IV. Bilateral Negotiations

A. Free Trade Agreements

1. Chile

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

Our two-way trade in goods and services totaled $8.8 billion in 2001. Trade in services amounted to $2.2 billion with the United States in surplus by $472 million. Trade in goods totaled $6.6 billion with the United States in deficit by $424 million. In the seven years prior to 2001, U.S. goods trade with Chile expanded by 44 percent and services trade by 37 percent.

On December 11, 2002, the United States and Chile reached agreement on an historic Free Trade Agreement (FTA) designed to strip away barriers and facilitate trade and investment between both countries. The U.S.-Chile FTA will be the first comprehensive free trade agreement between the United States and a South American country. To date, the United States has only four FTA partners: Canada, Mexico, Israel and Jordan. The U.S.-Chile FTA is expected to spur progress on negotiations of the Free Trade Area of the Americas (FTAA, targeted for completion by 2005), as well as ongoing global trade negotiations.

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

The December 2002 agreement represented the culmination of fourteen rounds of negotiations, initiated in December 2000. Throughout the process, U.S. negotiators consulted closely with Congress, industry representatives and labor and environmental groups to ensure the FTA advanced U.S. interests and, in its final provisions, reflected the goals contained in Trade Promotion Authority. Under the Trade Act of 2002, the Administration must notify Congress at least 90 days before signing an FTA. On January 30, 2003, President Bush notified Congress of his intent to enter into an FTA with Chile. During the 90-day period, both the United States and Chile will undertake legal reviews of the texts and continue to consult with their respective legislatures and other interested groups regarding the provisions negotiated.

Under the agreement, more than 87 percent of two-way trade in goods will become tariff-free immediately, with most remaining tariffs and quotas eliminated in four years and all tariffs and quotas eliminated in 12 years. Among the key U.S. industrial sectors benefitting from the agreement and the aggressive liberalization schedule are agricultural and construction equipment, autos and auto parts, computers and other information technology products, medical equipment and paper products. More than three-quarters of U.S. farm goods will enter Chile tariff-free within 4 years, with all tariffs and quotas phased out within 12 years. U.S. farm products such as pork, beef, soybeans, durum wheat, feed grains, potatoes and processed food products will benefit from increased market access. Tariffs on wine will be harmonized at low U.S. rates, then eliminated.

This agreement will create access to Chile's fast growing services market, including telecommunications, insurance, banking, securities, express delivery and professional services. U.S. firms will be able to offer financial services to participants in Chile's private pension system. The agreement offers state of the art protections for digital products such as software, music, text and video. Protection for patents and trade secrets exceeds past trade agreements.

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

With respect to labor and the environment, both parties commit to effectively enforce their domestic labor and environment laws. An innovative enforcement mechanism includes monetary assessments to enforce commercial, labor and environmental obligations of the trade agreement. In addition, it establishes a framework for cooperative environmental projects and promotes internationally recognized labor standards.

2. Singapore

The United States and Singapore completed the negotiations of an FTA in early 2003. The U.S.-Singapore FTA is the first comprehensive U.S. FTA with any Asian nation. Singapore is our 11th largest trading partner, with two-way trade of goods and services exceeding $38 billion. The provisions of the U.S.-Singapore FTA build on the WTO and NAFTA and make important advances in many key areas. Most tariffs will be eliminated immediately upon entry into force of the Agreement, with the remaining tariffs phased-out over a 3-10 year period.

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

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

The FTA has other important features. For example, this FTA will provide: a secure, legal environment for U.S. investors operating in Singapore; explicit guarantees for electronic commerce and digital products; enhanced, state-of-the art protection for intellectual property; specific commitments regarding the conduct of Singapore's government enterprises; reinforced commitments to strong and transparent disciplines on government procurement procedures; strong, simple and transparent rules of origin; firm

commitments to combat illegal transhipments of all traded goods and to prevent circumvention for textiles and apparel; mobility for highly-trained personnel; and requirements to ensure effective enforcement of domestic labor and environmental laws. An innovative enforcement mechanism includes monetary assessments to enforce commercial, labor and environmental obligations of the trade agreement.
The FTA with Singapore will foster economic growth and create higher paying jobs in the United States by reducing and eliminating barriers to trade and investment. The agreement will not only improve market opportunities for U.S. goods and services exports, but it may also serve as a model for the Asia-Pacific region, encouraging trade liberalization, regulatory reform and transparency, including under the Enterprise for ASEAN Initiative (EAI), which President Bush announced at the Summit of Leaders' of the Asia-Pacific Economic Cooperation forum in October 2002. The FTA will offer important benefits to U.S. workers, ranchers, farmers, and businesses while reinforcing important American values in the region.

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

B. The Americas

1. Canada

Canada is the largest trading partner of the United States with over $1 billion of two-way trade crossing our border daily. At the same time, the United States and Canada share one of the world's largest bilateral direct investment relationships. In 2001, the stock of U.S. foreign direct investment in Canada was $139 billion, an increase of 7.9 percent from 2000. In 2001, the stock of Canadian direct foreign investment in the United States was $108.68 billion, a decrease of 5.2 percent.[22]

a. Softwood Lumber

The 1996 U.S.-Canada Softwood Lumber Agreement expired on March 31, 2001. The bilateral agreement was put in place to mitigate the effects of subsidies in several Canadian provinces. Upon expiration of the 1996 Agreement, the U.S. lumber industry filed antidumping and countervailing duty petitions regarding Canadian softwood lumber. Preliminary investigations found both dumping and subsidies, and led to the imposition of preliminary duties. On March 22, 2002, the U.S. Department of Commerce announced its final, company-specific antidumping duties and a countrywide (except for the Maritime provinces) countervailing duty determination. On April 26, 2002, the Commerce Department announced amended final antidumping rates ranging from 2.18 percent to 12.44 percent and an amended final countervailing duty rate of 18.79 percent.

Canada is challenging the underlying Commerce Department and ITC investigations in the WTO and NAFTA. On November 1, 2002 the WTO Dispute Settlement Body officially adopted a panel report which addressed the Canadian challenge of the Commerce Department's preliminary countervailing duty

[22] 2002 estimates are annualized based on 11 months data.

determination. The report is a victory for the U.S. on two key issues in the ongoing dispute: Canadian provinces' sale of timber from public lands can constitute a subsidy under the WTO Subsidies Agreement; and U.S. laws governing reviews of countervailing duty orders are consistent with the WTO Subsidies Agreement.

