requires a phased transfer of 80 percent of its gas purchase contracts.

As the result of a 1997 court decision, the Turkish government has blocked full repatriation of profits by oil companies under Article 116 of the 1954 Petroleum Law, which protected foreign investors from the impact of lira depreciation. Affected companies have challenged the 1997 decision. Almost all such lawsuits have been finalized against the claimant companies. A new petroleum law that seeks to provide greater investment incentives and protections still awaits passage in the parliament.

OTHER BARRIERS

Corruption

Turkey has ratified the OECD antibribery convention and passed implementing legislation providing that bribes of foreign officials, as well as domestic officials, are illegal and not tax deductible. Corruption is perceived to be a major problem in Turkey by private enterprises and the public at large, particularly by government officials and politicians. The judicial system is also perceived to be susceptible to external influence and to be biased against outsiders to some degree.

Energy

In 2001, the Turkish government cancelled 46 contracted power projects based on the build-operate-transfer (BOT) and transfer-of-operating-rights models. Turkey's constitutional court ruled in 2002 that the government would have to either honor the contracts or compensate the companies involved. One of those companies has launched an international arbitration case. In 2002, the government requested BOT projects

FOREIGN TRADE BARRIERS

already in operation, which include U.S.-owned companies and/or creditors, to apply for new licenses from the new Energy Market Regulatory Authority (EMRA).

Negotiations between the Turkish government and the relevant companies concerning the request of the Turkish government to reduce the electricity sale tariffs are continuing while the license application process is still underway. Despite lack of action on new licenses, the Turkish government has continued to purchase electricity produced under the existing contracts.

Taxes

Punitive taxation of cola drinks (raised in 2002 to 47.5 percent under Turkey's "Special Consumption Tax") discourages investment by major U.S. cola producers. Turkey assesses a special consumption tax of 27 percent to 50 percent on all motor vehicles based on engine size. This tax has a disproportionate effect on U.S. automobiles.

Corporate Governance

Weaknesses in the protection of minority shareholder rights and regulatory oversight have left some American companies at a disadvantage in disputes with Turkish partners.

Pharmaceuticals

Besides their intellectual property concerns detailed above, the pharmaceutical industry's sales have been hurt by government price controls. Research-based industry is also concerned about achieving transparent and equitable treatment in upcoming reforms of the government's health care and pension system.

UKRAINE

TRADE SUMMARY

The U.S. goods trade deficit with Ukraine was \$571 million in 2005, an increase of \$171 million from \$400 million in 2004. U.S. goods exports in 2005 were \$532 million, up 33.1 percent from the previous year. Corresponding U.S. imports from Ukraine were \$1.1 billion, up 37.9 percent. Ukraine is currently the 78th largest export market for U.S. goods.

The stock of U.S. foreign direct investment (FDI) in Ukraine in 2004 was \$256 million, up from \$238 million in 2003.

WTO Accession

Ukraine is in the process of negotiating terms of accession to the World Trade Organization (WTO). Negotiations with Working Party Members are active and ongoing. On March 6, 2006, the United States and Ukraine signed a WTO bilateral market access agreement. Other countries with which Ukraine must still conclude a bilateral agreement include: Australia, Colombia, Chinese Taipei, and Kyrgyzstan.

Significant progress towards Ukraine's accession to the WTO was made in 2005. In particular, the passage of key legislation in areas such as intellectual property rights, services, and sanitary and phytosanitary measures helped to bring Ukraine's legislative framework into conformity with WTO requirements and will serve as an important framework going forward for resolving bilateral trade concerns.

IMPORT POLICIES

Ukraine continues to maintain fees and licensing requirements on imports. Ukraine imposes four levies on imported goods: customs tariffs, import duty/fees, value-added-tax (VAT), and excise taxes on alcohol, tobacco, automobiles, and oil products. The current customs tariff schedule comprises approximately 11,000 tariff lines. Most customs tariffs are levied at *ad valorem* rates, but 1,765 tariff line items are subject to specific and combined rates of duty. These specific and combined rates apply to approximately one-third of tariff-lines for agricultural goods, primarily those that are produced in Ukraine. These protected goods include grains, poultry products, sugar, and vegetables such as carrots and potatoes. Between March and July 2005, the Parliament passed three packages of amendments to the Customs Code of Ukraine to decrease tariff rates in an effort to meet WTO accession requirements. The average applied tariff rate for all goods is now 6.5 percent. For agricultural goods, the average applied rate is 13.8 percent (down from 19.7 percent) and for industrial goods the average applied rate is 4.4 percent (down from 8.3 percent). The VAT, currently 20 percent, is levied on top of customs tariffs and excise taxes (when applicable) and can also hinder U.S. exports to Ukraine. Import tariffs were particularly high with respect to petroleum products; they

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were reduced, however, to zero during a summer 2005 energy crisis and have not been increased again despite a number of proposals in Parliament. Excise taxes on both imported and domestically produced petroleum products remain high, although there have been a number of proposals to reduce these rates.

Most discriminatory excise taxes were eliminated in 2005. However, discriminatory excise taxes still hinder U.S. exports of wine and grape spirits to Ukraine. According to Ukrainian legislation, the excise tax rate on imported wine and grape spirits is 12 and 13 times higher, respectively, than domestically-produced products and will remain at that level until Ukraine accedes to the WTO. Excise tax rates in most cases are fixed and are assessed in hryvnas or Euros. VAT and excise tax exemptions for locally produced vehicles were eliminated on March 29, 2005. Excise taxes on automobiles remain high, ranging from 0.2 EUR/cc to 3 EUR/cc. Also, the excise tax is based on the cubic capacity of the engine, so it disproportionately affects automobiles with larger engines. The import tariff on fully assembled automobiles was raised from 15 percent to 25 percent during 2005 to compensate local producers for the loss of these VAT and excise privileges. This increase has negatively impacted importers of fully assembled automobiles, who are also disadvantaged since the tariff on semi-knocked down (SKD) vehicles is lower.

Import licenses are required for some goods, primarily pesticides, alcohol products, optical media production inputs, some industrial chemical products and equipment containing them, official foreign postage stamps, excise marks, officially stamped/headed paper, checks and securities, and some goods that contain sensitive encryption technologies. Removing unnecessary licensing barriers to trade in mass-market, commercially-traded goods containing encryption is an issue under discussion in Ukraine's WTO accession negotiations. Because product certification is a prerequisite for an import license, those seeking such licenses have two options depending on the value and the frequency of shipments as compared with the cost of certification. The first option entails certification of compliance of a foreign facility to the existing regulations on quality and safety. The U.S. distilled spirits industry reports that this option usually involves a burdensome visit and costly inspection by Ukrainian government officials. The supplier receives a certificate of conformity valid for two to three years, which avoids certification of each shipment. The second option involves certification of each product shipment with mandatory laboratory tests upon arrival in Ukraine.

In terms of customs-related issues affecting trade, imports of U.S. salmon roe (red caviar HS Code 0303 or 0305) were delayed when, early in 2005, the Ukrainian State Customs Service reclassified the products as fish roe substitute (HS Code 1604), which would require payment of a higher customs tariff. Customs requires court decisions to clear the products under the correct category, causing delays and leading to diminished U.S. exports of this highly perishable product.

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STANDARDS, TESTING, LABELING AND CERTIFICATION

Foreign investors regard Ukraine's product certification system as a serious obstacle to trade, investment, and ongoing business. U.S. businesses have complained that the standards and certification requirements affecting the consumer goods industry: (1) lack clarity; (2) include registration requirements that are not feasible for mass trade; (3) lack procedural flexibility; (4) impose overly complex and expensive certification requirements; (5) are unevenly enforced; and (6) involve high certification and licensing fees. The process for developing standards has been streamlined over the past few years, however, it remains complex and is subject to frequent changes. At present, Ukrainian authorities do not recognize foreign certificates of conformity with Ukrainian product standards unless recognition is mandated through an international treaty signed by Ukraine. A draft law to harmonize Ukrainian law with the WTO Agreement on Technical Barriers to Trade passed its first reading in Parliament in October 2005.

The standardization and certification body in Ukraine is the State Committee for Technical Regulation and Consumer Policy (DerzhSpozhyvStandard), the former "DerzhStandard." As of November 2005, DerzhSpozhyvStandard had a network of 109 accredited product certifying bodies including 51 accredited certifying bodies for quality management systems, as well as about 780 testing laboratories throughout Ukraine. Appropriate resources, such as modern analytical equipment and reactants, are not available in most laboratories. DerzhSpozhyvStandard's system includes 27 territorial departments for consumer protection and 28 state centers for standardization, systematizing weights and measures, and certification.

Numerous certification bodies in Ukraine effectively operate as independent (often monopolistic) entities on a profit-making basis, returning just 20 percent of their fees to the state. Consequently, certification agencies do much of their regulatory work with little or no coordination. Many products require multiple certificates from different agencies, with local, regional and municipal authorities often requesting additional documentation beyond that required by central bodies. According to industry sources, access to the Ukrainian market is impeded by numerous burdensome certification and licensing procedures for equipment. Pharmaceutical and other companies report that they have been required to pay exorbitant additional fees (up to \$20,000) to purchase equipment needed to test ingredients that have been used safely for many years.

Sanitary and Phytosanitary (SPS) Measures

Ukraine applies a range of sanitary and phytosanitary (SPS) measures which restrict imports of a number of U.S. agricultural products. Ukrainian barriers to U.S. agricultural goods are estimated to cost U.S. producers between \$60 million and \$100 million annually. The certification and approval process is lengthy, duplicative, and expensive. Amendments to several laws, including the law "On Quality and Safety of Food Products and Food Raw Materials," intended to bring Ukrainian legislation into compliance with requirements of the WTO Agreement on the Application of Sanitary and Phytosanitary Measures (SPS Measures), passed in September and November 2005. Further, legislation

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to bring Ukrainian law into compliance with international norms regarding veterinary medicine, standards, conformity assessment procedures and other sanitary and phytosanitary measures remain at various stages of consideration by Ukraine's Parliament.

The following issues are subjects of discussion between the United States and Ukraine as part of Ukraine's accession to the World Trade Organization:

- (1) A two-year ban on U.S. poultry products was lifted in 2003 following the negotiation of a new veterinary certificate. Although not an SPS barrier, high import tariffs and the elimination of Free Economic Zones (FEZs) on March 29, 2005 hampered trade in poultry in 2005. On October 20, 2005, Ukraine's parliament narrowly passed a six-month ban on imports of poultry and poultry products into Ukraine following the discovery of avian influenza in neighboring Russia and Romania. President Yushchenko vetoed this bill, and another similar bill, in November and December 2005;
- (2) In the past, Ukraine has blocked the importation of meat and meat products treated with growth promoting hormones. The United States is working with Ukraine to ensure that any measures that Ukraine undertakes are consistent with World Organization for Animal Health (OIE) standards. Ukraine's pending Law of Veterinary Medicine, which is part of the WTO legislative package under consideration, addresses this issue;
- (3) U.S pork exports to Ukraine have been hampered by regulations concerning trichinae. The United States is working with Ukraine so that it takes the necessary steps to align Ukrainian standards for trichinae in pork exports with international norms;
- (4) Ukraine's biotechnology approval process has been essentially defunct for some time, creating an unofficial ban on biotechnology products. This has resulted in lost sales of corn products, soybeans, and meal. The United States is working with Ukraine to establish procedures regarding biotechnology that are based on modern, science-based risk assessment principles and guidelines, including those of the WTO SPS and Technical Barriers to Trade (TBT) Agreements, the Codex Alimentarius Commission, and the International Plant Protection Convention; and
- (5) Beginning in October 2003, the State Department of Veterinary Medicine began detaining large consignments of U.S. salmon, sardines, and roe-citing technical reasons ranging from newly enforced shelf-life regulations to minor certificate errors. In February 2004, a ban on imports of seafood with a shelf-life longer than 4 months was announced. For about a year, seafood shipments from the United States worth a total of \$2 million were detained for an average of 2 months until eventually being released. No incidents have been reported since October 2004 and in WTO discussions Ukraine has agreed to eliminate this standard.

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GOVERNMENT PROCUREMENT

Government procurement is conducted under Ukraine's law "On Procurement of Goods, Works and Services Using State Funds," which came into force on February 22, 2000. Under this law, all government procurement of goods and services valued above €40,000 must be conducted via tenders (either open or open with pre-qualification). Open international tenders must be conducted when procurement is financed by any entity outside of Ukraine. The Ministry of the Economy and European Integration publishes information on government procurement in the "State Procurement Bulletin" Among the problems still faced by foreign firms (particularly for smaller procurements) are: (1) the absence of public notice of tender rules; (2) the failure to state tender requirements; (3) covert preferences in tender awards; (4) awards made subject to conditions that were not part of the original tender; and (5) the lack of an effective avenue for firms to air grievances over contract awards or an effective means to resolve disputes. Amendments to the law "On Procurement" introduced in November 2004 and June 2005, attempted to target the problems but raised more concerns. Special requirements for internet sites to publish tender requirements limited competition. The amendments also entrusted the non-government organization (NGO) "Tender Chamber of Ukraine" with the authority to consider claims of tender participants and issue conclusions regarding procurement from a single supplier, leading to discrimination against other NGOs. In order to repair the situation, the Ministry of Economy drafted legislative amendments that are awaiting government and parliamentary approval. Ukraine is not a signatory to the WTO Agreement on Government Procurement. U.S. pharmaceutical companies reported losing government tenders even when they had provided the most competitive offer.

EXPORT SUBSIDIES

Ukraine's use of industrial policies aimed at import substitution and export promotion is decreasing. The March 2005 budget law either eliminated or initiated the phase-out of tax and customs privileges to favored sectors such as automobiles, shipbuilding, and aerospace as well as on specific companies such as Kyivmiskbud Holding.

The Ukrainian legislation "On State Support of Agriculture" allows the executive branch to establish high minimum prices that could be used for state market interventions. As state-owned grain stocks build up, the Ukrainian government may be tempted to consider the use of export subsidies. The State Reserves Committee of Ukraine was believed to export wheat to Iran and Algeria from July to August 2005 at \$125/MT (metric ton), at a time that the purchase price from the farmer was no less than \$125/MT. Considering the costs of storage and transportation to the Ukrainian ports, the Committee could not have exported grain without "taking a loss," i.e. without an export subsidy.

INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

Ukraine was the only country named a Priority Foreign Country in the 2002 to 2005 Special 301 reviews conducted by USTR based on widespread piracy of copyrighted goods such as compact discs (CDs) and digital video discs (DVDs).

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The United States withdrew Ukraine's benefits under the Generalized System of Preferences (GSP) program in August 2001 and imposed \$75 million worth of sanctions on Ukrainian imports on January 23, 2002. These sanctions, which affected a number of Ukrainian products, including metal, footwear, and chemicals, were lifted on August 30, 2005 after the Ukrainian government secured passage of important amendments to the Laser-Readable Disk Law and other laws, which went into effect on August 2, 2005. The United States concluded a Special 301 Out-of-Cycle Review (OCR) of Ukraine in January 2006. In recognition of the Government of Ukraine's efforts to improve the enforcement and protection of intellectual property rights, the United States reinstated GSP benefits for Ukraine effective January 23, 2006, and lowered Ukraine's designation under Special 301 from Priority Foreign Country to Priority Watch List. Ukraine agreed to work with the U.S. Government and with the U.S. copyright industry to monitor the progress of future enforcement efforts through an Enforcement Cooperation Group. The United States will continue to monitor developments in the protection of intellectual property rights in Ukraine pursuant to Section 306 of the Trade Act of 1974.

Enforcement of optical media piracy in Ukraine has slowly improved since 2002, when Ukraine was widely viewed as the primary producer and exporter to Europe of pirated copyrighted goods.

A fundamental area of progress is the creation of a regulatory regime for the production, distribution, and export and import of optical media. Many of the deficiencies in Ukraine's early regulations to stem the commercial-scale pirate production of CDs, CD-ROMs and DVDs were addressed by the amendments to the Laser-Readable disk law that were passed in July 2005 and went into force in August 2005. The new amendments enhanced law enforcement's role and lowered the threshold for imposing penalties and sanctions. These amendments related to issues such as: (1) establishing a system for monitoring raw materials (optical grade polycarbonate) for optical media production; (2) creating a clear obligation to engrave all manufacturing equipment and molds with SID Codes; (3) expanding non-compliance penalties to include plant closures and deterrent criminal penalties; and (4) stronger enforcement authority to seize infringing machinery and product. The amendments were drafted in close consultation with U.S. industry and the U.S. government.