Negotiations to find a durable solution as an alternative to litigation broke off in March 2002. The United States remains prepared to offer Canadian lumber producers the market access they seek in exchange for Canadian provinces implementing market-based pricing for sales of timber from public lands. However, the provinces have not offered sufficient commitments to ensure that competitive timber markets would operate in Canada. The Department of Commerce has indicated its willingness to consider petitions from individual provinces for a review of provincial market reforms, with the potential for province-specific revocation of the countervailing duty order. In the absence of an agreement on basic reforms, the United States will effectively enforce U.S. trade laws to address the U.S. industry's concerns about subsidies to, and dumping of, Canadian softwood lumber.

b. Agriculture

Canada is the United States' second largest market for food and agricultural exports. For fiscal year 2002 (October 2001 - September 2002), U.S. agricultural exports to Canada grew by 7.4 percent to $8.6 billion. As a result of the 1998 U.S.-Canada Record of Understanding on Agricultural Matters (ROU), the U.S.-Canada Consultative Committee (CCA) and the Province/State Advisory Group (PSAG) were formed to provide fora to strengthen bilateral agricultural trade relations and to facilitate discussion and cooperation on matters related to agriculture. In 2002, the CCA and PSAG met twice on issues covering livestock, processed food, plant, seed, and horticultural trade, as well as pesticide and animal drug regulations.

The U.S. Government continues to have concerns about the marketing practices of the Canadian Wheat Board. On October 23, 2000, USTR initiated a Section 301 investigation of certain trade practices of the Canadian Wheat Board, in response to a petition filed by the North Dakota Wheat Commission. At the request of USTR, the ITC conducted an investigation on Canadian wheat marketing practices, and released its report in December 2001. On February 15, 2002, USTR announced a positive determination in the 301 investigation that the Government of Canada provides special monopoly rights and privileges that disadvantage U.S. wheat farmers and undermine the integrity of the trading system.

USTR announced a four prong approach to level the playing field for American farmers and began implementation in 2002. First, on December 17, 2002, USTR announced that it would pursue dispute settlement proceedings against the Canadian Wheat Board and the Government of Canada in the WTO. Second, USTR identified specific impediments to U.S. wheat entering Canada. Those findings are a part of the U.S. WTO dispute settlement case. Third, the United States is seeking reforms to state trading enterprises (STE) 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 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. Fourth, the Administration is conducting countervailing and antidumping investigations in response to petitions filed by the North Dakota Wheat Commission.

In April 1999, the United States and New Zealand successfully challenged Canada's subsidized dairy industry under WTO dispute settlement procedures. A WTO panel found that the Canadian government, through its government-managed provincial marketing boards, was subsidizing the price of exported milk through a two-tiered pricing system. In light of this finding, the Panel also concluded that Canada had violated its export subsidy reduction commitments by exporting a higher volume of subsidized dairy products than permitted by Canada's obligations under the WTO Agreement on Agriculture. The Panel also found that Canada had improperly imposed a limit on the value of milk that could be imported in any single entry under the relevant tariff-rate quota. This finding was sustained by an appeal panel in October 1999.

Under a negotiated implementation agreement, Canada committed to bring its export regime into compliance with its WTO export subsidy commitments on butter, skimmed milk powder and an array of other dairy products by January 31, 2001. Although Canada eliminated one export subsidy program in this process, new programs were substituted in nine provinces. Because the United States was concerned that the new measures appear to duplicate most of the elements of the export subsidies which they replaced, the United States requested a panel be reconvened to review Canada's compliance. In July 2001, the compliance review panel agreed with the United States that Canada was not in compliance. However, Canada appealed the July report. On December 3, 2001, the Appellate Body determined that there was insufficient information to make a ruling. The United States and New Zealand then requested another WTO panel to review the additional information requested by the Appellate Body. In July 2002, the panel concluded that Canada was continuing to provide illegal export subsidies to Canadian dairy processors with the discounted milk. Canada appealed that decision, and in December 2002, the Appellate Body affirmed that panel's findings. The WTO's Dispute Settlement Body formally adopted the Appellate Body's report on January 17, 2003. There is no further appeal.

c. Intellectual Property Rights

Canada made some progress in improving its IPR regime over the past year, including amending its patent law to provide at least a 20-year term of protection for patents filed before October 1, 1989. However, some problems remain unresolved. For example, Canada does not provide adequate data protection in the pharmaceutical area, and systematic inadequacies in Canadian administrative and judicial procedures allow early and often infringing entry of generic versions of patented medicines into the marketplace. Moreover, progress has stalled on resolving the outstanding issue of national treatment for U.S. artists in the distribution of proceeds from Canada's private copying levy and its "neighboring rights" regime. The United States is also concerned about Canada's lax, and potentially deteriorating, border measures that appear to be non-compliant with TRIPS requirements.

2. Mexico

Mexico is our second largest single-country trading partner and has been among the fastest growing major export markets for goods since 1993, with U.S. exports up an estimated 134 percent through 2002.[23] The NAFTA, now commencing its tenth year, has fostered this enormous relationship with its unprecedented, comprehensive market opening rules. It is also creating a more equitable set of trade rules as Mexico's higher trade barriers are being reduced or eliminated.

a. Intellectual Property Rights

Piracy and counterfeiting of U.S. intellectual property in Mexico continue to raise serious concerns. Over the past year, enforcement against piracy has declined dramatically, resulting in even greater losses for

[23]2002 estimates are annualized based on 11 months data.

U.S. copyright industries and the closure of legitimate copyright industry-related businesses in Mexico. Despite significant efforts to raid pirate production facilities, only a small percentage of arrests have resulted in court decisions and deterrent penalties. The United States is concerned about the lack of coordination between health and intellectual property agencies in Mexico. The Ministry of Health has granted health registration to generic products even where a patent exists for these products. Both the U.S. pharmaceutical and agrochemical industries also have expressed concern regarding the confidentiality of data submitted in conjunction with applications for marketing approval.

b. Agriculture

North American agricultural trade has grown significantly since the NAFTA was implemented. Mexico is currently the United States' third largest agricultural export market. For fiscal year 2002, U.S. agricultural exports to Mexico fell by 2.6 percent, to $7.1 billion.

Current trade irritants include Mexico's limits on the importation and domestic consumption of high fructose corn syrup (HFCS). In 1997, Mexico initiated an antidumping investigation and in 1998 imposed antidumping duties. The United States challenged Mexico's determination in the WTO. The panel ruled in favor of the United States in January 2000. Mexico did not appeal. In September 2000, Mexico issued a new determination that purported to comply with the original panel decision. The United States challenged the new determination and in June 2001 the panel ruled in favor of the United States. Mexico appealed the panel's decision. The Appellate Body rejected Mexico's appeal on October 22 and on November 21, 2001, the WTO adopted the Appellate Body's report.

On December 31, 2001, the Mexican Congress imposed a tax on soft drinks produced using HFCS. Although temporarily suspended by the Fox Administration, the tax was reimposed in 2002, and remains in place. The tax effectively eliminated the use of HFCS in the Mexican beverage industry, and will reduce sales of HFCS by U.S. firms, lower U.S. corn exports used to produce HFCS, and threaten U.S. beverage exports. USTR continues to work to achieve a long term solution.

The Administration has worked to address problems associated with Mexico's antidumping regime. The United States is concerned about the procedures applied in the investigation of U.S. exports of beef, rice, and apples. In addition, despite repeated assurances, the Mexican government has not published a redetermination of the antidumping order on U.S. exports of live swine. Until these regulations are published, U.S. exports continue to be subject unnecessarily to antidumping duties. In December 2002, the Mexican Congress amended certain provisions of the Foreign Trade Law that apply to the conduct of antidumping investigations. The United States is analyzing these changes to ensure consistency with Mexico's international obligations.

In April 2002, USTR and the U.S. Department of Agriculture entered into a Memorandum of Understanding on Agricultural Trade with Mexico to strengthen cooperation on agricultural trade, including sanitary and phytosanitary measures. The MOU established a Consultative Committee on Agriculture, which held its inaugural meeting in October 2002, and discussed a range of issues covering livestock, grains and horticulture.

On January 7, 2003, Mexico initiated an antidumping investigation on U.S. pork. The United States has raised its concerns regarding the initiation, which appears to be inconsistent with the requirements of the WTO Antidumping Agreement.

c. Telecommunications

Market barriers in Mexico's telecommunications sector remain a serious source of concern. In particular, through a series of rules and other measures, Mexico does not permit effective competition and otherwise discriminates against U.S. suppliers of basic telecommunications services. As a result, wholesale telecommunications rates for U.S.-Mexico calls are still roughly four times their cost. These high rates cost U.S. companies and consumers about $600 million in excess payments each year.

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

3. Brazil and Southern Cone

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

The Common Market of the South, referred to as "Mercosur", from its Spanish abbreviation, is the largest preferential trade agreement in Latin America. It consists of Brazil, Argentina, Uruguay and Paraguay and represents over half of Latin America's gross domestic product. Chile and Bolivia are Associate Members of the group. Mercosur was established in 1991, with the goal of creating a common market. Implementation of the Mercosur customs union commenced January 1, 1995, with the establishment of a common external tariff (CET), covering some 85 percent of intra-Mercosur trade. Convergence of tariffs on remaining items is slated for completion by January 1, 2006.

Four Plus One: In September 2001, the United States and the four Mercosur countries resumed meeting under the auspices of the 1991 Rose Garden Agreement. This agreement created a framework, known as the Four Plus One, for the United States and the Mercosur countries to discuss means to deepen their trade relationship. At the September ministerial meeting, the Four Plus One agreed on a work plan and a series of meetings to discuss coordination in multilateral fora, such as the FTAA and the WTO, and bilateral trade and investment issues of mutual interest. The Four Plus One met in Buenos Aires, Argentina in April 2002 and continued its work plan with respect to the multilateral agenda and on-going work on sanitary and phytosanitary issues and technical barriers to trade.

b. Argentina

U.S. exports to Argentina were $1.5 billion in 2002, down 61 percent from 2001. Overall bilateral trade was $4.6 billion, and the U.S. surplus of $0.9 billion in 2001 shifted into deficit of $1.6 billion in 2002.[24] A key factor in the Argentine economy is its trade with Brazil, Argentina's number one trading partner.

During 2002, the trade agenda with Argentina was affected by the on-going financial crisis and the devaluation of the currency. With the conclusion of an agreement regarding the WTO patent issue (see below) the United States Trade Representative sent a team to Argentina to explain the possibilities of utilizing Generalized System of Preferences (GSP) to the Argentine private sector. On August 6, President

[24] 2002 estimates are annualized based on 11 months' data.

Bush signed a proclamation granting Argentina's request for GSP redesignation and *de minimis* waivers for 57 tariff line items. USTR is in the process of conducting an expedited review for Argentina's 2001 GSP petitions.

Intellectual Property Rights (IPR): Argentina's intellectual property rights regime does not yet appear to meet TRIPS standards and fails to fulfill long-standing commitments to the United States. Failure to provide adequate protection for copyright and patents has led to Argentina's placement on the Special 301 Priority Watch List through 2002. In 1997, the United States withdrew 50 percent of Argentina's benefits under the GSP over this same issue, and benefits will not be restored unless the concerns of the United States are addressed adequately. In May of 1999, the United States initiated a WTO case against Argentina because of its failure to protect patents and test data. The United States added additional claims to this case in May of 2000, due to the fact that the TRIPS Agreement became fully applicable for Argentina in the year 2000. The United States engaged in a series of consultations with Argentina in Geneva throughout 2001, however, the problem remained unresolved. The establishment of the U.S.-Argentina Bilateral Council on Trade and Investment (BCTI) gave the two countries a vehicle to address various bilateral trade issues.

As a result of the April 24, 2002 meeting of the BCTI, the U.S. and Argentina finalized the elements of a joint notification to the World Trade Organization (WTO) regarding the dispute on intellectual property matters. In the joint notification, Argentina clarified how certain aspects of its intellectual property system, such as those related to its import restriction regime, operate so as to conform with the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights. In addition, Argentina agreed to amend its patent law to provide protection for products obtained from a process patent and to ensure that preliminary injunctions are available in intellectual property court proceedings, among other amendments. Finally, on the remaining issues, including that of data protection, the United States retains its right to seek resolution under the WTO dispute settlement mechanism. Argentina and the United States notified a settlement of these issues to the WTO on May 31, 2002. Consultations continue on the unresolved issues.

The United States is committed to giving full consideration to Argentine requests to expand market access for Argentine products under the preferences of the U.S. GSP.

c. Brazil

The United States exported goods valued at an estimated $12.4 billion to Brazil in 2002. Brazil's market accounts for 24 percent of U.S. annual exports to Latin America and the Caribbean excluding Mexico, and 72 percent of U.S. goods exports to Mercosur.[25]

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

[25] 2002 estimates are annualized based on 11 months' data.

On April 30, 2000, the United States requested that the WTO establish a dispute resolution panel to review a narrow part of Brazil's patent law referred to as a local manufacturing requirement. Article 68(1)(I) of the law provides that if a patented product is not being manufactured in Brazil within three years of the issuance of the patent, the government may compel the patent owner to license a competitor. However, Article 27.1 of the TRIPS Agreement provides that patents may be used without discrimination as to " . . . whether the products are imported or locally produced." The United States continues to question the consistency of this provision under the obligations of the TRIPS Agreement, which prohibits such conditions.