Implementation and enforcement of these new amendments and other existing intellectual property laws has been ongoing with some positive results. In 2005, the State Department for Intellectual Property (SDIP), which is responsible for the formulation and implementation of Ukraine's intellectual property laws, as well as the Ministry of Interior conducted 522 inspections of plants and retail establishments resulting in 77 criminal cases and the seizure of 214,882 units of pirated products valued at more than \$796,000. Furthermore, the Ministry of Internal Affairs, Ministry of Culture, the General Prosecutors' office, and the State Security, Tax, and Customs Administration have developed a joint program to coordinate their enforcement efforts. Ukraine remains a major transshipment point, storage location, and market for illegal optical media produced in Russia and elsewhere, however, and needs to significantly improve its customs border enforcement to deal with these continuing problems.

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As part of its ongoing efforts to negotiate accession to the WTO, Ukraine has adopted legislation, including a May 2003 Omnibus package, to bring its laws into compliance with the WTO Agreement on Trade- Related Aspects of Intellectual Property Rights (TRIPS). Some issues, however, remain with Ukraine's treatment of foreign geographical indicators. In addition, Ukraine is in the process of strengthening its legal protections for pharmaceutical test data against unfair commercial use. Also, a December 2004 resolution establishing fees for the protection of foreign trademarks and other rights depending on the foreign country's gross domestic product appears not to be in line with international norms.

Patent and trademark violations are common in Ukraine. The Ukrainian Ministry of Health reportedly does not check the validity of patents when it permits pharmaceutical sales in Ukraine. In one case, the Ministry of Health allowed a European company to register the same drug for which a U.S. company held a valid patent. Legal experts and government officials have called for the formation of a special patent court in Ukraine to adjudicate patent cases, but to date there has been no concrete action to establish such a court.

For protection of their trademarks, in many cases, the rights holder must actively and continually engage with the Ministry of Internal Affairs or the State Customs Service to obtain enforcement. Trademarked and copyrighted goods must be registered for a fee (\$400 for the first good for the first year) in the Customs Authorities' rights holder database in order to be guaranteed protection.

Generally speaking, the number of judges trained in IPR law remains low and companies lack confidence in the Ukrainian judicial system and therefore do not bring private lawsuits. Ukraine has brought a number of criminal cases especially related to trademark violations and retail sale of pirated goods. With lowered thresholds for criminal sanctions in the area of copyright, Ukrainian officials have brought additional cases related to copyright. At the time of writing, however, none of the cases have been completed.

SERVICES BARRIERS

Ukraine has few explicit restrictions on services. Foreign professionals are permitted to work in Ukraine, but the lack of transparency and the multiplicity of licensing authorities hinders foreign access to the Ukrainian services market. A local content requirement exists for radio and television broadcasting, although it has not been stringently enforced. In July 2005, the Parliament adopted legislation that would permit foreign insurance companies to open branches in Ukraine within five years after WTO accession. In July 2005, the Parliament passed the first reading of a draft law that would permit foreign banks to open branches, but it has failed repeatedly in the second reading. Currently, investors can open 100 percent foreign-owned subsidiaries.

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INVESTMENT BARRIERS

An underdeveloped banking system, poor communications networks, a difficult and frequently changing tax and regulatory climate, crime and corruption, and a weak legal system create major obstacles to U.S. investment in Ukraine. The government is working on streamlining regulations and eliminating duplicative and confusing laws regarding investment and business. In 2003, Ukraine passed legislation on tax reform, establishing a flat tax on personal income of 13 percent and lowering the enterprise profit tax from 27 percent to 25 percent. After the President twice vetoed laws reducing the Value Added Tax (VAT) from 20 percent to 17 percent, Parliament postponed lowering the VAT. The accumulation of VAT refund arrears has also been a serious problem for foreign and domestic exporters in Ukraine, although the GOU has pledged to eliminate VAT arrears and in 2005 improved its repayment record. In 2005, the GOU increased the pace of VAT refunds to 87 percent of the verified claims, up from 65 percent refunded in 2004. However, the process for obtaining a refund of VAT payments can take from three months to eighteen months and remains cumbersome.

Prior to March 2005, only domestic firms were permitted to use promissory notes for the payment of VAT. This discriminatory provision was eliminated by Parliament when the March 2005 budget extended this right to foreign companies.

Combined payroll taxes (mainly for pensions) remain high at an average of 37.5 percent. The 2006 draft budget proposes to lower this tax slightly to 35.5 percent. There are frequent changes in other tax laws and regulations, such as import duties and excise taxes, often with little advance notice, giving companies little time to adjust to new requirements. Improvements are being made in tax filing and collection procedures, although these still differ significantly from those in western countries. The Chairman of the State Tax Administration established an advisory committee on the tax problems of foreign companies, which has been functioning for about three years and has achieved resolution of some difficult issues brought before it by U.S. and other foreign companies.

The United States has a Bilateral Investment Treaty (BIT) with Ukraine, which took effect on November 16, 1996. The BIT guarantees U.S. investors the better of national and MFN treatment, the right to make financial transfers freely and without delay, international legal standards for expropriation and compensation and access to international arbitration. There are a number of longstanding investment disputes faced by several U.S. companies. These disputes mainly date from the early 1990s and the initial opening of the Ukrainian economy to foreign investors. In most cases, however, there has been little progress toward resolution under subsequent Ukrainian governments.

In early 2005, Ukraine lifted all tax exemptions to investors in Special Economic Zones (SEZ) in order to stop large-scale misuse of the zones. An abrupt and complete cancellation of tax exemptions and lack of compensatory provisions were criticized by investors who suffered from the cancellation, further destabilizing the investment climate. The GOU claims it is currently developing a compensation mechanism for investors. U.S. investors both with planned and existing investment in the SEZs faced substantial

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losses from the elimination of customs and tax privileges. The Parliament adopted legislation to create technology parks on November 15, 2005, which allows some government financial support, targeted subsidies, and tax privileges for a list of 16 technoparks based on existing scientific and research institutes.

Privatization rules generally apply to both foreign and domestic investors, and, in theory, a relatively level playing field exists. As contrasted with the privatization rush in the 2004 Presidential election year, no major new privatizations were conducted in 2005. Revision of the non-transparent privatization of Ukraine's major steel plant, Krivoriizhstal, with a new transparent tender open to international participation allowed the GOU to raise \$4.8 billion, as opposed to the \$800 million earned from its earlier privatization in 2004. Lack of a clear policy regarding reversals of previous non-transparent privatizations added to the uncertainty of the business climate through most of 2005, resulting in low investment. The GOU made contradictory proposals ranging from revising all suspicious previous privatizations, to relying on private court cases, to seeking amicable agreements with current owners to "pay up" the difference between the purchase and fair market price of the privatized enterprises. The GOU has asserted the need for a law to protect property rights, giving amnesty to current owners after an amicable agreement is reached. Despite these declarations, no such law has been registered in the Parliament yet. The Prime Minister stated publicly in November 2005 that the GOU now plans no further reversals of previous privatizations.

ELECTRONIC COMMERCE

The Internet and electronic commerce are underdeveloped in Ukraine's regions where active Internet users number only a few percent of the population. There is a higher level of usage in Kiev, where 60 percent of city residents are reportedly active Internet users and where Internet commerce, while small in total volume, reportedly increased 50 percent from 2004 to 2005. There are more than 100 Internet retailers in Kiev, 10 of which are large-scale enterprises. The main products sold via the Internet are home appliances and electronics, especially mobile phones. In most cases the Internet retailer operates as a middleman between the wholesaler and the end user. In 2003, the Ukrainian parliament adopted three laws regulating the Internet and setting framework regulations for the telecommunications market. Based on one of those laws ("On Telecommunications"), in 2004, then President Kuchma established the National Council on Communications entrusted with monitoring the telecommunications market. President Yushchenko disbanded that Council and formed a new one, which began operating in April 2005 after President Yushchenko appointed its eight commissioners. It is developing regulations for VoIP (Voice-over Internet Protocol) telephony, but in large part the Internet in Ukraine remains unregulated. A controversial April 2005 Ministry of Transport and Communication regulation that would have forced the registration of Internet websites in Ukraine was cancelled in October 2005, after a public outcry that called the measure an attempt at state-control over the sector and a violation of freedom of speech and expression.

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OTHER BARRIERS

Since January 1, 2003, Ukraine has imposed an export duty of 30 euros per metric ton on ferrous steel scrap and a ban on exports of non-ferrous metals. The ferrous scrap export duty contributed to a decline in scrap exports from Ukraine, when global demand and prices for steel scrap were rising. Ukrainian metallurgical producers benefited from lower than world price scrap inputs. This year, in the course of its efforts toward WTO accession, the GOU has repeatedly proposed legislative amendments that would lower the export duty on ferrous scrap to €25 as of January 1, 2006 and to €18 as of January 1, 2007. The GOU also proposed lifting the ban on exports of non-ferrous metal by introducing a 30 percent export duty instead. The Parliament repeatedly defeated these bills during 2005, although a bill to lower ferrous scrap export tariffs passed in the first reading November 15, 2005. Sunflower seeds were subject to a similar export duty since June 21, 2001, which benefited local sunflower oil producers. In July 2005, the export duty on sunflower seeds was lowered to 16 percent of its customs value with further (starting in 2007) one percent annual reductions to reach a final 10 percent. Export duties are also in place on live cattle, sheep, hides, and skins since 1996. For live calves the duty is 75 percent of custom value (but no less than 1500 EUR/ton of live weight); for live cows it is 55 percent (but no less than 540 EUR/ton of live weight); and for live sheep it is 50 percent (but no less than 390 EUR/ton of live weight). For raw hides of cattle the duty is 30 percent (but no less than 400 EUR/ton of live weight); for sheep hides it is 30 percent (but no less than 1 EUR/hide); and for pigskins the duty is 27 percent (but no less than 170 EUR/ton of live weight). On November 15, 2005 the Parliament passed in the first reading a bill to lower the export duty for cattle exports to 30 percent and rawhide exports to 15 percent. Some GOU officials claim these export tariffs are less effective than they appear, as exporters reportedly often circumvent them by transshipping scrap and hides through Moldova, with which Ukraine has a free trade regime.

UNITED ARAB EMIRATES

TRADE SUMMARY

The U.S. goods trade surplus with United Arab Emirates was \$7.0 billion in 2005, an increase of \$4.1 billion from \$2.9 billion in 2004. U.S. goods exports in 2005 were \$8.5 billion, up 107.5 percent from the previous year. Corresponding U.S. imports from United Arab Emirates were \$1.5 billion, up 28.6 percent. United Arab Emirates is currently the 21st largest export market for U.S. goods.

The stock of U.S. foreign direct investment (FDI) in United Arab Emirates in 2004 was \$2.4 billion, up from \$2.0 billion in 2003.

After consultations with Congress, the United States began Free Trade Agreement (FTA) negotiations with the UAE in March 2005 and finished the 3rd round of negotiations in November 2005. An important objective of these ongoing negotiations is the removal of trade barriers for U.S. goods and services providers. The FTA with the UAE is the next stage in achieving President Bush's vision for a Middle East Free Trade Area by 2013.

IMPORT POLICIES

The United Arab Emirates is a federation of seven emirates (Abu Dhabi, Dubai, Sharjah, Ajman, Umm Al-Qaiwain, Fujairah, and Ras Al-Khaimah). The UAE is part of the Gulf Cooperation Council (GCC), an economic and political policy-coordinating forum for the six member states (Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the UAE). The individual emirates founded the UAE in December 1971. Over the last 33 years, the UAE has developed into the third largest economy in the Arab world, with an estimated 2004 Gross Domestic Product (GDP) of about \$104 billion. The UAE has pursued free market, trade liberalizing policies to diversify its economy away from a dependence on oil. Despite possessing around 9 percent of the world's proven oil reserves and the fourth largest proven gas reserves in the world, rapid growth in the non-oil economy reduced oil's share of GDP from 60 percent in 1980 to about 30 percent now.

Tariffs

At a December 2001 Summit, GCC Heads of State adopted an across-the-board common external tariff of five percent for most products. The new tariff regime was implemented in January 2003 as part of the GCC Customs Union agreement. The GCC states also agreed to develop a list of products to which a higher tariff would apply. Currently, the UAE's exceptions to the five percent tariff are a 50 percent tariff on alcohol, a 100 percent tariff on tobacco, and duty exemptions for 53 food and agricultural items.

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Import Licensing

Only firms with an appropriate trade license can engage in importation and only UAE nationals can obtain such a license (this licensing provision is not applicable to goods imported into free zones). In addition, not all goods require an import license.

Documentation Requirements

Since July 1998, the UAE has required that documentation for all imported products be authenticated by the UAE Embassy in the United States. There is an established fee schedule for this authentication. If validation is not obtained in the United States, customs authorities will apply the fee schedule when the goods arrive in the UAE.

Customs Valuation

The UAE notified the WTO Customs Valuation Committee in October 2004 of its customs valuation scheme.

Textiles

Textile manufacturing represents approximately 10 percent of the UAE's non-oil GDP, and Ministry of Economy officials have said that the textile sector is key to UAE efforts to diversify its economy. In 2004, textiles made up approximately 4.8 percent of the UAE's non-oil exports, 9.6 percent of re-exports, and 7 percent of imports. The UAE has attracted a number of garment manufacturers because of its close proximity to the Indian subcontinent and a lack of corporate and personal income taxes. The majority of garment factories are located in free trade zones, where they operate exempt from UAE commercial law and can be 100 percent foreign owned. In 2003, the Dubai Government announced the development of a \$60 million textile free zone, called Dubai Textile City that opened in the fall of 2005. The UAE has proposed eliminating the four percent textile tariff that currently exists between GCC members to further ease restrictions on textile trade.

STANDARDS, TESTING, LABELING AND CERTIFICATION

As part of the GCC Customs Union, member countries are working toward unifying their standards and conformity assessment systems and have progressed considerably toward the goal of a unified food standard, originally targeted for adoption by 2006, but now estimated to be adopted not before 2009. Each country currently applies either its own standard or a GCC standard causing confusion among some U.S. businesses.

In October 2002, the UAE created the Emirates Authority for Standardization and Metrology (ESMA), established under the auspices of the Ministry of Finance and Industry to manage issues of standardization arising from the GCC Customs Union. The UAE has decided not to implement the GCC International Conformity Certification Program (ICCP). Instead, ESMA launched its own conformity assessment program, the Emirates Conformity Assessment

Scheme (ECAS) on selected products. ECAS applies national or GCC standards to domestically manufactured products, or international standards if neither national or GCC standards exist. The UAE asserts that the ECAS is a voluntary program and only applicable to domestically produced goods, but the scope and parameters of ECAS lack clarity and transparency.

Not all UAE national and GCC food standards are consistent with international standards published through the Codex Alimentarius Commission (CODEX), Office of Epizootics (OIE) and International Plant Protection Convention (IPPC) organizations. In addition, the UAE requires that all consumer-ready food products carry both production and expiration dates and stipulates that at least one-half of a product's shelf-life must be valid when a product reaches the port of entry. For red meat and poultry, the product must arrive within four months of production. The UAE lifted its import bans on U.S. poultry in April 2005 and on U.S. beef in June 2005.

Control of the country's food standards is with the General Secretariat of Municipalities (GSM). The GSM develops food standards through a technical advisory committee, although individual municipalities still apply food and non-food standards of their own development, independent of the GSM authority, (i.e., labeling of foods with biotechnology enhanced ingredients, prohibition of foods labeled as Kosher prepared, standards for pet foods). The GSM is unable to control such actions by individual municipalities which, when taken, periodically cause confusion among U.S. suppliers.

GOVERNMENT PROCUREMENT

The UAE grants a 10 percent price preference for local firms in government procurement. The UAE requires companies to register with the government before they can participate in government procurements. To be eligible for registration, a company must have at least 51 percent UAE-ownership. This rule does not apply to major projects or defense contracts where there is no local company able to provide the goods or services required. Established in 1990, the UAE's offset program requires defense contractors that are awarded contracts valued at more than \$10 million to establish commercially viable joint ventures with local business partners that yield profits equivalent to 60 percent of the contract value within a specified period (usually seven years). There are also reports, as well as anecdotal evidence, indicating that defense contractors can sometimes satisfy their offset obligations through an up-front, lump-sum payment directly to the UAE Offsets Group. This requirement is designed to further the UAE objective of diversifying its economy away from oil. To date, more than 40 projects have been launched, including *inter alia* a hospital, an imaging and geological information facility, a leasing company, a cooling system manufacturing company, an aquiculture enterprise, Berlitz Abu Dhabi, and a firefighting equipment production facility. Two of the largest offset ventures are an international gas pipeline project (Dolphin) and the Oasis International leasing company, a British Aerospace offsets venture. The UAE is not a signatory to the WTO Agreement on Government Procurement.

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INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

The UAE has made the protection of intellectual property a priority in recent years. The UAE repealed previous copyright, trademark, and patent laws and issued improved legislation in 2002, providing high levels of protection for U.S. intellectual property.

In addition, an agreement between the UAE and U.S. pharmaceutical companies provides for *de facto* patent protection for a number of U.S. patent-protected medicines, and in 2004 the UAE resolved a number of IPR complaints with U.S. pharmaceutical manufacturers.