In June 2001 the United States and Brazil agreed to transfer their WTO disagreement over Brazil's patent law from formal WTO litigation to a newly created bilateral consultative mechanism. Under the terms of the agreement, Brazil will provide advance notice to the U.S. Government before utilizing Article 68 (1)(I). If Brazil seeks to activate this provision there will be an adequate opportunity for consultations in the bilateral Consultative Mechanism. This will provide an early warning system to protect U.S. interests. The United States reserved all its rights in the WTO with respect to this matter.

Autos: In March 1998, USTR signed an agreement with the Government of Brazil to terminate its TRIMS-inconsistent auto regime, enacted in December 1995. The regime had offered auto manufacturers reduced duties on imports of assembled cars and auto parts and other benefits if they exported sufficient quantities of parts and vehicles and promised to meet local content targets in their Brazilian plants. The Brazilian government committed to eliminate the trade and investment distorting measures in its auto regime and not to extend the measures to its Mercosur partners when their auto regimes were unified in 2000. Argentina and Brazil recently reached agreement on a new regime, which remains TRIMS-inconsistent. Argentina requested a WTO TRIMS extension, which was granted.

d. Paraguay

With a population of just over five million, Paraguay is one of the smaller markets in Latin America. In 2002, the United States exported an estimated $444 million worth of goods to Paraguay.[26] However, Paraguay is a major exporter of, and a transshipment point for, pirated and counterfeit products in the region, particularly to Brazil.

Intellectual Property Rights (IPR): In January 1998, the USTR identified Paraguay as a “Priority Foreign Country” (PFC) under the “Special 301" provisions of the Trade Act of 1974. In identifying Paraguay as a PFC, the USTR noted deficiencies in Paraguay’s intellectual property regime, especially a lack of effective action to enforce IPR. As required under the Trade Act of 1974 as amended, the USTR initiated an investigation of Paraguay in February 1998.

During negotiations under Special 301, the Government of Paraguay indicated that it had undertaken a number of actions to improve IPR protection, such as passing new copyright and trademark laws and undertaking efforts to improve enforcement. In November 1998, in light of commitments made by the Government of Paraguay in a bilateral Memorandum of Understanding (MOU), USTR concluded its Special 301 investigation. The Government of Paraguay committed to take a number of near-term and long-term actions to address the practices that were the targets of the investigation, including implementing institutional reforms to strengthen enforcement and taking immediate action against known centers of piracy and counterfeiting. The U.S. Government is currently monitoring Paraguay’s

[26] 2002 estimates are annualized based on 11 months’ data.

implementation of the MOU. The two governments have agreed to review the MOU with a view toward revising and extending it in 2003.

e. Uruguay

With the smallest population of Mercosur (just over three million people), Uruguay nonetheless imported an estimated $203 million of goods from the United States in 2002.[27] Areas of recent consultation have included coordinating U.S efforts in multilateral fora such as the FTAA and WTO and the importance of Uruguay's apparent failure to bring its intellectual property regime into line with TRIPS standards by January 1, 2000. In April 2001, the two countries established the U.S.-Uruguay Joint Commission on Trade and Investment in order to explore means to deepen the trade and investment relationship between the two countries. This group completed a comprehensive work program in 2002.

f. Chile

U.S.-Chile bilateral trade relations in 2002 were dominated by the negotiation of an FTA as discussed at the beginning of this Chapter.

4. The Andean Community

The U.S. trade deficit with the Andean region increased from $12.6 billion in 2001 to an estimated $13 billion in 2002. U.S. goods exports to the region were an estimated $11.5 billion in 2002, a decrease of 7 percent from 2001. U.S. goods imports were $24.6 billion in 2002, a decrease of 2 percent from 2001.[28]

The Andean Community originated as the Andean Pact in 1969, with Bolivia, Colombia, Ecuador, Peru and Venezuela as members. However, it was only in the 1990s that the Andean Pact's commitment to form a customs union gained momentum, with the reduction and elimination of most duties among the members and an increasingly common external tariff. In 1997 the Andean Community became operational. Among its features are strengthened institutions, such as a Council of Presidents and a Council of Foreign Ministers, meetings of Trade Ministers, and the creation of a General Secretariat of the Andean Community mandated to act as the group's executive body.

a. Andean Trade Preference Act

On August 6, 2002, President Bush signed into law the Andean Trade Promotion and Drug Eradication Act (ATPDEA). In doing so he fulfilled an Administration goal to renew and expand the product coverage of the Andean Trade Preference Act (ATPA), which had expired on December 4, 2001. The ATPA was originally enacted in 1991 in order to provide incentives to Bolivia, Colombia, Ecuador and Peru to diversify their economies away from narcotics production. As virtually all cocaine sold in the United States originates in these countries, the program functions as a U.S. trade policy tool that contributes to our fight against drug production and trafficking. It has strengthened the legitimate economies in these Andean countries and created viable alternatives to the profitable drug trade.

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[27] 2002 estimates are annualized based on 11 months' data.

[28] 2002 estimates are annualized based on 11 months' data.

The original ATPA provided beneficiary countries duty-free treatment for most of their exports to the United States, except for textiles, apparel, footwear, leather, tuna in airtight containers, and certain other items. The ATPDEA restored all of the benefits of the original program, providing for retroactive reimbursement of duties paid during the period since the program's lapse in December 2001. It also expanded the list of items eligible for duty-free treatment to about 700 more products.

The most significant expansion of benefits in the ATPA as amended by the ATPDEA is in the apparel sector. Apparel assembled in the region from U.S. fabric or fabric components or components knit-to-shape in the United States may enter the United States duty-free in unlimited quantities. Apparel assembled from Andean regional fabric or components knit-to-shape in the region may enter duty-free subject to a cap. The cap is set at two percent of total U.S. apparel imports, increasing annually in equal increments to five percent. These countries currently account for only about one percent of U.S. apparel imports. New products benefitting from the program include: tuna in pouches, leather products, footwear, petroleum and petroleum products, and watches and watch parts.

b. ATPDEA Eligibility

The ATPDEA established a number of criteria which countries must meet in order to be designated as eligible for the expanded benefits of the ATPA. The new criteria relate to issues such as intellectual property rights, worker rights, government procurement procedures, and cooperation on countering narcotics and combating terrorism. After analyzing with other U.S. Government agencies the responses to a USTR request for public comment on the matter, USTR raised with the four countries a number of commercial matters, investment disputes and worker rights issues related to the eligibility criteria. In response, the four governments took several measures and provided written commitments for future actions to address U.S. Government concerns. For instance, Colombia issued a decree on the protection of data; Bolivia ratified its WTO financial services commitments; Ecuador committed to establish a high-level commission to investigate the treatment of banana plantation workers; and Peru committed to issue a decree requiring that software used by government agencies be legally acquired. On the basis of these and other measures and commitments, the President on October 31, 2002 signed the proclamation designating the four countries as full beneficiaries of the ATPA, as amended. The U.S. Government will continue to monitor the performance of the beneficiary countries with respect to the program's eligibility criteria.