The new copyright law, enacted in July 2002, grants protections to authors of creative works and expands the categories of protected works to include computer programs, software, databases, and other digital works. Efforts to combat computer software piracy in the UAE have been successful. According to 2002 industry estimates, the rate of software piracy in the UAE is the lowest in the Middle East. The UAE is recognized as the regional leader in fighting computer software piracy.

The UAE's new Trademark Law, also issued in July 2002, confirms that the UAE will follow the International Classification System and that one trademark can be registered in a number of classes. The new law provides that the owner of the registration shall enjoy exclusive rights to the use of the trademark as registered and can prevent others from using an identical or similar mark on similar, identical, or related products and services if it causes confusion among consumers. It remains unclear, however, how the UAE provides the protection for geographical indications required by the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS).

The UAE published the official and final version of the long-awaited Patent Law in November 2002. The Patent Law provides for national treatment for intellectual property owners from other WTO Members, product and process patent protection, and enforcement of intellectual property rights utilizing civil and criminal procedures and remedies. In October 2003, the Ministry of Health issued a circular providing protection of test and other data against unfair commercial use in the UAE for pharmaceutical products for up to five years or until a patent is granted or rejected in the UAE, whichever period is shorter. This is an improvement over the previous situation, but protection of test data should not be dependent on patent protection.

In 2004, the Ministry of Information issued new regulations allowing for specialized collecting societies as a practical way for sound recording companies to collect royalties on the broadcast and performance of copyrighted material. The UAE is also considering legislation for data protection, privacy, and other IP-related issues. In response to Trade and Investment Framework Agreement Council discussions, the UAE has identified points of contact for rights holders to address complaints.

SERVICES BARRIERS

Insurance

While the Ministry of Economy and Planning announced in 2004 that it would open its insurance sector to new foreign insurance companies, no changes have yet taken place. About half of the current 47 insurance companies in the UAE are foreign, but the UAE government froze new entries to the market in 1989 due to a perception that the market was saturated.

New foreign companies will be required to meet high international rating criteria and to offer new products to the market. Foreign insurance companies may enter the market through a branch. Subsidiaries are not permitted.

Banking

The UAE has 21 national banks, 26 foreign financial entities, and a total of 457 branches. Following a banking crisis caused by accumulating bad debts after the oil boom in the mid-1980s, the Central Bank stopped granting licenses to new foreign banks. In September 2003, however, the UAE Central Bank announced that it would allow the operation of more banks from other countries on a reciprocal basis. The Central Bank is also considering allowing foreign banks operating in the UAE to set up new branches provided that they undertake to employ UAE nationals. Figures by the Central Bank show national banks enjoy a stronger financial position than foreign banks operating in the UAE, with assets peaking at the end of March 2003 at nearly \$68.3 billion compared with foreign banks' assets of around \$21.5 billion. The UAE opened the Dubai International Free Zone in 2004, which exempts foreign banks from civil and commercial, though not criminal, law. The UAE opened the Dubai International Financial Exchange in 2005.

Agent and Distributor Rules

The UAE's Commercial Agencies Law requires that all commercial agents be either UAE nationals or companies wholly-owned by UAE nationals. The foreign principal may appoint one agent for the entire UAE or for a particular emirate or group of emirates. Once chosen, agents/distributors have exclusive rights, and the law provides that an agent may be terminated only by mutual agreement of the foreign principal and the local agent, notwithstanding the expiration of the term of the agency agreement. Since 1996, the UAE has not recognized new agency agreements in the food sector. Agency agreements in existence prior to this period are still recognized. The restrictive terms of the laws currently governing agency relationships are under discussion in the proposed United States-UAE Free Trade Agreement.

INVESTMENT BARRIERS

Except for companies located in one of the free zones, at least 51 percent of a business established in the UAE must be owned by a UAE national. A business engaged in importing and distributing a product must be either a 100 percent UAE-owned agency/distributorship or a 51 percent UAE-owned/49 percent foreign owned limited liability company.

FOREIGN TRADE BARRIERS

Subsidies for manufacturing firms are only available to those companies with at least 51 percent UAE national ownership.

The laws and regulations governing foreign investment in the UAE are evolving. There is no national treatment for investors in the UAE. Non-GCC nationals cannot own land, but the emirate of Dubai currently is offering so-called freehold real estate ownership for non-GCC nationals within certain areas. However, the exact legal status of this scheme is still uncertain. In August 2005, UAE President Sheikh Khalifa bin Zayed Al-Nahyan, acting in his role as the ruler of the Emirate of Abu Dhabi, signed Abu Dhabi law number 19 of 2005 concerning real property. The law will be effective after it is published in the Abu Dhabi Gazette.

It provides that UAE nationals may own land and interests in land throughout the Emirate of Abu Dhabi. GCC citizens will be able to own land within designated investment areas. Non-GCC nationals will have the right to own buildings, but not the land, in investment areas. Use of buildings may be done through a leasehold arrangement. Foreign investors may purchase 22 of the 53 issues on the UAE stock market. The Ministry of Economy and Planning rules allow foreign investors to own up to 49 percent of companies on the stock market; however, company by-laws in many cases prohibit foreign ownership. Dispute resolution is a problem, as foreign companies tend not to press claims for fear that doing so may jeopardize their business activities in the UAE.

ELECTRONIC COMMERCE

The Emirate of Dubai passed The Law of Electronic Transactions and Commerce in 2002, which protects certain electronic records and signatures, and some electronic communications. This law also provides penalties for any person who knowingly creates, publishes or otherwise makes available a false signature or certificate, or provides false statements online for fraudulent or any other unlawful purpose. In March 2003, the International Bar Association hosted a conference in Dubai entitled "Middle East Law and the Internet Age." The conference addressed the legal developments related to new technologies, with a focus on electronic commerce in the Middle East. The Emirate of Dubai has established the Dubai Technology, Electronic Commerce and Media Free Zone (TECOM), which houses both Internet City and Media City, two subdivisions which cater, respectively, to the information technology and media sectors. In April 2004, the UAE announced the opening of the telecommunications sector, revoking Emirates Telecommunications Corporation's (Etisalat) monopoly rights. This decree took effect on January 1, 2005. On May 6, 2005, the Telecommunications Regulatory Authority announced that it had approved the establishment of a new telecommunications company to compete with Etisalat.

FOREIGN TRADE BARRIERS

UZBEKISTAN

TRADE SUMMARY

The U.S. goods trade balance with Uzbekistan went from a trade surplus of \$142 million in 2004 to a trade deficit of \$22 million in 2005. U.S. goods exports in 2005 were \$74 million, down 68.0 percent from the previous year. Corresponding U.S. imports from Uzbekistan were \$96 million, up 8.7 percent. Uzbekistan is currently the 139th largest export market for U.S. goods.

The stock of U.S. foreign direct investment (FDI) in Uzbekistan in 2004 was not available, \$77 million in 2003.

IMPORT POLICIES

The Government of Uzbekistan restricts imports in many ways, including high import duties, licensing requirements for importers and wholesale traders, restricted access for sellers of imported items to retail space, and limited access to hard currency and the local currency (the soum).

Highly discriminatory excise taxes exist to protect locally produced goods. From November 1, 2005, the government raised excise taxes on a number of food products as well: from 50 percent to 70 percent on meat and sub products of poultry (in addition to a 30 percent import duty), and from 10 percent to 30 percent on final products made of meat and fish. A Presidential Decree introduced new excise taxes of 20 percent on imported beef and 40 percent on crackers. New excise taxes were also introduced on imported entertainment goods (30 percent), as well as differentiated imported duties on 46 different knitted products. A slight increase was also introduced on imported sugar (20 percent to 30 percent). Combined with unofficial payments that often must be made to border and customs officials to import goods, most imported goods are prohibitively expensive for the majority of Uzbeks.

According to reports from foreign investors, “unofficial duties” combined with other tariffs and taxes can cost as much as 100 percent to 150 percent of the amount of the actual value of the product, making the product unaffordable for virtually everyone in the country. For example, imported liquor is reportedly subject to an excise tax of 90 percent versus a rate of 40 percent to 65 percent for domestic liquors. Additionally, at retail level, imported automobiles have been subjected to duties and taxes totaling approximately 100 percent.

FOREIGN TRADE BARRIERS

Tariffs are officially (not including unofficial duties) 30 percent for most textile products, including carpets and rugs, home furnishings, and essentially all other fabrics and apparel.

The government also requires retailers to present certificates of origin and customs receipts for imported products upon the request of tax or customs authorities. The Uzbek government often confiscates goods found without such certificates. A new decree enacted in August 2004 imposed further import restrictions on traders. In addition to demanding that all individual traders be registered with the local authorities and the Ministry for Foreign Economic Relations, Investment and Trade the traders will have to prove that they have a commercial bank account and imported the goods themselves from the originating country. Surveys of foreign companies consistently conclude that restrictions on access to local currency in order to transact business and pay employees is one of the worst of the many serious obstacles to doing business in Uzbekistan.

In 2004 – 2005, the Government of Uzbekistan continued to restrict imports by limiting access to hard currency for private importers. On October 14, 2003, the Government of Uzbekistan accepted the International Monetary Fund's Article VIII agreement. This led to dramatic legislative changes in the import registration system and the import regime as a whole. One of these new changes states that companies that are not government-owned do not need advance approval for each import contract. However, the government continues to restrict consumer goods imports in order to prevent hard currency flows and curb the threat of devaluation of the soum (see above). Unfortunately, in recent months the GOU has taken several steps backwards. Currency conversion has slowed significantly. The Central Bank is currently about two months behind in processing imported goods conversion requests and six weeks behind in raw material orders.

Although clearance of import contracts with the state-controlled clearing company is no longer needed for customs registration, the regulation requiring the registration has not been abolished. The State Customs Committee still turns down about five percent of contracts submitted for registration, purportedly due to mistakes in documents. The companies entitled to convert local currency under import contracts encounter problems with arbitrary requests for documentation by banks. While the required documents are outlined in the instructions issued by the relevant bank, these instructions are often amended without any prior notice. As a result, documents are often rejected on disputable grounds and conversion can be delayed for up to a month, which results in devaluation losses for the importer. Bank dealers have reported cases in which the Central Bank did not approve applications for conversion for some of their clients who needed large sums of hard currency.

In addition to official barriers, the customs clearance process is full of unofficial bureaucratic obstacles leading to significant processing delays of two to three months, even for U.S.-Uzbek joint ventures. Problems include the arbitrary seizure of goods, as well as frequent official and unofficial changes in customs procedures without prior notification. Excessive documentation also makes the Uzbek importing process costly and time consuming.

FOREIGN TRADE BARRIERS

The lack of proper equipment and legislative regulations provides an environment in which the customs official on duty can arbitrarily apply his or her own case-by-case search and seizure procedures. In 2004, the Government of Uzbekistan made an effort to increase regulation transparency at customs border posts, primarily by posting all relevant regulations and decrees where traders can review them.

STANDARDS, TESTING, LABELING AND CERTIFICATION

The system of standardization, accreditation, certification and application of sanitary and phytosanitary (SPS) standards still presents significant barriers to trade. Currently, Uzbekistan applies a mandatory certification requirement to most of its imported and domestically produced products. The National Agency of Standards (Uzstandard) remains in charge of certification, accreditation and state control. The Uzbek Government is in the process of drafting a new law on technical regulation designed to bring Uzbekistan's regime in line with the requirements of the WTO Technical Barriers to Trade (TBT) and SPS Agreements.

The Commonwealth of Independent States has an agreement on mutual recognition of certificates, which is not being fully honored by Uzbekistan. In August 2004, Uzbekistan's Parliament ratified a decision to join the International Union on Plants Variety Protection, which has been in force since November 11, 2004.

The Government of Uzbekistan accepts U.S. manufacturers' self-certification of conformity with Uzbek foreign product standards and environmental regulations. Effective June 2003, all foreign products must be labeled in Russian and Uzbek. Industry reports that some domestic entities, including Uzbek Government enterprises, do not have to meet these mandatory-labeling requirements.

GOVERNMENT PROCUREMENT

There is no systematic approach to government procurement in Uzbekistan. Instead, procurement decisions are generally made on a decentralized and *ad hoc* basis. Often, the procurement practices of the central government are similar to those of many countries, incorporating tenders, bid documents, bids and a formal contract award. A law enacted in 2002 created more transparency in the procurement process by mandating that all government procurement over \$100,000 be completed on a tender basis. However, many tenders are announced with short deadlines and are awarded to companies based on corruption. Uzbekistan is in the process of modifying its trade regime to become a member of the WTO, and it is not yet a signatory of the WTO Agreement on Government Procurement.

The most serious barrier to trade with respect to government procurement is in the field of contract obligations. There are numerous cases in which the Uzbek Government is not complying with contract obligations in relation to procuring equipment, equipment pricing and payment guarantees. Further, there are several cases in which a U.S. company provided product for a government tender and then was not paid.

FOREIGN TRADE BARRIERS

EXPORT SUBSIDIES

The Government of Uzbekistan provides agricultural export subsidies on cotton in the form of heavily subsidized inputs, such as electricity, water and fertilizer, to farmers who then sell their cotton directly to the Uzbek government. This creates an end product that can be sold more cheaply in the international market. Moreover, in December 2002, the Government of Uzbekistan issued regulations allowing cotton farmers to sell half of their actual harvest, most often back to the government, at more favorable prices than those allowed in the state order system. It is unclear, however, how well the new regulation is being enforced by the end consumer, which in 90 percent of cases is still the Uzbek Government.

INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

Significant deficiencies remain in Uzbekistan's regime for the protection of intellectual property. Due to these deficiencies, there is an ongoing review of Uzbekistan's status as a beneficiary country under the U.S. Generalized System of Preferences (GSP) Program. Uzbekistan has been on the Special 301 Watch List since 2000.

In 1996, the Government of Uzbekistan undertook a comprehensive revision of its copyright law, but copyright protection in Uzbekistan remains significantly below international standards. In its December 2000 session, the Uzbek parliament made minor changes to the Uzbek copyright law and added trademark protections. The 2000 copyright amendments put in place additional protection for national authors and producers of sound recordings; however, these amendments did not extend protection to all works and recordings. In 2005, Uzbekistan joined the Berne Convention for the Protection of Literary and Artistic Works (Berne Convention), but the Uzbek Government declared an exception to Berne Article 18, which requires that signatory countries extend copyright protection to pre-existing works. Further, Uzbek law does not protect U.S. sound recordings, and, although the Government of Uzbekistan has announced its intention to join the Geneva Phonograms Convention, it has not yet applied to do so.

Enforcement of intellectual property remains weak in Uzbekistan. Pirated audio and videotapes and compact disks are sold openly. In fact, it is a challenge to purchase legal recordings in Uzbekistan. Current border enforcement is weak. As a result, illegal recordings freely cross into Uzbekistan for sale. Additional personnel and training courses are needed for more effective border enforcement. Uzbekistan does not provide for either civil or criminal *ex parte* search procedures needed for effective anti-piracy enforcement.

SERVICES BARRIERS

For years, the most significant barrier to foreign services firms entering the Uzbek market has been difficulty in currency conversion. The Uzbek Government's adoption of currency convertibility in October 2003 eased the process of conversion in 2004 and the

FOREIGN TRADE BARRIERS

first half of 2005. However, during the second half of 2005, conversion procedures began to slow again. According to unofficial estimates, the Central Bank is two months behind on import-related conversion requests and six weeks delayed on raw material-related requests.

Although the Government of Uzbekistan has created an insurance supervisory board, a system of licensing insurance companies does not yet exist. Insurance firms can currently only operate in Uzbekistan on the basis of a governmental decree. Uzbekistan imposes a ten percent withholding tax on reinsurance premiums for policies with reinsurers from countries that do not have a double taxation treaty with Uzbekistan. As the United States and Uzbekistan do not have such a treaty, U.S. reinsurers must add the ten percent charge to their premiums.

Uzbek law grants state-owned companies a monopoly over certain forms of mandatory state insurance (i.e., mandatory insurance paid for out of the state budget). Foreign banks may not operate in Uzbekistan except in a subsidiary status, which makes the banks subject to Uzbek laws, including the requirement of a charter capitalization fund of \$20 million. This is a common requirement in other Commonwealth of Independent States (CIS) countries as well. The \$20 million fund requirement does not apply to Uzbek firms. The Government of Uzbekistan determines the required size of the charter funds for Uzbek firms on a case-by-case basis.