5. Central America and the Caribbean

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

On January 8, 2003, the United States Trade Representative and Ministers from Costa Rica, El Salvador, Guatemala, Honduras and Nicaragua announced the launch of negotiations on an agreement to eliminate tariffs and other barriers to trade in goods, agriculture, services, and investment between the United States and those Central American nations. Negotiations on the U.S.-Central American Free Trade Agreement, or CAFTA, began in San José, Costa Rica, on January 27. The participants will seek to complete the negotiations by December 2003.

The United States and Central America enjoy an increasingly productive trade partnership. U.S. exports to the region have grown 54 percent since 1996 and totaled an estimated $9.8 billion in 2002. Imports totaled $11.7 billion.[29]

[29] 2002 estimates are annualized based on 11 months' data.

On January 16, 2002, President Bush announced his intention to explore an FTA with Central American nations. Throughout 2002, USTR held a series of preparatory "trade workshops" with Costa Rica, El Salvador, Guatemala, Honduras and Nicaragua to discuss topics that are covered in a free trade agreement such as: market access; investment and services; government procurement and intellectual property rights; labor and environment; and institutional issues including dispute settlement. The President formally notified Congress of his intention to begin free trade negotiations on October 1, 2002, following passage of Trade Promotion Authority. USTR held public hearings on November 19, 2002, at which oral testimony from more than 20 witnesses was heard and more than 40 additional written submissions were received.

b. Central America

The United States is Central America's principal trading partner. The Central American Common Market (CACM) consists of Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua, and provides duty-free trade for most products traded among the five countries. Panama, which has observer status, and Belize participate in CACM summits but not in regional trade integration efforts. The Central American countries continued during 2002 to pursue a range of bilateral and regional trade agreements. Negotiations between Canada and El Salvador, Guatemala, Honduras and Nicaragua made substantial progress in 2002. Negotiations for a Panama-CACM free trade agreement have resulted in agreement on common disciplines; negotiations of related market access provisions continued throughout 2002.

All of the countries are active participants in the FTAA negotiations. From May 2001 until October 2002, Guatemala chaired the Negotiating Group on Agriculture, Costa Rica chaired the Negotiating Group on Government Procurement, and Nicaragua served as Vice-Chair of the Consultative Group on Smaller Economies. Beginning November 1, 2002, Costa Rica will continue as the chair of the Government Procurement group and Panama will assume the chairmanship of the FTAA Investment group. At the Quito Ministerial meeting on November 1, 2002, El Salvador offered to host a meeting of the FTAA Trade Negotiating Committee in 2003.

The United States continues to meet with Panama under our existing Trade and Investment Council (TIC) mechanism. In 2002, the countries met twice and maintain a ongoing work program that includes investment issues.

c. Caribbean Basin Initiative

The trade programs collectively known as the Caribbean Basin Initiative (CBI) remain a vital element in the United States' economic relations with its neighbors in Central America and the Caribbean. CBI was initially launched in 1983 through the Caribbean Basin Economic Recovery Act (CBERA), and was substantially expanded in 2000 through the U.S.-Caribbean Basin Trade Partnership Act (CBTPA).

The Trade Act of 2002 increased the type and quantity of textile and apparel articles eligible for the preferential tariff treatment accorded to designated beneficiary CBTPA countries. Among other actions, the Trade Act of 2002 extended duty-free treatment for clothing made in beneficiary countries from both U.S. and regional inputs, and increased the quantity of clothing made from regional inputs that regional producers can ship duty-free to the United States annually. The Administration will continue to work with Congress, the private sector, CBI beneficiary countries, and other interested parties to ensure a faithful and effective implementation of this important expansion of trade benefits.

Since its inception, the CBERA program has helped beneficiaries diversify their exports. On a region-wide basis, this export diversification has led to a more balanced production and export base and has resulted in a reduction in the region's vulnerability to fluctuations in markets for traditional products.

Since 1983, the year prior to the implementation of the CBI, total CBI country non-petroleum exports to the United States have more than tripled. Light manufactures, principally printed circuit assemblies and apparel, but also medical instruments and chemicals, account for an increasing share of U.S. imports from the region and constitute the fastest growing sectors for new investment in CBERA countries and territories.

Apparel constitutes one of the fastest growing categories of imports from the CBI countries and territories – growing from just 5.5 percent of total U.S. imports from the region in 1984, to nearly 46 percent in 2001, valued at over US$9.5 billion. Apparel has ranked as the leading category of U.S. imports from the region since 1988.

CBI currently provides 24 beneficiary countries and territories with duty-free access to the U.S. market. They are: Antigua and Barbuda, Aruba, The Bahamas, Barbados, Belize, British Virgin Islands, Costa Rica, Dominica, Dominican Republic, El Salvador, Grenada, Guatemala, Guyana, Haiti, Honduras, Jamaica, Montserrat, Netherlands Antilles, Nicaragua, Panama, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, and Trinidad and Tobago.

d. The Caribbean

The Dominican Republic: The Dominican Republic continues to lead all countries in taking advantage of CBI, as they have done in virtually every year since the program became effective, accounting for 28 percent of U.S. imports under CBI provisions. The Dominican Republic does not belong to any regional trade association, but has negotiated trade agreements with its partners in Central America and CARICOM.

The Dominican Republic is the United States' largest single trading partner in the CBI region. Reflecting the importance of this trade relationship, the United States and the Dominican Republic revitalized the Trade and Investment Council (TIC) mechanism and held productive meetings under the TIC during 2002, covering both bilateral issues and cooperation in the FTAA and WTO negotiations. On November 1, 2002, the Dominican Republic assumed the chairmanship of the FTAA Intellectual Property Rights group.

The United States has expressed ongoing concerns about the Dominican Republic's Industrial Property Law and its implementing regulations, which are now currently under review within the Dominican Republic. The United States has also raised concerns regarding the discriminatory effects of the Dominican Republic's Dealer Protection Law 173 and has sought improvements in government procurement practices and resolution of outstanding investment disputes.

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

CARICOM countries are active in the FTAA negotiations, which provide opportunity for frequent bilateral dialogue between U.S. and Caribbean officials. In addition, the United States Trade Representative met with CARICOM trade ministers in Trinidad in September, 2002 to discuss ways to further enhance our trade relations both bilaterally and in multilateral trade negotiations.

C. Western Europe

Overview

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

From its origins in the 1950s, the European Union has grown from six to fifteen Member States, with Austria, Finland, and Sweden becoming the newest EU members states on January 1, 1995. These fifteen countries together comprise a market of some 370 million consumers with a total gross domestic product of more than $8 trillion. U.S. goods exports to the EU totaled an estimated $143.5 billion in 2002. Since 1994, U.S. goods exports to the EU have increased 33 percent.[30]

The other major trade group within Western Europe is the European Free Trade Association (EFTA), which includes Switzerland, Norway, Iceland, and Liechtenstein – Austria, Finland, and Sweden had also been members prior to their accession to the EU in 1995. Formed in 1960, EFTA provides for the elimination of tariffs on manufactured goods and selected agricultural products that originate in, and are traded among, the member countries.