In 1999, the Uzbek Government issued a decree ordering all Internet Service Providers (ISPs) to be re-registered with the state-owned monopoly UzPAK and to obtain new ISP licenses, forcing all ISPs to provide services only over UzPAK lines. In October 2002, the Uzbek Government rescinded its decision as a part of larger market reforms and removed UzPAK's monopoly powers. The Uzbek Government then reversed this decision first unofficially beginning in March 2003 and then officially in November 2004, giving UzPAK monopoly powers once again. The Uzbek Government has granted exclusive control over all international telecommunications services to Uzbektelekom, the largest national telecommunications operator. All international voice and data transmission services, including Internet and IP-telephony, must be provided over Uzbektelekom's network.

INVESTMENT BARRIERS

According to the Uzbek State Statistics Committee, the volume of foreign investment (including foreign loans covered by Uzbek Government Guarantee) in January-September 2005 decreased 6.4 percent in comparison with the same period in 2004. Foreign investment for the first nine months of 2005 totaled \$343.5 million, with investment backed by sovereign guarantee totaling \$96.87 million (2.2 times less than for the same period in 2004), and direct investment equaling \$246.6 million (60 percent increase).

FOREIGN TRADE BARRIERS

To be considered “an enterprise with foreign investment” under the new laws implemented in 1998, a firm must be at least 30 percent foreign-owned and have initial foreign equity of \$150,000. Otherwise, a firm is treated as a domestic enterprise. Normally this equity is “hidden” through assets such as equipment or technical expertise. Although reduced from previous levels, these ownership and capital requirements are still high enough to discourage foreign investment by small companies. The Government of Uzbekistan has postponed consideration of proposals to ease these requirements further. U.S.-owned companies in Uzbekistan also face cumbersome regulations and licensing requirements. Profit repatriation remains extremely difficult for foreign-owned companies due to constant government interference.

In the past, businesses had to register with numerous government organizations and obtain licenses from separate entities. However, in 2001, the Government of Uzbekistan introduced legislation to create a “one-stop shop” to make the company registration process easier. These one-stop shops are located in local government offices (Hokimiyats) throughout Uzbekistan and have reportedly made it easier to start a new business. However, even with the new regulations, businesses sometimes must satisfy bureaucratic requirements in multiple government offices.

Uzbekistan’s Tax Code, introduced for the first time in 1998, lacks important provisions that are part of the business environment in most countries. For example, unless a company receives permission through a special Presidential decree, Uzbekistan allows no credit for VAT on capital imports, including plant, machinery, and buildings. This puts firms operating in Uzbekistan at a competitive disadvantage compared to those in countries that do allow such credits. In addition, earnings of foreign-owned enterprises are subject to double taxation. Their earnings are taxed in Uzbekistan and then taxed again when remitted to the foreign parent. Another significant problem in the Uzbek Tax Code involves the classification of expenses. Many expenses that are normally deductible for purposes of calculating taxable profits are not deductible under the Uzbek Tax code, thereby increasing the effective tax burden in comparison to other countries. In most countries, expenses such as advertising and business travel are not subject to taxation. In Uzbekistan, however, travel is not deductible and advertising is only deductible based on an archaic and onerous formula. In 2005, the government initiated a major revision of the tax code. The changes, however, have yet to be officially announced or implemented.

Foreign firms in Uzbekistan face high labor costs. Corporate income tax rates, although reduced slightly over the last two years, total 18 percent, which is combined with a mandatory contribution for insurance 32 percent, a rate significantly higher than other similarly developed countries. While most Uzbek companies successfully evade their tax obligations, foreign investors generally adhere to the law. The Government of Uzbekistan imposed minimum salary requirements in 2001 to obligate foreign firms to pay full taxes on their employees. U.S. companies have also complained that Uzbek laws are not interpreted or applied in a consistent manner. On many occasions, local officials have interpreted laws in a manner that is detrimental to individual private investors and the business community at large.

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Companies are particularly concerned about the lack of consistency and fairness in the application of the Foreign Investment Law, which contains a number of specific protections for foreign investors.

Due to the burdensome tax code and regulatory environment, foreign investors in Uzbekistan often find it necessary to seek special tax and regulatory abatements in the form of Cabinet of Ministers decrees, which must be signed by the President in order to be approved. Such decrees have been helpful to foreign investors in certain strategic industries (e.g., mining, oil and gas, and large manufacturing). The process is lengthy and uncertain, however, and lacks the necessary transparency required to attract significant investment over the longer term. Despite the protections that such decrees are meant to provide, investors working under Cabinet of Ministers decrees still face significant regulatory and bureaucratic impediments.

Persons doing business in Uzbekistan note that if they are engaged in a sector in which either the Government of Uzbekistan or an Uzbek-controlled firm is a competitor, they face higher bureaucratic hurdles and currency conversion problems. Often, competitors are not even allowed in such sectors.

Businesses complain that they lack access under Uzbek law to international arbitration. Moreover, the judiciary in Uzbekistan is not independent. In the event of disputes, courts usually favor firms that are controlled or owned by the state. Disputes involving foreign-owned businesses are common and have proven difficult to resolve even with high-level intervention from senior U.S. policymakers and legislators.

Finally, the regulatory framework for joint ventures in Uzbekistan is also extremely burdensome. Many international corporations complain that the Government of Uzbekistan demands more financial reports than are necessary for shareholders.

OTHER BARRIERS

American investors unanimously complain that they do not control their corporate bank accounts in Uzbekistan. The main problem involves restrictions on businesses' access to, and use of, cash in their accounts. Every routine banking operation requires official permission. As a result, businesses expend an enormous amount of senior staff time on simple transactions. A March 24, 2000 decree improved this situation by allowing many farms, restaurants, cafes and other small and medium enterprises with foreign investment (\$150,000 or more in foreign capital) to access their own funds in commercial bank accounts, so long as those funds were received and deposited within the previous ninety days.

Most other businesses may hold cash for only a small number of permitted purposes, such as paying salaries and travel expenses. All other money must be held in the bank. Cash receipts must be deposited on the day in which they are received. Even small purchases, such as office supplies, must be paid for using a bank transfer. Uzbek companies handle this problem with salary withdrawals for non-existent staff. Western

FOREIGN TRADE BARRIERS

accounting practices prevent American companies from using these deceptive practices, and instead, companies are required to wait for as long as a week or more for a wire transfer to arrive before purchases of any kind can be made.

Local and international entrepreneurs face payoff-seeking officials due to pervasive corruption, exacerbated by low salaries for officials and an opaque, cumbersome, and internally contradictory legal regime that makes it difficult for business owners to comply with Uzbek regulations. It is reported that local, regional, and national officials, police officers, as well as tax, customs, fire, health, safety, and labor inspectors are all susceptible to bribery and other corrupt practices.

Another barrier to investment in Uzbekistan is the perception that Uzbekistan will not in all cases implement its internationally contracted obligations. A long standing case involves a decision in favor of an international grain company by the Grain and Feed Trade Association in London, the arbiter agreed to by Uzbekistan when the contract was signed. Uzbekistan has indicated that it will not honor the ruling.

VENEZUELA

TRADE SUMMARY

The U.S. goods trade deficit with Venezuela was \$27.6 billion in 2005, an increase of \$7.4 billion from \$20.2 billion in 2004. U.S. goods exports in 2005 were \$6.4 billion, up 34 percent from the previous year. Corresponding U.S. imports from Venezuela were \$34.0 billion, up 36.3 percent. Venezuela is currently the 27th largest export market for U.S. goods.

U.S. exports of private commercial services (i.e., excluding military and government) to Venezuela were \$2.4 billion in 2004 (latest data available), and U.S. imports were \$529 million. Sales of services in Venezuela by majority U.S.-owned affiliates were \$4.3 billion in 2003 (latest data available), while sales of services in the United States by majority Venezuela-owned firms were \$113 million.

The stock of U.S. foreign direct investment (FDI) in Venezuela in 2004 was \$8.5 billion, down from \$9.1 billion in 2003. U.S. FDI in Venezuela is concentrated largely in the manufacturing, and mining sectors.

IMPORT POLICIES

Tariffs

Venezuela is part of the Andean Community. Venezuela has been using the tariffs established under the Andean Community's price band system since 1995 for certain agricultural products, including feed grains, oilseeds, oilseed products, sugar, rice, wheat, milk, pork, and poultry. *Ad valorem* rates for these products are adjusted according to the relationship between commodity market reference prices and established floor and ceiling prices. When the reference price for a particular commodity falls below the established floor price, the compensatory tariff for that commodity and related products is adjusted upward. Conversely, when the reference price exceeds the established ceiling, the compensatory tariff is eliminated. Floor and ceiling prices are set once a year based on average prices during the past five years. Venezuela publishes these prices each April.

In addition to the traditionally high import tariffs of the Andean Community's price band system, Venezuela also protects its agricultural producers through a non-legislated system of guaranteed minimum prices and the restrictive use of import licenses and permits. For many years, the government and domestic producers have agreed -- behind closed doors -- to minimum prices for major crops such as corn, sorghum and rice. The government generally prohibits imports until the entire local crop has been purchased at the set price, resulting in an effective import ban.

FOREIGN TRADE BARRIERS

Under its WTO commitments, Venezuela is entitled to maintain tariff-rate quotas (TRQ) for up to 62 Harmonized System code headings, but its administration of the TRQs has been arbitrary and nontransparent and has negatively affected trade in basic agricultural commodities as well as processed products. The issuance of import licenses and sanitary permits has become very restrictive. Import licenses as well as the correspondent sanitary permits are needed for corn, sorghum, oilseeds, and dairy products. Only sanitary permits are needed for products where the licensing system has not yet been implemented, such as beef, pork, poultry, fruits, and vegetables. The Venezuelan government has denied import licenses for both in-quota and over-quota quantities, even though importers are often willing to pay the over-quota tariff for additional quantities of some products. Furthermore, for some products eligible for TRQs, the Venezuelan government has not taken the necessary steps to publish regulations establishing the TRQ mechanism. For other products, such as pork, the government has refused to activate the quota at all.

Under the Andean Community's Common Automotive Policy, assembled passenger vehicles constitute an exception to the 20 percent maximum tariff and are subject to 35 percent import duties.

Non-Tariff Measures

In response to the rapid decline in the value of the national currency, the Bolivar, following a two-month general strike that brought oil production to a near standstill, the Central Bank of Venezuela halted trade in Bolivars on January 22, 2003. President Chavez announced the creation of an Exchange Administration Board (CADIVI) on February 5, 2003, to regulate the purchase and sale of foreign currency. During much of 2003, CADIVI was unable to process requests for authorization of foreign exchange in an efficient and timely manner, and only supplied \$3.6 billion or approximately two months worth of transactions. There has been significant improvement over time. The supply of foreign currency reached a level of approximately \$15 billion in 2004, or 55 percent of approved authorizations, and \$15.8 billion or 94.1 percent of approved authorizations by November 4, 2005. The Ministry of Light Industry (formerly the Ministry of Production and Commerce) maintains a list of imports that are eligible to receive foreign currency approval. This list has grown significantly since the introduction of the exchange controls, and now includes services and the repatriation of capital. Although the number of currency certificate approvals has increased steeply, the exchange controls have put a significant constraint on imports, which currently account for 64.4 percent of requests, followed by private foreign debt with 7.8 percent and foreign investments with 6.3 percent. Exchange control authorities have repeatedly said that the exchange control system will be eased, but will remain in place permanently.

FOREIGN TRADE BARRIERS

The 2006 national budget recently passed to the National Assembly for ratification, does not anticipate any currency devaluations from the current parity of 2.150 Bolivars per \$1. Importers of agricultural products have received the majority of dollars available under the CADIVI system, since most basic food products are on the import list. Even so, problems with coordinating the timing of access to dollars, approval of import permits and licenses, and contracting the shipments have led to numerous delays and cancelled shipments. Trade in higher value products, such as apples, pears, grapes, nectarines, and other fruits and nuts, has been dramatically reduced as they are not included among the list of high priority products for which foreign exchange is available.

Venezuela also requires that importers obtain sanitary and phytosanitary (SPS) permits from the Agriculture Ministry for most agricultural imports. U.S. industry has raised concerns about the use of SPS permits to unreasonably restrict agricultural and food imports, as well as the consistency of Venezuela's SPS practices with WTO requirements. These practices have particularly affected trade in pork, poultry, beef, apples, grapes, pears, nuts, onions and potatoes. Industry representatives have reported that Venezuela also restricts the sale of nutritional supplements or natural products to pharmacies, limiting direct sales efforts.

Although the Venezuelan government has not published requirements on absorption agreements, it has been common practice for years to require the purchase of domestic production before issuing import licenses or permits. Imports of yellow corn are dependent upon the purchase of local sorghum and/or white corn. Soybean meal imports are dependent upon the purchase of "domestically produced" soybean meal that is crushed from imported soybeans, and permits for grape and black bean imports have been tied to the purchase of local product.

In 2002, the United States Trade Representative initiated formal WTO consultations with Venezuela on its agricultural import license procedures for a wide-range of products. Canada, the EU, Chile, Argentina, and New Zealand participated in the first round of consultations. Official consultations were held in November 2002 in Geneva. A subsequent exchange of letters on the SPS permit system was conducted in 2003. During the most recent meeting of the WTO Committee on Agriculture in November 2004, the United States again raised questions about permit and licensing procedures. At that time, Venezuela argued that these questions should be discussed under the WTO Sanitary and Phytosanitary Committee.

Venezuela prohibits the importation of used cars, buses, and trucks; used tires; and used clothing. No other quantitative import restrictions exist for industrial products. Some products such as cigarette paper, bank notes, weapons of war and certain explosives can only be imported by government agencies (tax authorities calculate the cigarette tax on the volume of cigarette paper imported by the manufacturers). The government can delegate authority to import on its behalf and can place orders for such products with the local sales agents of the foreign manufacturers.

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STANDARDS, TESTING, LABELING AND CERTIFICATION

Some Venezuelan importers of U.S. products have alleged that Venezuela applies product standards more strictly to imports than to domestic products. The certification process is expensive. The Venezuelan Commission for Industrial Standards normally requires certification from independent laboratories located in Venezuela, but at times will accept a certificate from independent laboratories elsewhere.

Venezuela's labeling regulations, which became effective in 2002, established the register of domestic manufacturers and importers of clothing and footwear, as well as the minimum labeling requirements for all clothing and footwear products marketed in Venezuela. Imported product labels must include the legal name or tax payer number of the Venezuelan importer. Industry reports that such information is difficult if not impossible to know during the construction process when permanent labels are attached. Re-labeling of products upon entry to meet these requirements results in additional costs and delays.

GOVERNMENT PROCUREMENT

Venezuela's government procurement law covers purchases by government entities, national universities and autonomous state and municipal institutions. The law requires a contracting agency to prepare a budget estimate for a procurement based on reference prices maintained by the Ministry of Production and Commerce. This estimate is to be used in the bidding process. The law forbids discrimination against tenders based on whether they are national or international. However, the law also states that the President can mandate temporary changes in the bidding process "under exceptional circumstances," or in accordance with "economic development plans" to promote national development, or to offset adverse conditions for national tenders. These measures can include margins of domestic price preference; reservation of contracts for nationals; requirements for domestic content, technology transfer and/or the use of human resources; and other incentives to purchase from companies domiciled in Venezuela. For example, government decree 1892 establishes a 5 percent preference for bids from companies with over 20 percent local content. In addition, half of that 20 percent of content must be from small to medium-sized domestic enterprises. The Government of Venezuela (GOV) is increasingly awarding contracts directly, thus avoiding competition required by the government procurement law.

In an effort to move away from proprietary software products, the Government of Venezuela in 2004 introduced a law mandating the use of open-source software in government entities and public institutions. This is expected to reduce the demand for U.S. software products somewhat, though much software currently in use is unlicensed or pirated.

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The Venezuelan government has created a huge food distribution network, aimed at low-income people. CASA (Corporación de Abastecimiento y Servicios Agrícolas) is the government food purchasing entity, and MERCAL (Mercado de Alimentos) is a government organization created for the commercialization and marketing of food products. The state-trading entity, CASA, purchases both domestic and imported products. To date, it has purchased sugar, rice, wheat flour, black beans, milk powder, edible oil, margarine, poultry, and eggs from a variety of countries. MERCAL now distributes more than 30 percent of all basic food staples consumed in Venezuela, offering products at prices that are lower than those of controlled-price products. CASA and Mercal compete with private industry, although the private sector also supplies products to this chain. The private sector has complained that CASA has an unfair advantage because it is ensured access to dollars, import licenses, and permits. Furthermore, CASA, as a government entity, imports products without tariffs and customs duties.

The GOV has also created several state-owned enterprises, such as CVA Cereals and Oilseeds, CVA Dairy, and CVA Sugar, to supply the food network. Additionally, the GOV has controlled food prices since 2003, when it set prices for 107 food products. In addition to price controls, the government implemented exchange controls in an attempt to keep food prices low and to control inflation. Nevertheless, at times these measures have had the opposite effect and have created new distortions in the market, such as temporary scarcities of certain products. Huge increases in input prices, as well as the need to maintain at least a reasonable profit margin, have led both producers and merchants to reduce production, withhold product for sale, or illegally sell outside the controlled price. There has never been an admission of such activities. Some products frequently disappear from the market shelves, and some end up in the Colombian market, which does not have price regulations.