Norway, Iceland, and Liechtenstein have structured their economic relations with the EU through the Agreement on the European Economic Area (EEA), which permits the three countries to participate in the EU Single Market – Switzerland rejected the EEA in a referendum at the end of 1992. In practice, the EEA involves the adoption by non-EU signatories of approximately 70 percent of EU legislation.

2002 Activities

1. European Union

In 2002, the EU continued on its path of deepening the economic and political integration of its Member States. The pace of additional Western European integration efforts over the next few years is being set first by the experience of implementing the Economic and Monetary Union (EMU) established by the EU's Maastricht Treaty, which went into force on November 1, 1993, and amendments to Maastricht contained in the 1997 Amsterdam and 2000 Nice Treaties. Under the Maastricht Treaty schedule, eleven Member States, on January 1, 2002, replaced their national currency notes and coins in circulation with the new "euro."

The second major factor affecting the pace of European integration will be the process of enlarging the EU to include new members to the East and South. The EU has signed association agreements and other types of free trade arrangements with many of its neighbors, including the Czech Republic, Slovakia, Hungary, Poland, Bulgaria, Romania, Latvia, Lithuania, Estonia, Albania, Slovenia, Israel, Algeria, Morocco, and Tunisia. The EU has also negotiated a customs union with Turkey. In December 2002, at the EU Summit in Copenhagen, the EU formally decided to finalize EU accession agreements with ten new members - Cyprus, Malta, Poland, Czech Republic, Slovakia, Hungary, Slovenia, Estonia, Latvia and Lithuania.

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[30] 2002 estimates are annualized based on 11 months data.

Signature of the accession agreements for these countries is expected in early 2003, to be followed by ratification procedures in each country involved, with the aim of formal accession to the EU of the new members by early 2004. The EU has also committed to enter into accession negotiations with Romania and Bulgaria (Turkey remains an accession candidate, with no EU commitment to commence formal negotiations). Important EU institutional questions associated with enlargement still need to be resolved as the enlargement process proceeds.

In 2002, USTR continued to devote considerable resources to addressing pressing or potential trade problems with the EU and its individual Member States, as well as to efforts to enhance the transatlantic economic relationship. In May 2002, U.S. and EU leaders at the U.S.-EU Summit announced their intention to pursue as a priority a Positive Economic Agenda, aimed at increasing U.S.-EU cooperation in a number of areas (See below). In addition, both sides worked to resolve or manage a number of ongoing trade disputes.

a. Geographical Indications

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

For these reasons, in 1999 the United States initiated formal WTO consultations with the EU on Regulation 2081/92. A number of subsequent bilateral discussions have taken place; however, to date the EU has not amended Regulation 2081/92 to address any of the United States' concerns.

b. Agricultural Biotechnology

The EU's four and a half year moratorium on the approval of new products of modern biotechnology continues to hinder U.S. exports of corn, and threatens exports of soya. Restarting the EU approvals process remains a high priority for the United States in order to restore these exports. The U.S. Government continues to raise its concerns regarding the failure of the EU to have a functioning approval process.

Despite implementation of EU Directive 01/18 in October 2002 (which governs the approval of biotechnology products, including seeds and grains, for environmental release and commercialization), EU Member States continue to refuse lifting the approvals moratorium. Member States insist that EU proposals for new rules governing traceability and labeling and biotechnology food and feed authorizations must first enter into force. The proposals include mandatory traceability and labeling requirements for all biotechnology products that would be onerous and expensive for producers and foreign suppliers to meet. As of December 2002, the European Council had reached common positions on the proposed food and feed directive and the traceability and labeling directives. The proposed directives must still go through the Parliament before final adoption by the Council. If adopted, the proposals will not come into force for at least one year.

c. Positive Economic Agenda

U.S. and EU Leaders at the May 2002 U.S.-EU Summit in Washington agreed on a list of subject areas in which the United States and the EU intend to initiate, or give new impetus to existing, cooperative efforts. Labeled as the "Positive Economic Agenda," both sides have indicated their interest in using this list as a first step in an open-ended process of enhancing transatlantic cooperation, both for its own sake and as a means to put headline-grabbing trade disputes in their proper context. The agenda initially covers activities with respect to financial services, regulatory cooperation, electronic procurement and customs, regulation of organic foods, and sanitary and phytosanitary measures. Through 2002, officials on both sides worked to develop or advance transatlantic dialogues in all of these areas.

d. Transatlantic Economic Partnership

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

These areas include: technical barriers to trade, agriculture, intellectual property, government procurement, services, electronic commerce, environment and labor. In addition, the United States and the EU agreed to put an emphasis throughout the initiative on shared values, i.e., they agreed to more fully involve citizens and civil society on both sides of the Atlantic in trade policy so as to strengthen the consensus for open trade. Cooperation under the TEP occurs with respect to bilateral matters, as well as in the context of multilateral activities such as in the WTO. The TEP Action Plan, endorsed by Leaders at the December 1998 U.S.-EU Summit in Washington, lays out specific goals under each of the above categories. At the June 1999 U.S.-EU Summit, U.S. and EU leaders agreed to use TEP mechanisms to carry out part of a joint effort to identify – and hopefully defuse – potential trade problems at an early stage, before they become irritants to the bilateral economic relationship.

e. Public Dialogues

Important companions to the official exchanges between governments in the United States and the EU are the various private dialogues among European and American businesses, labor organizations, and environmental and consumer groups. The first of these to be established, the Transatlantic Business Dialogue (TABD), is a forum in which American and European business leaders can meet to discuss ways to reduce barriers to U.S.-European trade and investment. Other dialogues – such as the Transatlantic Consumer Dialogue (TACD) – stem from a similar premise, i.e., that corresponding organizations on both sides of the Atlantic should share views and, where possible, present joint recommendations to governments in both the United States and the EU on how to improve transatlantic relations and to elevate the debate among countries in multilateral fora. In 2002, a number of the dialogues forwarded recommendations related to trade policy issues to governments on both sides of the Atlantic.

f. Technical Regulations and Standards

As traditional trade barriers affecting transatlantic trade and investment have declined in recent years, specific trade obstacles arising from unnecessary divergences in U.S. and EU regulations and the lack of transparency in the EU rulemaking and standardization processes have loomed relatively larger in importance. During 2002, the United States continued efforts to enhance U.S.-EU regulatory cooperation and reduce unnecessary technical barriers to transatlantic trade.

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

The United States and the EU also reached agreement in 2002 under TEP auspices on a new, precedent-setting mutual recognition agreement (MRA) on marine equipment, under which designated U.S. equipment which meets all U.S. requirements can be marketed in the EU without additional testing. This agreement is expected to enter into force during 2003. The United States also continues to pursue implementation of the 1998 U.S.-EU Mutual Recognition Agreement (MRA), which includes sectoral annexes on telecommunications equipment; electromagnetic compatibility (EMC) for electrical products; electrical safety for electrical and electronic products; good manufacturing practices (GMP) for pharmaceutical products; product evaluation for certain medical devices; and safety of recreational craft. The annexes on telecommunications equipment, EMC, and recreational craft are fully operational.

g. Foreign Sales Corporation Tax Rules

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

h. Ban on Growth Promoting Hormones in Meat Production

The EU continues to ban the import of U.S. beef obtained from cattle treated with growth-promoting hormones. In 1996 the United States challenged the EU ban on imports of U.S. beef in the WTO. In June 1997, a WTO panel found in favor of the United States on the basis that the EU's ban was inconsistent with the EU's obligations under the WTO Agreement on the Application of Sanitary and Phytosanitary Measures (SPS Agreement) because the ban was not based on a scientific risk assessment. In January 1998, the WTO Appellate Body upheld the panel's finding that the EU's ban on imported meat from animals treated with certain growth-promoting hormones is inconsistent with obligations under the WTO SPS Agreement. In 1999, the WTO authorized U.S. trade retaliation because the EU failed to comply with the WTO rulings by the May 13, 1999 deadline. Subsequent to receiving WTO authorization, in July 1999 the United States applied 100 percent duties on $116.8 million of U.S. imports from the EU. The duties remain in effect.

In December of 2002, the EU permanently banned the use of estradiol-17-ß, a growth promoting hormone widely used in the United States and which has been determined by the U.S. Food and Drug Administration (FDA) to pose no health risk to consumers. The EU also presented a number of studies that analyzed the use of hormones in beef production, though none of these studies presented any new evidence to support the EU's hormone ban.

The United States and the EU continue to explore possible ways to resolve this dispute.

i. Veterinary Equivalence - U.S. Poultry Exports to the EU

Though the 1999 U.S.-EU Veterinary Equivalence Agreement was designed to make trading in various livestock products, including poultry and poultry products, less restrictive, the EU continues to maintain its 1997 ban on imports of U.S. poultry because U.S. producers have regularly used washes of low-concentration chlorine as an antimicrobial treatment (AMT) to reduce the level of pathogens in poultry meat production, a practice not permitted by the EU sanitary regime. The United States has been working to compile detailed scientific information regarding U.S. food safety rules for poultry to address EU concerns with a view to reestablishing poultry exports to the EU. U.S. and EU leaders agreed at the May 2002 Summit to place this issue on the Positive Economic Agenda (See Section on Positive Economic Agenda above).

j. Wine

U.S.-EU negotiations on a bilateral wine agreement were launched in 1999 and accelerated during 2002. The United States continues to be concerned about the EU's requirements for import certification and the review and approval of wine making practices, and has sought reductions in the EU's export subsidies and subsidies to its grape growers and wine producers. A major EU concern is the use of semi-generic names on some U.S. wines. Other issues include tariffs and trade restrictive requirements under the April 29, 2002 EU wine labeling regulation (Commission Regulation No. 753/2002). The United States will continue to press the EU to provide U.S. wine makers equitable access to the EU market.

k. Margin of Preference

In mid-2002, the European Commission (EC) notified the United States of its intentions to withdraw from market access concessions on grains made during the Uruguay Round. These concessions, known as the Margin of Preference (MOP), were meant to replace the EU's pre-1995 variable levy system for grains so as to ensure maintenance of market access opportunities for grain imports into the EU. The EC proposed replacing the MOP with a series of global Tariff-Rate Quotas (TRQs) on grain imports, which were scheduled to go into effect on January 1, 2003.

The United States has derived substantial benefits from the Margin of Preference. In response to the EC proposal, the United States worked with the governments of Argentina and Canada to ensure that access to EU markets would not be impeded. In December 2002, the United States and the EC reached an agreement that would maintain the MOP for almost all wheat and feed grain imports. The EC agreed to limit its changes only to certain qualities of wheat not commonly exported by the United States. These new import arrangements for low and medium quality common wheat and barley went into effect on January 1, 2003.

2. EFTA

Although USTR activity in 2002 with the EFTA countries as a group was modest, we intend to start negotiation of a mutual recognition agreement (MRA) with the EFTA EEA countries (i.e., Norway, Iceland, and Liechtenstein) in 2003, and we have begun exploring other ways to expand the U.S.-EFTA trade relationship.

3. Turkey

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

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

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

Qualifying Industrial Zones (QIZs): In January 2002, President Bush offered to make Turkey eligible for Qualifying Industrial Zones (QIZs), which would permit products manufactured within such QIZs to enter the United States duty-free. At the U.S.-Turkey Economic Partnership Commission (EPC) meeting in February, and at the U.S.-Turkey Trade and Investment Framework Agreement (TIFA) Council meeting in April, U.S. delegations presented the Turkish government with information on the QIZ program, requesting that the Turkish side in return provide basic information on how it foresaw utilizing the program. In Fall 2002, the Administration submitted draft legislation to Congress to amend current QIZ legislation to permit Turkish participation in the initiative. Although the legislation passed the U.S. House of Representatives, the Senate was unable to act prior to adjournment. We anticipate the new Congress will take up the QIZ legislation early in 2003.

D. Russia, Central Europe and the Newly Independent States

Overview

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

2002 Activities

1. Normal Trade Relations Status

Russia, Ukraine, and seven of the other NIS republics within the region receive conditional NTR tariff treatment pursuant to the provisions of Title IV of the Trade Act of 1974, also known as the Jackson-Vanik amendment. As part of U.S. sanctions policy related to the conflict in Southeast Europe, the United States revoked NTR from Serbia-Montenegro (now the Federal Republic of Yugoslavia) in 1992. While certain sanctions against Serbia-Montenegro were lifted in 1996 pursuant to the peace accords negotiated in Dayton, Ohio, NTR tariff treatment has not yet been restored.

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

The President has determined that Russia, Ukraine and all of the other NIS republics, with the exception of Belarus, are in full compliance with the emigration requirements. Belarus, on the other hand, receives NTR tariff treatment under an annual waiver, as Congress must enact a law to terminate application of Title IV to a country. In 2000, pursuant to specific legislation, the President terminated application of Title IV to the Kyrgyz Republic, Albania and Georgia. These countries now receive full NTR treatment. The Administration is currently consulting with the Congress and interested stakeholders with a view to removing Russia and the remaining NIS republics (except Belarus) from the coverage of Title IV provisions.