Venezuela is not a signatory to the WTO Agreement on Government Procurement.

EXPORT SUBSIDIES

Exporters of selected agricultural products -- coffee, cocoa, some fruits, and certain seafood products -- are eligible to receive a tax credit equal to 10 percent of the export's value.

INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

Venezuela is a member of the World Intellectual Property Organization (WIPO). It is also a signatory to the Berne Convention for the Protection of Literary and Artistic Works, the Geneva Phonograms Convention, the Universal Copyright Convention, and the Paris Convention for the Protection of Industrial Property.

The Venezuelan Industrial Property Office's (SAPI) actions and occasional publicly stated antagonism towards IPR often draw criticism from IPR advocates and right holders. Protection of IPR is also hindered by the lack of adequate resources for the Venezuelan copyright and

FOREIGN TRADE BARRIERS

trademark enforcement police (COMANPI) and for the special IPR prosecutor's office. Venezuela's tax agency, SENIAT, is promoting several measures to fight piracy in an effort to reduce tax evasion, including a new anti-piracy law and the introduction of a tax on street vendors. According to industry representatives, SENIAT seems to be a promising enforcement entity due to its technical and financial capabilities.

Unfortunately, pirated software, music, and movies remain readily available throughout the country, and levels of piracy are increasing. In the 2005 Annual Review, Venezuela was placed on USTR's Special 301 "Priority Watch List."

Copyrights

Andean Pact Decision 351 and Venezuela's 1993 Copyright Law provide the legal framework for the protection of copyrights. The 1993 Copyright Law is modern and comprehensive and extends copyright protection to all creative works, including computer software. A National Copyright Office was established in 1995 and given responsibility for registering copyrights, as well as for controlling, overseeing and ensuring compliance with the rights of authors and other copyright holders. Industry experts are concerned about a proposed new copyright law that would require the mandatory registry of works in order to receive protection, reduce protection terms, hamper distribution agreements, and increase royalties.

Patents and Trademarks

Venezuela provides the legal framework for patent and trademark protection through Andean Community Decision 486 and the 1955 National Industrial Property Law. Andean Community Decision 486 implements the TRIPS Agreement to a degree, but Venezuela falls short with respect to its domestic laws. Andean Community Decision 345 covers protection for plant varieties.

U.S. companies remain concerned about the impact of the Andean Tribunal's 2002 interpretation of Articles 14 and 21 of Decision 486, which do not allow for the patenting of "second-use" products (e.g. new uses of previously known or patented products). Under pressure from the Andean Community and in line with some changes in leadership at SAPI, Venezuela has revoked previously issued patents. Very few patents for new pharmaceuticals were awarded in 2004. Since 2002, Venezuela's food and drug regulatory agency (INH) began approving the commercialization of new drugs, which were the bioequivalent of innovative drugs that previously received INH marketing approval, thereby denying the innovative drug companies protection against unfair competition of their test data as required by TRIPS. In effect, the government now allows unfair reliance on the test data, which required lengthy and expensive development, to be used by others seeking marketing approval for the same products.

FOREIGN TRADE BARRIERS

Enforcement

The Venezuelan copyright and trademark enforcement branch of the police (COMANPI) continues to provide copyright enforcement support with a small staff of permanent investigators. A lack of personnel, coupled with a very limited budget and inadequate storage facilities for seized goods, has forced COMANPI to work with the National Guard and private industry to improve enforcement of copyrighted material. COMANPI can only act based on a complaint by a copyright holder. It cannot carry out an arrest or seizure on its own initiative, leading to weaker enforcement.

SERVICES BARRIERS

Venezuela maintains restrictions on a number of service sectors. Venezuela requires that certain professions be licensed in Venezuela (e.g., engineers, architects, economists, business consultants, accountants, lawyers, doctors, veterinarians and journalists). Foreign nationals wishing to practice these professions in Venezuela must have their credentials validated by a Venezuelan university, provided that a reciprocity agreement exists with their country of origin. Some (particularly government-related) accounting and auditing functions require Venezuelan citizenship, and only Venezuelan citizens may act as accountants for companies with publicly traded stock valued at more than 25 percent. A foreign lawyer cannot provide legal advice on foreign or international law without being licensed in the practice of Venezuelan law.

Foreigners are required to establish a commercial presence for the provision of engineering services. Foreign consulting engineers must work through local firms or employ Venezuelan engineers. There is a law governing public service tenders that gives preferential treatment to Venezuelan firms for projects financed with public funds. Foreign participation is restricted to a maximum of 19.9 percent in professional firms.

Venezuela limits foreign equity participation (except from other Andean Community countries) to 20 percent in enterprises engaged in television and radio broadcasting and Spanish language newspapers.

The government enforces a "one-for-one" policy that requires foreign musical performers giving concerts in Venezuela to share stage time with national entertainers. There is also an annual quota regarding the distribution and exhibition of Venezuelan films. At least half of the television programming must be dedicated to national programs, and at least half of FM radio broadcasting must be dedicated to Venezuelan music.

Finally, in any enterprise with more than 10 workers, foreign employees are restricted to 10 percent of the work force, and Venezuelan law limits foreign employee salaries to 20 percent of the payroll.

FOREIGN TRADE BARRIERS

By signing the 1997 WTO Financial Services Agreement, Venezuela made certain commitments to provide market access for banking, securities, life and non-life insurance, reinsurance and brokerage activities. Venezuela did not make commitments on pensions, or on maritime, aviation and transportation insurance, and it reserved the right to apply an economic needs test as part of the licensing process.

Rules governing maritime activities and transportation insurance were issued in 2001 in a package of 49 laws passed under enabling powers granted to President Chavez in 2000. A new law for civil aviation was passed in June 2005. Many of the laws still need implementing regulations. The impact of the legislation is, therefore, still unclear.

INVESTMENT BARRIERS

The government continues to control key sectors of the economy, including oil, petrochemicals and much of the mining and aluminum industries. Venezuela began an ambitious program of privatization under the Caldera administration, but under President Chavez further privatization has been halted.

Foreign investment continues to be restricted in the petroleum sector. The exploration, production, refinement, transportation, storage, and foreign and domestic sale of hydrocarbons are reserved to the state. However, private companies may engage in hydrocarbons-related activities through operating contracts and equity joint ventures with the state-owned oil company Petroleos de Venezuela, S.A. (PDVSA). The Venezuelan constitution reserves ownership of PDVSA to the Venezuelan government. Sales to foreign investors of interests in subsidiaries and affiliates of PDVSA are permitted. In the early 1990s, the Venezuelan government partially opened the sector to private investment in order to promote new petrochemical joint ventures and to bring inactive oil fields back into production. Almost 60 foreign companies, representing 14 different countries, participated in these partial privatizations. PDVSA and foreign oil companies signed 33 operating contracts for marginal fields after three rounds of bidding.

The Hydrocarbons Law of 2001 has raised concerns in the industry as it mandates a minimum 51 percent national participation in future projects and increases most royalties paid to the government from 16.67 percent to 30 percent. Over the last two years, the national government has made a number of changes in royalty policies, tax policies, and contracts that have substantially increased the uncertainty for companies operating in Venezuela. In recent months, the government commenced the “migration” of operating contracts to mixed companies, looking to conform the contracts to the 2001 Hydrocarbons Law under which it would hold a controlling interest. Recently, however, the Minister of Energy and Petroleum (MEP) has placed government participation at a minimum of 60 percent.

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The Gaseous Hydrocarbons Law of 1999 offers more liberal terms, and the Venezuelan government has sought foreign investment to develop offshore natural gas deposits near the Orinoco delta. In October 2004, the Venezuelan government eliminated a royalty holiday granted to joint venture projects relating to the development of Venezuela's extra heavy crude oil reserves. These joint venture projects, known as "the strategic associations," were established during the partial opening of the sector and received 35-year contracts that were endorsed by the National Congress. PDVSA has recently begun seeking partners to develop 27 blocks of the country's heavy crude reserves. National oil companies of strategic partner-countries seem to be the preferred partners for the development of the new projects.

Both the 2001 Hydrocarbons Law and the Gaseous Hydrocarbons Law require that there be a competitive process for the identification of private partners for projects to be developed by PDVSA. However, the government may directly award contracts when the project is to be developed under special circumstances, or is of national interest.

The government passed legislation in 1998, aimed at introducing domestic and foreign competition into the domestic gasoline market. The law allows foreign and private Venezuelan investors to own and operate service stations, although the government retains the right to set product prices. The government has not raised gasoline prices in several years, and currency devaluations and a high inflation rate have eliminated service station profit margins.

Electric power generation, transmission, and distribution are open to private participation. Hydroelectric power-generation on several rivers is reserved to the state, although private sector participation is permitted in transmission and distribution. In early 2000, the U.S. power-generating company, AES Corporation, successfully took control, by means of a stock swap, of Electricidad de Caracas (EDC), the company that provides power to the Caracas metropolitan area.

Private participation is allowed in the mining sector. In early 2005, President Chavez reorganized the ministries that govern the energy and mining sectors. One result of this restructuring was to increase control over basic industries at the ministerial level and to strengthen the state-owned Corporacion Venezolana de Guayana (CVG), which controls steel and aluminum production, electricity generation, and mining. Under its new board of directors, named in February 2005, CVG announced a review of all existing contracts between CVG companies and third parties.

Supply contracts by CVG companies are currently under revision by the Ministry of Basic Industries and Mining (Mibam). The government is looking to increase the development of downstream industrial sectors and to add value to Venezuelan exports. To this end, Mibam is taking several steps to help local companies, including making available to them a higher percentage of materials, improving payment terms, and providing discounts of up to 10 percent.

FOREIGN TRADE BARRIERS

VIETNAM

TRADE SUMMARY

The U.S. goods trade deficit with Vietnam was \$5.4 billion in 2005, an increase of \$1.3 billion from \$4.1 billion in 2004. U.S. goods exports in 2005 were \$1.2 billion, up 2.4 percent from the previous year. Corresponding U.S. imports from Vietnam were \$6.6 billion, up 25.7 percent. Vietnam is currently the 58th largest export market for U.S. goods.

The stock of U.S. foreign direct investment (FDI) in Vietnam in 2004 was \$241 million, up from \$218 million in 2003.

WTO ACCESSION NEGOTIATIONS

The United States continued WTO accession negotiations with Vietnam, seeking a strong commercial package. Progress was made in January 2006 when the two teams met in Hanoi and the gaps were further narrowed during meetings in March 2006 in Geneva. The U.S. Government hopes to conclude the bilateral track of the accession negotiations shortly, opening up Vietnam's markets to U.S. goods, agriculture and services exports and investment. We also are working to conclude the multilateral track of negotiations, which focus on WTO rules issues including agriculture, customs, intellectual property rights, standards, subsidies, treatment of state-owned enterprises, trading rights, and services.

IMPORT POLICIES

Tariffs

Vietnam's tariff schedule has been based on the ASEAN Harmonized Tariff Nomenclature (AHTN) system since September 1, 2003. Within this structure, Vietnam maintains fifteen tariff rate bands, resulting in a simple average Most-Favored-Nation tariff rate of 18.2 percent. Currently, there are three categories of tariff rates: MFN rates that apply to about 75 percent of total imports from about eighty countries that have bilateral trade agreements with Vietnam, including the United States; Common Effective Preferential Tariff (CEPT) rates that apply to imports from ASEAN countries that qualify under the ASEAN Free Trade Agreement (AFTA); and general tariff rates (50 percent higher than NTR/MFN) that apply to all other countries.

Under the terms of the U.S.-Vietnam Bilateral Trade Agreement (BTA), which entered into force on December 10, 2001, Vietnam significantly reduced tariffs by an average of about one-third to one-half on a broad range of imports from the United States (approximately 244 lines) over a period of three years ending on December 10, 2004. Tariff reductions under the BTA apply to imported goods having certificates of origin from the United States. Some other countries with whom Vietnam has an MFN agreement also enjoy these rates.

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The National Assembly retains authority over setting tariff bands for each product and the government is free to adjust applied tariffs within the bands. In an effort to improve transparency, tariff information is now available on the Vietnam Customs website (www.customs.gov.vn). The website provides general tariff, NTR/MFN, and ASEAN/CEPT rates, but not lower rates that may have been negotiated in other bilateral agreements.

Non-tariff barriers

Non-tariff barriers (NTBs) were introduced in Vietnam when the country shifted from a centrally-controlled economy toward more market-oriented trade in the late 1980s to early 1990s, and quickly became a key component of Vietnam's trade policy. In the past few years, Vietnam has made significant progress in reducing the use of NTBs.

Under the terms of the BTA, Vietnam agreed to eliminate all non-tariff barriers, including import and export restrictions, quotas, licensing requirements, and controls for all product and service categories over a period of three to seven years, depending on the product.

Import prohibitions: Vietnam currently prohibits the commercial importation of the following products: arms and ammunition; explosive materials (not including industrial explosives); military technical equipment and facilities; equipment that interferes with traffic speed measuring devices; prohibited cultural products, firecrackers; a wide range of second-hand consumer goods including used information technology products; right-hand drive motor vehicles; used chassis, motors, spare parts and tires for automobiles and motorized two- and three-wheeled vehicles; used internal combustion engines; used bicycles; used motorized two- and three-wheeled vehicles; used ambulances; automobiles with modified transmission or altered chassis; engine identification numbers; waste materials; garbage; refrigeration equipment using Cluro Fluro Carbons; asbestos materials under the amphibole group; various encryption devices; encryption software; and toxic chemicals identified by the Chemical Weapons Convention. Under Decree 12/2006/ND-CP dated January 23, 2006, Vietnam's previous prohibition on the importation of motorcycles with engine capacity exceeding 175 cubic centimeters is no longer listed. Instead this product is now listed in the annex of goods that can be imported with a license from the Ministry of Trade. The Ministry of Public Security has the responsibility to determine who can register and use such motorcycles, and importation is allowed only for special purposes such as for the armed forces, security personnel, or for competitive sports. One U.S. motorcycle manufacturer has been seeking removal of this import prohibition in order to gain access in the near term to an estimated \$5 million in potential exports with good long term growth potential. Other items that were previously listed on the prohibition list such as narcotics, toys, and cigarettes have been moved to the list of goods to be managed/licensed by various ministries. Vietnam plans to lift its previous ban on used passenger automobiles that are less than five years old beginning March 2006, possibly under a quota system.

Quantitative restrictions and non-automatic licensing: Vietnam has been phasing out the use of quantitative restrictions on imports. An April 2001 Decision of the Prime Minister on export-import management for the period from 2001 to 2005 phased out quantitative restrictions on imports with the exception of sugar (which was eliminated in 2005). A September 2003 government decision established conditions for importing and re-exporting petroleum.

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This trading is subject to annual licensing and price regulation. Quantitative limitations on exports in most sectors have been eliminated, with the exception of textiles and garments, in accordance with the U.S.–Vietnam agreement on textiles and clothing, and a list of sensitive items. Decree 12/2006/ND-CP is the new export-import management plan for 2006 and beyond, implementing the new Commercial Law of June 14, 2005.

In May 2003, the Prime Minister issued a decision to implement tariff-rate quotas (TRQs) on certain agricultural products that were not previously under quotas. From January 2004, TRQs applied to cotton, raw tobacco, salt, milk, condensed milk, corn, and chicken eggs. In March 2005, the Government removed cotton, milk, condensed milk, and corn from the list of items subject to TRQs. The remaining items subject to TRQs are raw tobacco, salt, eggs, and raw and refined sugar, and apply to all non-ASEAN member countries. In practice, however, only salt and raw tobacco imports are currently restricted by quotas. Currently all companies are required to apply for import licenses in order to import unregistered foreign pharmaceutical products.

Special authority regulation: Previously, importers required approval from the relevant ministries to import many goods, but this system changed in 2001. Now, ten ministries and agencies are responsible for overseeing a system of minimum quality and performance standards for animal and plant protection, health safety, local network compatibility (in the case of telecommunications), money security, and cultural sensitivity. Goods that meet the minimum standards can be imported upon demand and in unlimited quantity and value.

Foreign exchange system: Vietnam has adopted a crawling peg with the U.S. dollar for its exchange rate. The State Bank of Vietnam (SBV) sets the official exchange rate daily, and commercial banks set their dealing rate within a trading band of plus or minus 0.25 percent. The SBV tends to keep the Dong depreciated against the U.S. dollar by keeping the exchange rate on an upward trend.

Customs: Under the terms of the BTA, Vietnam was obligated by December 2003 to apply transaction value for U.S. imports and to ensure that no administrative fee or charge imposed by customs authorities in connection with importing or exporting any good exceeds the actual cost of the service provided by Customs. In June 2002, the government issued Decree 60 establishing rules for customs valuation based on transaction value, in accordance with WTO principles. Subsequently the Ministry of Finance issued Circular 118 in December 2003, implementing the provisions of Decree 60, as well as Circular 87 in August 2004, abolishing the use of all minimum import prices. Vietnam also committed to apply transaction values to imports from ASEAN countries as well as 56 other countries on the basis of reciprocity. These changes have significantly improved customs valuation in Vietnam over the last year. However, the application of Customs Valuation Agreement principles is not entirely uniform and importers complain about the low level of automation of Vietnam's customs system. A revised Customs Law took effect on January 1, 2006, to address remaining problems and facilitate implementation of a \$70 million World Bank-supported customs modernization project in Vietnam.

Following a July 2005 decision by the Prime Minister to implement e-customs procedures that meet both regional and international standards, the Ho Chi Minh City Customs Office began a pilot electronic customs service in early October 2005. Processing time between submission of customs declarations and receipt of approval is less than two minutes, compared to an average of eight hours for paper-based procedures. Hai Phong and Ho Chi Minh City are the first localities to launch e-customs service for seaborne goods. The service will soon extend to other areas, including procedures in export processing zones, and will eventually be implemented in several locations throughout Vietnam in 2006.

Trading rights: The government of Vietnam currently maintains different regulations on trading rights for domestic and foreign-invested enterprises. Domestic Vietnam-owned enterprises are entitled to import in accordance with the business line(s) prescribed in their business registration certificates. These entities are not required to apply for an import license, except for goods for which the Ministry of Trade requires a non-automatic import license. Foreign-invested enterprises are not permitted to import goods freely in Vietnam.

Foreign-invested enterprises are allowed only to import goods used as inputs in the manufacturing process, as well as machinery, equipment, transportation means, and materials used in the construction and installation of their project in accordance with their investment license.

Under the terms of the BTA, beginning in December 2004, enterprises with capital directly invested by U.S. nationals and companies in production and manufacturing were to be able to engage in trading activities in most products and to enter into joint ventures with Vietnamese partners to engage in trading activities in all products, as long as the U.S. partner held no more than a 49 percent share in the venture. However, it was not until July 2005 that Vietnam established a mechanism for U.S. companies to benefit from these rights, and only as an interim measure until official regulations to implement BTA commitments are issued. Under the BTA, beginning in December 2008, U.S. companies will be able to establish wholly owned trading companies in Vietnam.

Taxes: In December 2002, the government issued a strategy for the automotive sector with a primary goal of significantly increasing the local content in domestically-produced vehicles. At the same time, the Ministry of Finance issued a decision to raise the import duty rates for automobiles produced from kits (CKDs). A joint campaign waged by affected foreign automobile companies and their representative Embassies resulted in postponement of the change. However, in May 2003, the National Assembly passed a Ministry of Finance proposal to impose a 10 percent VAT on all cars and increase the special consumption tax (SCT) on cars manufactured from CKDs starting in 2004. The SCT was increased from 5 percent to 24 percent in January 2004 and from 24 percent to 41 percent in January 2005. The changes to the tax and tariff policy were made years after foreign automobile manufacturers had committed significant resources to Vietnam and have contributed to lower sales and erosion in the profitability of foreign automakers in Vietnam.

In November 2005, the National Assembly passed a new Law on the Special Consumption Tax to address issues of national treatment discrimination on automobiles, cigarettes, distilled spirits, and fresh and draught beer, for which imports and locally made products are taxed at different rates. Unfortunately, the new law does not eliminate discrimination for beer and distilled spirits. The United States will continue to work with Vietnam to address this situation.

STANDARDS, TESTING, LABELING AND CERTIFICATION

Sanitary and Phytosanitary Measures (SPS)

Vietnam is currently working on the establishment of an SPS regime based on international standards, guidelines and recommendations. Its existing regime is based on CODEX and Food and Agriculture Organization (FAO)/World Health Organization (WHO) standards, the standards of regional or developed countries, or national standards. Vietnam has an inter-ministerial Working Group that coordinates SPS activities, and the Ministry of Agriculture and Rural Development (MARD) currently serves as a general inquiry point for information on SPS requirements. Specific responsibility for sanitary and phytosanitary controls, plant and animal quarantine, health quarantine and fisheries inspection is further assigned to other ministries and agencies.

In December 2003, the government banned imports of U.S. beef following the announcement of a case of Bovine Spongiform Encephalopathy (BSE) in the United States. On October 5, 2004, Vietnam's MARD issued a notice that it would allow imports of U.S.-origin boneless beef, with the conditions that the beef not originate from the state of Washington, and would only be consumed in hotels and restaurants. After much discussion, MARD lifted the restriction on the state of Washington on November 8, 2004. U.S. boneless beef from cattle less than 30 months old is now permitted entry into Vietnam for all end-users. In early January 2005, the first shipment of U.S. boneless beef arrived in Vietnam since the December 2003 ban.

In November 2005, Vietnam imposed a ban on all poultry and poultry product imports from all countries based on Avian Influenza (AI) concerns, a decision clearly inconsistent with international guidelines which reject restrictions on imports from countries free of AI. After intensive discussions with the United States, Vietnam modified the measure in January 2006 to allow imports of processed poultry products, while continuing the prohibition on imports of fresh poultry and eggs.

Vietnam also requires that all food products contain an expiration date beyond which food cannot be sold. For most products, no such restriction is necessary for food safety, and would thus seem inconsistent with accepted SPS practice. The United States is suggesting a "best-by" date with no restrictions on sales as an alternative when food safety is not an issue.

A new Vietnamese biotechnology law has provisions requiring labeling of all biotechnology products as well as shipment-by-shipment special import permits for biotechnology products. Although not yet implemented, these restrictions cause concern. The United States has raised such concerns in connection with Vietnam's WTO accession.

FOREIGN TRADE BARRIERS

Standards and Technical Barriers to Trade (TBT)

The Ministry of Science and Technology (MOST) is the main ministry involved in standardization and quality requirements. The Directorate for Standards and Quality (STAMEQ) under the MOST is generally responsible for advising the government on issues related to standards, measurements, and quality. There are currently three levels of standards: national standards, sectoral standards, and company standards. The system is complex and not always transparent. Some items are subject to voluntary application, while other items are subject to regulation by the line ministries with direct responsibility for the product/sector.

Exporters and importers must obtain a permit from the line ministries or a receipt showing an inspection is in process for the controlled items to be permitted through customs.

On March 25, 2003 Vietnam formally established the offices of STAMEQ as its TBT enquiry and notification point. The TBT enquiry point is functioning and responding to queries from business. However, it will not begin to function as a notification point until Vietnam officially joins the WTO.

Pharmaceutical companies face significant barriers to trade. The Ministry of Health now prohibits the registration or re-registration for import of 11 pharmaceutical products (reduced from 23) that are produced domestically. In addition, pharmaceutical companies complain that the registration process for pharmaceuticals lacks transparency and that registrations need to be extended or re-submitted every five years. Guidelines and regulations are unclear and/or are not applied in a consistent manner. The Ministry of Health issues product visas for products for which companies want to conduct market surveys before doing registrations, with validity periods as short as one year.

The government requires that all pharmaceutical raw materials with an expiry period of less than three years be imported into Vietnam within six months of the date of manufacture. Additionally, foreign manufacturers of vaccines are required to conduct clinical trials in Vietnam before being permitted to register their vaccines for sale.

GOVERNMENT PROCUREMENT

Government procurement practices can be characterized as a multi-layered decision-making process often lacking transparency and efficiency. Although the Ministry of Finance allocates funds, various departments within the ministry or agency procuring the good or service determine government procurement needs. Competition for government procurement may take any of several forms: sole source direct negotiation, limited tender, open tender, appointed tender or special purchase. Currently, ministries and agencies have different rules on minimum values for the purchase of materials or equipment, which must be subject to competitive bidding. High-value or important contracts such as infrastructure (except World Bank, Asian Development Bank, UNDP, or bilateral official development assistance projects) require bid evaluation and selection, and are awarded by the Prime Minister's office or any other competent body. No consolidated or regular official listing of government tenders exists. However, some solicitations are announced in both Vietnamese and English-language newspapers.

FOREIGN TRADE BARRIERS

EXPORT SUBSIDIES

Export credit is very limited in Vietnam. The Export Promotion Fund managed by the Ministry of Finance provides subsidies in the form of interest rate support (full or partial refund of interest incurred on ordinary bank loans), direct financial support (to first-time exporters, for exports to new markets, or for goods subject to major price fluctuations) and export rewards and bonuses. Since 1998, the average annual export reward provided to eligible enterprises has ranged from \$2,900 to \$4,710. Provision of export bonuses, originally targeted for exports of agricultural products, was expanded in 2002 to include non-agricultural products such as handicrafts, rattan and bamboo ware, plastic products and mechanical products. Since 2001, the Export Promotion Fund has also provided support to enterprises for expenditures on trade promotion activities.

Beginning in September 2001, the Development Assistance Fund has administered an export credit program that has provided short-term loan guarantees, medium and long-term investment loans, post-investment interest rate support and investment credit guarantees to domestic enterprises.

INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

Vietnam is a member of World Intellectual Property Organization (WIPO) and is a signatory to the Paris Convention for the Protection of Industrial Property. It has acceded to the Patent Cooperation Treaty and the Madrid Agreement. On October 26 2004, Vietnam joined the Berne Convention on Protection for Literary and Artistic Works. Vietnam is also obligated, under the terms of the 1997 U.S.-Vietnam Bilateral Copyright Agreement, to provide U.S. copyrights protection on a national treatment basis in accordance with the terms of the Berne Convention. Vietnam acceded to the Geneva Convention for the Protection of Producers of Phonograms against Unauthorized Duplication of their Phonograms in July 6, 2005. On January 12, 2006, Vietnam's membership in the the Brussels Convention Relating to the Distribution of Programme-Carrying Signals Transmitted by Satellite went into effect. Under the terms of the BTA, Vietnam was obligated by December 2003 to make its system for protecting IPR, including enforcement, consistent with the WTO TRIPS agreement. Considerable progress has been made over the past few years in establishing the legal framework for IPR protection. New IPR related legislation in 2005 included the Intellectual Property Law, Law on Publishing, Civil Code, Civil Procedure Code, Inter-Circular No.129/2004/TTLT/BTC-BKHCN Guiding Border Control Measures for Industrial Property of Import Export Goods, Circular 132/2004/TT-BTC Providing Guidelines for the Collection, Payment, Control and Utilization of Industrial Property Fees and Charges (abolishment of two-tier price), and Decision No.12/2005/QD-BNV on the establishment of the Vietnam Anti-Counterfeit and Intellectual Property Protection Association of Foreign-Invested Enterprises (VACIP).

The new Intellectual Property (IP) Law was approved by the National Assembly on November 19, 2005, and it will take effect on July 1, 2006. Vietnam intends to issue implementing regulations prior to this date. The new law helps bring Vietnam into greater compliance with international norms. Changes include providing new remedies, correcting inconsistencies with the Berne Convention, protecting data exclusivity, and extending protection to new media, such as the Internet, and satellite signals carrying encrypted programs.

FOREIGN TRADE BARRIERS

However, many concerns remain, including overly broad provisions on compulsory licensing and terms for copyright protection that are less than those required by the BTA.

Enforcement of IPR protection remains extremely weak. The BTA requires the Government of Vietnam to provide expeditious remedies to prevent and deter infringement of IPR, including particular judicial and administrative procedures, prompt and effective provisional measures secured by sufficient evidence, and criminal procedures and penalties for willful trademark counterfeiting or infringement of copyrights or neighboring rights on a commercial scale. The Vietnamese government is considering how to address the piracy of television broadcast signals occurring in Vietnam.

Patent and Trademarks

Trademark registration in Vietnam is relatively straightforward, although infringement is widespread and enforcement of administrative orders and court decisions finding IPR infringement remains problematic. Vietnam's laws offer some protection for foreign patent holders, but infringement continues. The National Office of Intellectual Property (NOIP) under the Ministry of Science and Technology administers Vietnam's patent and trademark registration systems. NOIP has made significant progress in recent years to build adequate capacity to record and adjudicate patent and trademark claims, and is working with a number of foreign patent and trademark agencies to enhance its systems. Obtaining expeditious adjudication and administrative enforcement of patent and trademark violations remains difficult. Victims of infringement have encountered difficulties implementing NOIP enforcement decisions.

Vietnam's new Law contains a provision for protecting the secrecy of test data when the law requires submission of such data as a condition for approving the marketing of pharmaceutical or agricultural chemical products. Currently, Vietnamese law lacks the legal provisions necessary to protect test data from unfair commercial use.

Copyrights

The Vietnam Office of Literary and Artistic Copyright is under the control and supervision of the Ministry of Culture and Information. Significant progress has been made in putting in place the legal framework required to protect copyrights, including those belonging to foreigners, but enforcement is almost non-existent. This is particularly true for certain categories of products, such as computer software, music compact discs (CDs), video compact discs (VCDs), and digital video discs (DVDs). Industry estimates of piracy rates for software, music, and videos run as high as 92 percent. Local police authorities often are slow to act on administrative orders issuing fines for infringement and enforcing court decisions. Following Vietnam's accession to the Berne Convention and Geneva Convention, the Ministry of Culture and Information made an effort to tighten copyright regulations on foreign musical and theatrical works, as well as sound recordings. All event organizers must now obtain permission in writing from the copyright holders before performing their works.

SERVICES BARRIERS

Under the terms of the BTA, Vietnam agreed for the first time to liberalize a broad array of service sectors, including telecommunications, accounting, banking, and distribution services, and to apply MFN treatment to U.S. services suppliers in all sectors and for all modes of supply (with itemized exceptions). The BTA also incorporated the GATS (except Articles 3 and 4), Annex on Movement of Natural Persons, Annex on Telecommunications (except Articles 6 and 7), and the Telecommunications Reference Paper. Vietnam's commitments to liberalize market access on services are being phased in over specified time periods depending on the sector. In Diplomatic Note No. 3831/BKH-PC dated June 8, 2005, the Ministry of Planning and Investment confirmed that "Vietnam assures that investment licenses for investment projects in the services sector will be granted in line with the schedule and conditions stipulated in Annex G and Annex H of the Agreement." The commitments by sector are as follows:

Accounting, Auditing, and Bookkeeping Services: To establish in Vietnam, a company must employ at least five persons with licenses to be a CPA in Vietnam who have practiced in Vietnam for more than one year. Until 2003, firms with U.S. equity were only allowed to supply services to foreign-invested enterprises and foreign-funded projects in Vietnam. Auditing firms can be established in the form of partnerships, private enterprises or foreign-invested enterprises. Foreign-invested auditing firms are permitted to set up branches in Vietnam. Accounting firms can be established in the form of limited liability companies, partnerships or private enterprises. Branching is not permitted.

Taxation Services: Until 2006, licenses will be granted on a case-by-case basis, and firms with U.S. equity are only allowed to supply services to foreign-invested enterprises and foreign-funded projects in Vietnam. Branching is not permitted.

Architectural, Engineering, and Computer Services: For a period of two years from the date of establishment and operation of their Vietnam operations, U.S.-owned companies can only provide services with foreign-invested enterprises in Vietnam. U.S. companies have to be legally registered in the United States. Branching is not permitted.

U.S. companies and companies with U.S. directly-invested capital are not permitted to carry out topographic, construction, geological, meteorological, and environmental investigations, or technical investigations for designing rural-urban construction plans, unless otherwise authorized by the Government of Vietnam.

Legal Services: Under the terms of the BTA, 100 percent equity ownership in companies, joint ventures, and branches is permitted. U.S. lawyers may not appear before Vietnam's courts. However, U.S. firms may advise on Vietnam's law if they hire persons with Vietnamese law degrees who satisfy the requirements applied to Vietnamese practitioners. After the BTA took effect, Vietnam's law on lawyers was amended to provide that Vietnamese lawyers working for foreign firms may not appear before Vietnamese courts. Prior to the amendment, and at the time the BTA was signed, all Vietnamese lawyers were allowed to appear in court. Branches of law firms may receive a five-year renewable license. In July 2003, the government promulgated Decree 87 significantly reforming the regulatory framework for the operations of foreign law

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practices and foreign law firms. The decree substantially broadened the scope of practice of foreign law firms in Vietnam. Foreign law practices are permitted to provide advice on foreign and international law in the areas of business, investment and commerce, which had been prohibited previously. By virtue of these reforms, foreign law firms may now offer a full range of legal services and employ Vietnamese lawyers, but may not appear before Vietnamese courts. A further revision to the law on lawyers is planned in 2006.

Advertising Services and Market Research: Vietnam has not agreed to provide market access for advertising services for wines and cigarettes or for the cross-border supply of market research services. U.S. companies in these sectors may initially only establish a commercial presence through joint ventures or business cooperation contracts with Vietnamese partners. U.S. investment is limited to 49 percent of the legal capital for the first five years under the BTA, 51 percent for years six and seven, and is unlimited after that. Vietnam has not agreed to ensure national treatment for the cross-border supply of market research services.

Management Consulting: U.S. companies may only establish a commercial presence through joint ventures or business cooperation contracts. After the BTA has been in effect for five years, enterprises with 100 percent U.S. ownership will be permitted.

Telecommunications Services: The provision of basic telecommunications services, value-added telecommunications services, and voice telephone services is only permitted through business cooperation contracts (BCC) with Vietnamese gateway operators. At least one Voice over Internet Protocol (VOIP) telecommunications service provider investing in a BCC with a local partner is reporting difficulties due to quota restrictions placed on its Vietnamese partner. According to the terms of the BTA, U.S. value-added telecommunications service providers may establish joint ventures with Vietnamese partners with up to 50 percent equity ownership. These joint ventures may not, however, construct their own long-distance and international circuits. However, Vietnam's law does not yet provide specifically for joint ventures in the telecom sector, and the government has not issued any regulations or other documents specifically authorizing joint ventures with U.S. companies or clarifying the procedures for such partnerships in the telecommunications sector. The Common Investment Law passed at the end of 2005, along with its implementing decrees, will implement these obligations. Four years after entry-into-force of the BTA, U.S. basic telecommunications service suppliers can establish joint ventures with Vietnamese partners with up to 49 percent U.S. equity ownership. These joint ventures may not, however, construct their own long-distance and international circuits. Six years after entry-into-force of the Agreement, U.S. voice telephone service providers may establish joint ventures with Vietnamese partners with up to 49 percent U.S. equity ownership. The licensing for joint ventures in the sector will be implemented in accordance with commitments made in the BTA. As stated in a June 8, 2005 Ministry of Planning and Investment diplomatic note, licensing for investment projects in the service sector will be carried out in accordance with Annexes G and H of the BTA. To date, no U.S. or Vietnamese companies have applied for a joint venture license in the telecommunications sector.

Audiovisual Services: Vietnam has not agreed to provide market access or national treatment for cross-border supply or consumption abroad of audiovisual services. U.S. service suppliers may establish a commercial presence only through a business cooperation contract or joint venture

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with a Vietnamese partner. U.S. ownership may not exceed 49 percent until December 2006, when the cap increases to 51 percent. The government strictly limits the importation of foreign films, videos, television and books. Numerous licensing, pricing and remittance restrictions exist. IPR protection for audio-visual products is ineffective, censorship is restrictive and rules are often applied in an ad-hoc manner. The National Assembly debated the draft Law on Cinema, which governs film production, importation, distribution, archiving, international cooperation in film making and petitions and punishments for violations during its November 2005 session. Assembly members criticized the law as too vague and not in line with a market-economy approach. The law will be redrafted by the Ministry of Culture and Information and resubmitted to the next National Assembly session in spring 2006.

Construction and Related Engineering Services: Vietnam has not agreed to provide market access or national treatment for the cross-border supply of construction and related engineering services. Branches are not permitted. For the first three years after their establishment and operation, 100 percent U.S.-owned enterprises could only provide services to foreign-invested enterprises in Vietnam. U.S. companies must be legally registered for operation in the United States.

Decree 16 on management of construction projects in 2005 abolished the requirement that Joint Venture enterprises and Business Cooperation Contracts with state shares of at least 30 percent conduct tendering for construction projects in accordance with Vietnamese tendering rules.

Distribution Services: Under the BTA, Vietnam does not provide market access or national treatment for the cross-border supply of distribution services. In December 2004, U.S. service providers were able to establish joint ventures with Vietnamese partners with up to 49 percent U.S. equity. However, it was not until July 2005 that the Government of Vietnam established a mechanism for U.S. companies to avail themselves of these rights. In December 2007, six years after entry into force of the BTA, U.S. ownership in joint ventures will be unlimited. In December 2008, 100-percent equity ownership by U.S. companies will be allowed. One retail outlet per firm was permitted upon entry-into-force of the BTA, while additional outlets will be considered on a case-by-case basis. For some agricultural and industrial products, market access in this sector is subject to additional limitations, which will be phased out over a period of three to five years from 2001. There are a limited number of products for which Vietnam did not commit to allow distribution services.

Educational Services: Vietnam will not provide market access or national treatment for the cross-border supply of educational services. U.S. companies may only establish a commercial presence through a joint venture until December 2008, when schools with 100-percent U.S.-invested capital may be established. Foreign teachers employed by educational units with U.S.-invested capital must have five years teaching experience and be recognized by the Ministry of Education.

Insurance Services: Vietnam has agreed to allow market access for the cross-border supply of insurance services to enterprises with foreign invested capital or foreigners working in Vietnam; reinvestment services; insurance services in international transportation; insurance brokering and reinsurance brokering services; and advisory, claim settlement, and risk assessment services.

FOREIGN TRADE BARRIERS

Starting in 2005, U.S. companies can establish joint ventures with Vietnamese partners with up to 50 percent U.S. equity participation. After five years, 100-percent U.S.-invested companies may be established.

While the government has allowed, on a case-by-case basis, 100-percent foreign investment in both “life” and “non-life” insurance markets, access had been limited for U.S. service providers. Recently, three additional operating licenses, two for life insurance and one in the non-life sector, have been issued to U.S. insurers. These licenses allow 100-percent foreign ownership. Some joint ventures with Vietnamese companies have been allowed to convert to 100-percent foreign ownership, but the terms have been arbitrary and subject to the “ad hoc” approval of the government.

Companies with U.S.-invested capital cannot provide insurance for motor vehicle third party liability, for construction and installation, for oil and gas projects, or for projects and construction of high danger to public security and environment. Vietnam agreed to eliminate this limitation for joint ventures as of December 2004. After six years, this limitation will be eliminated for companies with 100-percent U.S. capital.

Until December 2005, any company with U.S. capital must reinsure part of its accepted liabilities (currently at a minimum rate of twenty percent) through the Reinsurance Company of Vietnam.

Banking: Vietnam has not agreed to provide market access or national treatment for the cross-border provision of banking services, except for financial information services and advisory, intermediation, and other auxiliary services. U.S. banks may establish a commercial presence through branches, joint ventures with Vietnamese banks, wholly-owned U.S. financial leasing companies or joint venture financial leasing companies with Vietnamese partners. Foreign banks can open full branches in both Hanoi and Ho Chi Minh City and operate as a single legal entity provided that each branch meets the capital requirement of \$15 million. This capital requirement does not apply to Vietnamese bank branches.

Until 2005, the only legal form other than banks and leasing companies under which U.S. companies could provide financial services was through joint ventures with Vietnamese banks. In the BTA, Vietnam only committed to allow U.S. equity in joint venture banks of over 30 percent and less than 49 percent until December 2009, at which point 100 percent equity participation in subsidiary banks will be allowed. However, current Vietnamese law allows foreign banks to own up to 50 percent equity in joint venture banks. The amended Law on Credit Institutions will permit the establishment of 100 percent foreign-owned banks in advance of Vietnam’s BTA obligations. The draft implementing decree for this amended law has been submitted to the government for consideration. Approval is expected in 2006.

The right of U.S. banks to accept Vietnamese currency deposits on the same basis as domestic banks is phased in over eight years (until 2009) for business clientele and ten years (until 2011) for retail depositors, at which point U.S. bank branches will be entitled to full national treatment. Vietnam is fulfilling this commitment by gradually allowing U.S. banks to increase the amount of deposits in Vietnamese Dong (i.e. the local currency) relative to the branch's legal paid-in capital with the ratio presently at 400 percent for legal persons and 350 percent for natural persons. (Prior to entry-into-force of the BTA, this ratio was 25 percent.) In addition, financial institutions with U.S. equity cannot issue credit cards on a national treatment basis until 2009. U.S. banks are now allowed to place automatic teller machines outside their offices on a national treatment basis.

Vietnam reserved the right to limit, on a national treatment basis, equity investment by U.S. banks in privatized Vietnamese state-owned banks.

U.S. bank branches, subsidiaries, or U.S.-Vietnam joint ventures must obtain a license to establish a commercial presence in Vietnam. Establishing a U.S.-Vietnam joint venture bank or a U.S. bank subsidiary requires minimum capital of \$10 million. Authorized capital levels for state-owned commercial banks, joint-stock commercial banks, investment banks and joint venture banks are set at much lower levels.

Starting in 2005, financial institutions with 100 percent U.S. equity ownership are allowed to take an initial mortgage interest in land-use rights held by foreign-invested enterprises, and may use mortgages or land-use rights for the purpose of liquidation in case of default.

Establishing a wholly owned subsidiary of a U.S. financial leasing company or a joint venture leasing company requires three consecutive profitable years, and \$5 million in legal capital.

Vietnam was not obligated, until December 2004, to provide national treatment with respect to access to central bank rediscounting, swap, and forward facilities. However, in 2003, the State Bank of Vietnam allowed one U.S. bank with branches in Vietnam (and some local banks) to provide swap service on a pilot basis. In May 2004, the State Bank of Vietnam issued Decision 648 allowing commercial banks to provide forward and swap facilities to their clients.

Licenses for foreign banks currently are limited in validity to only 20 years to 30 years and extensions (if any) are subject to the approval of the State Bank of Vietnam.

Non-banking Financial Services: The BTA allows 100 percent U.S. equity in financial leasing and in other leasing after 3 years. Government Decree 79 issued in 2002 permits the establishment and operation of finance companies in Vietnam, including joint venture and wholly foreign-owned finance companies.

Securities-Related Services: Vietnam has not agreed to provide market access or national treatment for the cross-border supply of securities-related services. Non-bank U.S. securities service suppliers may only establish a commercial presence in Vietnam in the form of a representative office. In 2003 the government issued Decree 144 on Securities and Securities Trading, allowing foreign investment in securities investment funds and fund management

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companies. Government Decision 238 issued in September 2005, which replaces Government Decision 146 issued in July 2003, maintains the limit on foreign capital contribution in joint venture security companies or joint venture fund management companies at 49 percent.

Health-Related Services: U.S. operators may provide services through the establishment of 100 percent U.S.-owned operations, joint ventures with Vietnamese partners or through business cooperation contracts. The minimum investment capital is \$20 million for a hospital, \$2 million for a polyclinic, and \$1 million for a specialty unit.

Tourism and Travel-Related Services: U.S. companies may establish a commercial presence to provide hotel and restaurant services, provided that this is done in conjunction with investment for the construction of a hotel. The commercial presence may take the form of a business cooperation contract, a joint venture with Vietnamese partners, or a company with 100 percent U.S. equity investment.

There are limitations with respect to travel agencies and tour operators. U.S. companies supplying these services may establish a commercial presence only through a joint venture with Vietnamese partners and can initially only contribute 49 percent of the capital. Starting in January 2005, 51 percent participation was allowed, and all limitations will be abolished after five years. Tourist guides in joint ventures must be Vietnamese citizens. Service-supplying companies with U.S.-invested capital may only supply inbound service.

INVESTMENT BARRIERS

Currently, the Government of Vietnam maintains an extensive investment licensing process, which is characterized by stringent and time-consuming requirements that are frequently used to protect domestic interests, limit competition, and allocate foreign investment rights among various countries. Foreign businesses are permitted to remit profits, and share revenues from joint ventures, incomes from services and technology transfers, legally-owned capital, and properties in hard currency. Foreigners are also allowed to remit royalties and fees paid for the supply of technologies and services, principal and interest on loans obtained for business operations, and investment capital and other money and assets under their legitimate ownership.

The BTA provides a broad range of benefits to U.S. investors in Vietnam to enhance the investment environment for U.S. firms. Vietnamese investment obligations under the BTA include: providing national and most-favored-nation treatment, except where explicit exceptions have been made; ensuring compensation for expropriation consistent with international standards; and guaranteeing access to third-party investor-state dispute settlement. In practice, however, recognition and enforcement of foreign arbitral awards in Vietnam currently remains unpredictable.

In addition, Vietnam is obligated under the BTA to gradually discontinue application of any WTO Trade-Related Investment Measures (TRIMS) or performance requirements inconsistent with the WTO TRIMS Agreement. In November 2005, the National Assembly passed the Common Investment Law (CIL), which is aimed at creating a level playing field for foreign and domestic investors, and implementing Vietnam's commitments under the BTA and international

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treaties. The CIL will enter into force on July 1, 2006. Implementing decrees for the CIL, which will provide operational details for investment in Vietnam, are currently in preparation. The U.S. government is actively monitoring this process.

Under the BTA, Vietnam is obligated to refrain from imposing requirements to transfer technology as a condition for the establishment, expansion, acquisition, management, conduct, or operation of an investment. Vietnam currently imposes a number of performance requirements with respect to the establishment of an investment and/or the receipt of a benefit or incentive. The CIL confirms that all remaining export performance requirements will be abolished. Vietnam retains restrictions on foreign shareholding in Vietnamese companies, although the ratio was raised from 30 percent to 49 percent in September 2005.

Decree 27 also now allows foreign investors to recruit Vietnamese workers directly, without having to go through labor recruitment agencies. However, in September 2003, Government Decree 105, drafted by the Ministry of Labor, Invalids and Social Affairs, established a regulation limiting all enterprises operating in Vietnam to employ foreign nationals at the lesser of: (1) a maximum rate of 3 percent of their total work force; or (2) 50 persons. Despite repeated complaints from the foreign business community, the government appears unwilling to lift the cap. In July 2005, Government Decree 93 announced amendments to Decree 105, including exempting certain sectors from limits on foreign workers and allowing some firms to apply to local governments to exceed the 3 percent/50 person cap.

However, Decree 93 reaffirmed the cap for most sectors, and it stated that firms in exempted sectors would need to apply to local governments in order to hire foreign workers.

In the BTA, Vietnam committed to gradually shift from an investment licensing regime to an investment registration regime for most sectors. According to Decree 27, the following types of investment are no longer subject to investment licensing: investment projects that export 80 percent of products; investments in “encouraged” or “specially encouraged” projects located in industrial zones (with some exceptions); and investment in the manufacturing sector with a value of up to \$5 million in investment capital. Under the new CIL, projects with foreign invested capital of under 300 billion Vietnamese Dong (approximately \$19 million), excluding projects on the list of sectors where investment is subject to conditions, are eligible for registration. Projects which must be evaluated for licensing include: projects on the list of sectors where investment is subject to conditions, or projects with invested capital of 300 billion Vietnamese Dong or more.

Investment Stock: According to official Vietnamese statistics, the stock of U.S. foreign direct investment (FDI) in Vietnam in 2005 was \$728 million, up from \$721 million in 2004. However, a recent joint study by the Vietnamese government and the U.S.- funded STAR program took a closer look at U.S. investment and found that when investment from U.S. subsidiaries located in third countries is included, U.S. investment in Vietnam totals \$2.6 billion. In 2004, U.S. firms were the largest foreign investors in terms of implemented capital, amounting to \$531 million or 19 percent of total investment in Vietnam and above investment from Japan, Korea, Singapore and Taiwan.

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The study also found that U.S.-related FDI has increased strongly since the U.S.-Vietnam BTA went into effect, growing by an average of 27 percent a year from 2002 through 2004 compared to just around 3 percent a year from 1996 to 2001.

ELECTRONIC COMMERCE

To date, electronic commerce has not exhibited much growth in Vietnam. Obstacles to its development include: the low number of Internet subscribers in-country, obtrusive firewalls, limited bandwidth and other problems with the Internet infrastructure, limitations of the financial system (including the low number of credit cards in use), and regulatory barriers. However, recent developments to facilitate the growth of electronic commerce in Vietnam include legal acceptance of e-signatures and implementation of the electronic inter-bank transaction system. The number of online transactions has been increasing. The e-transaction law was passed on November 19, 2005 and will take effect on March 1, 2006.

Vietnam continues to attempt to keep close control of all websites established in Vietnam. In October 2002, the Government passed a new regulation on the establishment and modification of websites. The regulation requires domestic and foreign agencies, organizations, and enterprises to obtain a license from the Ministry of Culture and Information (MOCI) before establishing new websites. The Ministry then has 30 days to make a decision on granting the license. The regulation also requires diplomatic and other foreign entities to obtain written approval from the Ministry of Foreign Affairs before requesting a license from MOCI.

Vietnam may also require organizations to request permission from MOCI before making changes to the content of their existing websites based on licensing requirements in the regulation.

OTHER BARRIERS

U.S., other foreign, as well as domestic firms have identified corruption in Vietnam in all phases of business operations as an obstacle to their business activities. In 2005, Vietnam scored a 2.6 out of a possible 10 points on Transparency International's Corruption Perception Index. Transparency International considers a score of less than 3 to be an indication of severe corruption. In large part due to a lack of transparency, accountability, and media freedom, widespread official corruption and inefficient bureaucracy remain serious problems that even the Government of Vietnam admit they must address on an urgent basis. Competition among government agencies for control over business and investments has created confusing overlapping jurisdictions and bureaucratic procedures and approvals, which in turn create opportunities for corruption. Low pay for government officials and woefully inadequate systems for holding officials accountable for their actions compound the problems.

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Implementation of the Government of Vietnam's public administration reform program, developed with the assistance of the World Bank, as well as Vietnam's obligations under the transparency provisions of the BTA promise some improvement in the situation in the medium to long term, but it appears unlikely there will be much improvement in the near term. The U.S. Government, through the Department of Commerce, is proposing initiatives to help improve the business environment in Vietnam through a good corporate governance program in cooperation with the private sector.

Vietnam maintains a policy of bias favoring domestic-market oriented industries, particularly those dominated by state-owned enterprises. Although all registered firms, regardless of ownership, can engage legally in foreign trade, barriers exist that discourage trading by non-state enterprises. Monopolies in production result in monopolies in trading, as in the case of coal. The tariff structure also favors domestic industries, particularly those dominated by state-owned enterprises. Tariffs are on items predominantly used by those enterprises as inputs are lower.

In April 2003, the United States and Vietnam concluded a textile trade agreement. The textile agreement assists U.S. domestic manufacturers by including Vietnam within the global textile quota regime and helps our importers by providing certainty and avoiding the unpredictability of frequent, random, unilateral limits. The agreement also reduces tariffs on a range of U.S. textile and garment imports from between 7 percent and 30 percent in 2003 to between 5 percent and 20 percent in 2005. A number of decisions issued by the Ministry of Finance between 2003 and 2005 implemented these tariff reductions. This agreement also contains a labor provision. Both parties reaffirm their commitments as members of the International Labor Organization and also indicate their support for implementing codes of corporate social responsibility as one way of improving working conditions in the textile sector. The agreement calls for a review of progress on the goal of improving working conditions in the textile sector through consultations between the U.S. Department of Labor and Vietnam's Ministry of Labor, Invalids, and Social Affairs. On December 9, 2005, the agreement was extended through 2006.

APPENDIX
US Data for Given Trade Partners in Rank Order of US Exports
(Values in Millions of Dollars)

Country	Trade Balance		Change 2004-05	Exports* 2004	Exports* 2005	Change 04/05		Imports** 2004	Imports** 2005	Change 04/05		FDI*** 2003	FDI*** 2004	% Change 2003-04	FDI Area
	2004	2005				Value	Percent			Value	Percent				
World	-650,930	-766,366	-115,436	818,775	904,382	85,607	10.46	1,469,704	1,670,751	201,047	13.68	1,792	2,064	15.19	Manuf., Finance, Wholesale
Canada	-66,480	-76,522	-10,042	189,880	211,348	21,468	11.31	256,360	287,870	31,510	12.29	189,754	216,571	14.13	Manuf., Finance, Mining
Mexico	-45,067	-50,149	-5,082	110,835	120,049	9,214	8.31	155,902	170,198	14,296	9.17	59,070	66,554	12.67	Manuf., Banking, Finance
Japan	-75,562	-82,681	-7,119	54,243	55,410	1,167	2.15	129,805	138,091	8,286	6.38	68,097	80,246	17.84	Finance, Manuf.,
People's Republic of China	-161,938	-201,625	-39,687	34,744	41,837	7,093	20.41	196,682	243,462	46,780	23.78	11,541	15,430	33.70	Manuf., Wholesale, Mining
United Kingdom	-10,274	-12,434	-2,160	36,000	38,629	2,629	7.30	46,274	51,063	4,789	10.35	278,745	302,523	8.53	Finance, Manuf., Banking
Germany	-45,850	-50,664	-4,814	31,416	34,149	2,733	8.70	77,266	84,813	7,547	9.77	68,358	79,579	16.42	Manuf., Wholesale, Finance
Republic of Korea	-19,755	-16,109	3,646	26,412	27,670	1,258	4.76	46,168	43,779	-2,389	-5.17	13,030	17,332	33.02	Manuf., Banking, Finance
Netherlands	11,839	11,635	-204	24,289	26,496	2,207	9.09	12,451	14,861	2,410	19.36	186,102	201,918	8.50	Manuf., Finance, Wholesale
France	-10,342	-11,445	-1,103	21,263	22,402	1,139	5.36	31,606	33,847	2,241	7.09	48,268	58,927	22.08	Manuf., Wholesale, Finance
Taiwan	-12,879	-12,788	91	21,744	22,050	306	1.41	34,624	34,838	214	0.62	12,148			Finance, Manuf., Banking
Singapore	4,238	5,528	1,290	19,608	20,646	1,038	5.29	15,370	15,118	-252	-1.64	50,343	56,900	13.02	Manuf., Wholesale, Information
Belgium	4,425	5,589	1,164	16,871	18,605	1,734	10.28	12,446	13,016	570	4.58	26,477	27,761	4.85	Manuf.,
Hong Kong	6,513	7,430	917	15,827	16,323	496	3.13	9,314	8,893	-421	-4.52	37,567	43,743	16.44	Finance, Wholesale, Manuf.,
Australia	6,680	8,431	1,751	14,225	15,771	1,546	10.87	7,546	7,340	-206	-2.72	48,858			Manuf., Finance, Wholesale
Brazil	-7,263	-9,092	-1,829	13,897	15,345	1,448	10.42	21,160	24,437	3,277	15.49	31,741	33,267	4.81	Manuf., Finance, Banking
Italy	-17,413	-19,496	-2,083	10,685	11,512	827	7.74	28,097	31,008	2,911	10.36	29,611	33,378	12.72	Manuf., Information, Wholesale
Switzerland	-2,348	-2,249	99	9,280	10,740	1,460	15.73	11,628	12,989	1,361	11.71	88,940	100,727	13.25	Manuf., Wholesale, Banking
Malaysia	-17,258	-23,252	-5,994	10,921	10,451	-470	-4.31	28,179	33,703	5,524	19.60	7,270	8,690	19.53	Manuf., Mining
Israel	-5,382	-7,143	-1,761	9,169	9,732	563	6.14	14,551	16,875	2,324	15.97	7,036	6,790	-3.50	Manuf.,
Ireland	-19,281	-19,286	-5	8,167	9,335	1,168	14.30	27,448	28,621	1,173	4.27	62,547	73,153	16.96	Manuf., Information, Finance
United Arab Emirates	2,943	7,008	4,065	4,086	8,477	4,391	107.48	1,143	1,469	326	28.55	2,016	2,368	17.46	Mining, Finance
India	-9,463	-10,849	-1,386	6,109	7,958	1,849	30.26	15,572	18,807	3,235	20.77	4,831	6,203	28.40	Manuf., Mining, Banking
Thailand	-11,211	-12,659	-1,448	6,368	7,233	865	13.58	17,579	19,892	2,313	13.16	7,098	7,747	9.14	Manuf., Prof. Services
Spain	-712	-1,683	-971	6,638	6,934	296	4.45	7,350	8,617	1,267	17.24	40,439	45,251	11.90	Manuf., Finance, Wholesale
Philippines	-2,050	-2,355	-305	7,087	6,893	-194	-2.74	9,137	9,248	111	1.22	5,790	6,338	9.46	Manuf., Utilities, Finance
Saudi Arabia	-15,702	-20,398	-4,696	5,257	6,830	1,573	29.93	20,959	27,228	6,269	29.91	3,513	3,835	9.17	Manuf., Wholesale, Prof. Services
Venezuela	-20,153	-27,557	-7,404	4,767	6,408	1,641	34.41	24,921	33,965	9,044	36.29	9,119	8,493	-6.86	Manuf., Mining
Colombia	-2,751	-3,431	-680	4,505	5,415	910	20.20	7,256	8,846	1,590	21.91	2,956	2,987	1.05	Manuf., Mining, Wholesale
Chile	-1,126	-1,468	-342	3,606	5,198	1,592	44.15	4,732	6,666	1,934	40.86	9,218	10,196	10.61	Finance, Manuf., Mining
Dominican Republic	-169	105	274	4,358	4,709	351	8.05	4,527	4,604	77	1.70	816	1,041	27.57	Manuf., Wholesale

* US Total Exports (f.a.s.); ** US General Imports (customs value); *** Stock of US Foreign Direct Investment Abroad.

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(Values in Millions of Dollars)

Country	Trade Balance		Change 2004-05	Exports* 2004	Exports* 2005	Change 04/05		Imports** 2004	Imports** 2005	Change 04/05		FDI*** 2003	FDI*** 2004	% Change 2003-04	FDI Area
	2004	2005				Value	Percent			Value	Percent				
Turkey	-1,572	-903	669	3,362	4,274	912	27.12	4,934	5,177	243	4.93	1,985	2,225	12.09	Banking, Wholesale, Manuf.,
Argentina	-357	-472	-115	3,388	4,100	712	21.01	3,746	4,572	826	22.07	10,948	11,629	6.22	Manuf., Finance, Infomation
Russia	-8,930	-11,337	-2,407	2,961	3,942	981	33.13	11,891	15,279	3,388	28.49	1,753	2,231	27.27	Mining
Sweden	-9,416	-10,119	-703	3,267	3,709	442	13.52	12,683	13,828	1,145	9.03	34,927	36,399	4.21	Finance, Manuf.,
Costa Rica	-27	176	203	3,306	3,595	289	8.75	3,333	3,419	86	2.57	863	1,098	27.23	Manuf.,
Honduras	-562	-506	56	3,078	3,244	166	5.38	3,640	3,750	110	3.02	262	339	29.39	Manuf.,
Egypt	1,794	1,078	-716	3,078	3,169	91	2.96	1,284	2,091	807	62.87	3,518	4,240	20.52	Mining
Indonesia	-8,139	-8,971	-832	2,671	3,045	374	13.98	10,811	12,016	1,205	11.15				
Guatemala	-603	-321	282	2,551	2,813	262	10.26	3,154	3,134	-20	-0.63	305	419	37.38	
New Zealand	-895	-507	388	2,073	2,648	575	27.74	2,968	3,155	187	6.30	3,886	4,481	15.31	Finance, Manuf., Wholesale
Austria	-3,853	-3,507	346	1,946	2,598	652	33.53	5,798	6,105	307	5.29	4,920	5,278	7.28	Manuf., Wholesale
Peru	-1,601	-2,832	-1,231	2,101	2,289	188	8.95	3,702	5,121	1,419	38.35	3,678	3,934	6.96	Mining
Panama	1,519	1,842	323	1,835	2,169	334	18.18	316	327	11	3.53	5,538	5,868	5.96	Finance, Wholesale,
Finland	-1,818	-2,088	-270	2,069	2,248	179	8.65	3,887	4,336	449	11.55	1,620	2,071	27.84	Manuf., Wholesale
Ecuador	-2,615	-3,780	-1,165	1,669	1,979	310	18.60	4,283	5,759	1,476	34.45	1,082	814	-24.77	Mining
Kuwait	-1,712	-2,361	-649	1,519	1,974	455	29.93	3,231	4,335	1,104	34.18		478		
Norway	-4,904	-4,880	24	1,604	1,929	325	20.24	6,509	6,809	300	4.61	7,677	9,104	18.59	Mining, Manuf.,
Denmark	-1,730	-3,230	-1,500	2,147	1,913	-234	-10.88	3,876	5,143	1,267	32.68	6,464	6,618	2.38	Manuf.,
El Salvador	-185	-143	42	1,868	1,846	-22	-1.16	2,052	1,989	-63	-3.08	645	837	29.77	
Nigeria	-14,694	-22,573	-7,879	1,554	1,615	61	3.90	16,249	24,188	7,939	48.86	1,080	955	-11.57	Mining, Wholesale
Poland	-892	-679	213	929	1,267	338	36.35	1,821	1,946	125	6.84	4,632	6,059	30.81	Manuf., Banking
Pakistan	-1,061	-2,006	-945	1,814	1,247	-567	-31.24	2,875	3,253	378	13.15	790	991	25.44	
Vietnam	-4,111	-5,438	-1,327	1,164	1,192	28	2.38	5,275	6,630	1,355	25.68	218	241	10.55	
Greece	1,340	306	-1,034	2,063	1,190	-873	-42.32	724	884	160	22.17	1,056	1,255	18.84	Wholesale, Finance, Manuf.,
Portugal	-1,197	-1,199	-2	1,046	1,129	83	7.93	2,243	2,328	85	3.78	3,027	3,151	4.10	Manuf., Finance, Wholesale
Czech Republic	-929	-1,158	-229	827	1,051	225	27.20	1,756	2,210	454	25.85	1,642	2,188	33.25	Manuf., Finance
Hungary	-1,430	-1,540	-110	1,143	1,022	-121	-10.59	2,573	2,562	-11	-0.42	2,824	3,285	16.32	Manuf.
Qatar	67	538	471	455	986	531	116.77	387	448	61	15.65	3,193	4,377	37.08	
Angola	-3,927	-7,556	-3,629	594	928	334	56.26	4,521	8,484	3,963	87.65	1,067	1,094	2.53	
Paraguay	564	845	281	623	896	273	43.85	59	51	-8	-12.94	115			

* US Total Exports (f.a.s.); ** US General Imports (customs value); *** Stock of US Foreign Direct Investment Abroad.

APPENDIX
US Data for Given Trade Partners in Rank Order of US Exports
(Values in Millions of Dollars)

Country	Trade Balance		Change 2004-05	Exports* 2004	Exports* 2005	Change 04/05		Imports** 2004	Imports** 2005	Change 04/05		FDI*** 2003	FDI*** 2004	% Change 2003-04	FDI Area
	2004	2005				Value	Percent			Value	Percent				
Luxembourg	414	393	-21	705	782	77	10.98	290	389	99	34.04	70,025	74,902	6.96	Manuf., Finance
Romania	-328	-576	-248	525	632	107	20.30	853	1,208	355	41.62	401	542	35.16	
Kenya	42	284	242	394	632	238	60.46	352	348	-4	-1.20	91	93	2.20	
Nicaragua	-398	-561	-163	592	620	28	4.65	990	1,181	191	19.25	271	220	-18.82	
Oman	-88	38	126	330	593	263	79.64	418	555	137	32.76	358	438	22.35	
Kazakhstan	-218	-563	-345	320	538	218	67.92	539	1,101	562	104.40	4,971	4,836	-2.72	
Ukraine	-400	-571	-171	399	532	133	33.20	800	1,103	303	37.94	238	256	7.56	
Morocco	10	85	75	526	528	2	0.45	515	443	-72	-14.01	307	306	-0.33	
Lithuania	-187	-245	-58	295	388	93	31.64	482	634	152	31.47	86			
Bahrain	-103	-81	22	302	351	49	16.31	405	432	27	6.60	141	176	24.82	
Ghana	164	180	16	310	338	28	9.16	145	158	13	8.65	268	258	-3.73	
Bulgaria	-335	-186	149	172	268	96	55.93	507	454	-53	-10.51	186	191	2.69	
Slovenia	-318	-178	140	192	233	41	21.52	510	411	-99	-19.35	38			
Bolivia	-67	-75	-8	194	218	24	12.46	260	293	33	12.51	360	221	-38.61	
Sri Lanka	-1,793	-1,885	-92	164	198	34	20.69	1,957	2,083	126	6.45	47	33	-29.79	
Malta	-202	-89	112	181	194	12	6.78	383	283	-100	-26.16		131		
Latvia	-244	-185	58	121	177	56	45.97	365	362	-2	-0.68				
Slovakia	-1,080	-811	269	132	150	18	13.75	1,211	960	-251	-20.71	1,014	1,152	13.61	
Estonia	-259	-366	-107	134	145	11	8.36	393	511	118	30.09	35	37	5.71	
Cote d'Ivoire	-597	-1,074	-477	118	124	6	5.08	715	1,198	483	67.62	215	247	14.88	
Cameroon	-209	-41	168	100	117	17	17.49	308	158	-150	-48.74	242	283	16.94	
Cyprus	70	53	-17	96	84	-12	-12.96	26	31	5	18.57	258	259		
Uzbekistan	142	-22	-164	230	74	-156	-67.79	88	96	8	9.09	77			
Cambodia	-1,438	-1,698	-260	59	69	10	17.07	1,497	1,767	270	18.00	1	1	0.00	
Laos	3	6	3	6	10	4	70.13	3	4	1	19.19				
European Union - 25	-109,337	-122,427	-13,090	172,622	186,342	13,720	7.95	281,959	308,769	26,810	9.51	871,684	965,379	10.75	Manuf., Finance, Wholesale
SACU	-3,597	-2,696	901	3,325	4,079	754	22.68	6,922	6,775	-147	-2.13	3,828	5,047	31.84	

* US Total Exports (f.a.s.); ** US General Imports (customs value); *** Stock of US Foreign Direct Investment Abroad.