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

2. Intellectual Property Rights

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

Three IPR issues in the region merit special mention:

a. Ukraine – Optical Media Piracy

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

b. Hungary, Slovenia, and Poland – Protection of Confidential Data

USTR places a high priority on protecting the confidential data submitted by pharmaceutical firms to health authorities in order to obtain marketing approval. Data exclusivity is an important issue in U.S. relations with the countries of Central Europe, because at present many pharmaceutical products of U.S. firms do not yet enjoy product patent protection in these countries. Many foreign pharmaceuticals, at best, receive process patents, a relatively weak form of protection. For those drugs without product patent protection, limits on other producer's use of data supporting marketing approval can take on special importance. Accordingly, USTR has pressed the Central European countries - especially Hungary and Slovenia with their large generic drug industries - to limit use of data submitted in connection with obtaining marketing approval. In December 2001, Poland restored the three-year period of data exclusivity which it earlier had had in place by amending a newer law which would have eliminated protection for confidential test data. In 2002, Slovenia passed legislation which provides such protection in conformity with the TRIPS Agreement. Hungary is scheduled to put limited protection on use of data into place in January 2003, in order to comply with EU directives.

c. The Russian Federation – Widespread Piracy

In April 2002, Russia was again placed on the Special 301 "Priority Watch List" because of deficiencies in both the protection and enforcement of IPR. Later in 2002, Russia revised several IPR laws, including those on the protection of trademarks, integrated circuits and plant varieties. Revisions to several other IPR laws, including the copyright law, remain under consideration in the Duma. Notably, enforcement of IPR remains a pervasive problem. The prosecution and adjudication of intellectual property cases remains weak and sporadic; there is a lack of transparency, and a failure to impose deterrent penalties. Russia's Customs administration also needs significant strengthening. Piracy of U.S. films, videos, sound recordings, and computer software is a growing problem. In October 2002, as a result of U.S. efforts to work with the Government of Russia to address the growing optical media piracy problem, the Government of Russia established an inter-ministerial task force, headed by Russian Prime Minister Kasyanov, to combat optical media piracy. Since October the Russian government has taken some steps to remedy this problem, including raids on several of the illegal plants in operation which resulted in the confiscation of 250,000 pirated CDs, DVDs and videos. We remain concerned about this issue and continue to urge adoption of effective measures to address optical media piracy, including adoption of an optical media law.

3. Generalized System of Preferences

Under the U.S. Government's GSP program, developing countries are eligible to receive duty-free access to the U.S. market for many items, if it is determined that these countries meet certain statutory criteria. All of the Central European countries (other than Slovenia and the Federal Republic of Yugoslavia) and most of the NIS (Armenia, Georgia, Moldova, Kazakhstan, the Kyrgyz Republic, Russia and Uzbekistan) participate in the GSP program. Azerbaijan, Tajikistan and Turkmenistan have never requested to be designated as a country eligible to receive the benefits of the GSP program. Belarus's GSP benefits were suspended in 2000 due to worker rights violations.

In 1997, the Government of Russia petitioned the United States for duty-free treatment under the GSP program for exports of both unwrought titanium and wrought titanium. On July 1, 1998, the President granted the request on wrought titanium. The petition on unwrought titanium was left pending based on the situation in the U.S. titanium industry at that time. Three petitions on titanium were submitted during the 2001-2002 GSP Annual Product Review. The GSP interagency committee will announce its decision on whether to accept or deny review of these petitions in early 2003.

In order to receive GSP benefits under the U.S. statute, beneficiary countries must provide for adequate and effective protection and enforcement of intellectual property rights. USTR has conducted reviews, based on petitions from the U.S. copyright industry, of several countries' eligibility to receive GSP benefits on this basis, namely Ukraine, Armenia, Moldova, Kazakhstan, Russia and Uzbekistan. In late 2000, based on significant improvement in Moldova's intellectual property rights regime, the U.S. copyright industry withdrew its petition with respect to Moldova. In August 2001, USTR withdrew GSP beneficiary status from Ukraine (see subsection on Ukraine -Optical Media Piracy above). The reviews of Armenia, Kazakhstan, Russia and Uzbekistan remain ongoing.

The GSP statute provides that a country may not receive GSP benefits if it affords preferential treatment to the products of a developed country, other than the United States, that has a significant adverse effect on U.S. commerce. Based in part on this legislative requirement, the U.S. Government has been consulting with several Central European countries concerning those countries' granting, pursuant to their Association Agreements with the EU, of preferential tariffs to EU exporters vis-a-vis U.S. exporters (see section on EU Association Agreements below).

4. WTO Accession

Prior to the end of 2002, virtually all of the Central European countries (Poland, Hungary, the Czech Republic, Slovakia, Romania, Albania, Slovenia, Croatia, Latvia, Lithuania and Estonia) and three NIS countries (the Kyrgyz Republic, Georgia, and Moldova) had become members of the WTO. In 2002 the terms of accession for both Armenia and the Former Yugoslav Republic of Macedonia were approved by the WTO General Council, and these countries are expected to become WTO members in early 2003 following ratification in these country's respective parliaments.

WTO accession working parties have been established for an additional seven NIS countries (the Russian Federation, Ukraine, Azerbaijan, Belarus, Kazakhstan, Tajikistan and Uzbekistan) and two Central European states (Bosnia-Herzegovina, and the Federal Republic of Yugoslavia). Of the NIS, Turkmenistan has not yet applied for observer status or membership in the WTO.

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

Russia's WTO accession was particularly active in 2002. Russia indicated an interest in accelerating the negotiations and has taken steps to put in place new and amended laws and regulations to bring it into conformity with WTO provisions. Since Russia applied for membership, the United States has strongly supported Russia's efforts to join the GATT 1947 and then the WTO, through active participation in the WTO Working Party established to conduct the negotiations and through technical assistance on how to move Russia's trade regime into conformity with WTO rules. In a series of Working Party meetings through December 2002, Russia continued to describe its trade regime, with WTO delegations noting specific aspects of the trade regime that require further legislative action to become compatible with the WTO. The United States and Russia also continued bilateral discussions on Russia's offers on goods and services market access throughout 2002.

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

5. Bilateral Trade Agreements and Bilateral Investment Treaties

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

In Central Europe, the United States has Bilateral Investment Treaties (BITs) in force with Albania, Bulgaria, the Czech Republic, Estonia, Latvia, Lithuania, Poland, Romania, Slovakia, and Croatia. Of the NIS, the United States currently has BITs in force with seven countries (Armenia, Azerbaijan, Georgia, Kazakhstan, the Kyrgyz Republic, Moldova, and Ukraine) and has signed BITs with three others (Russia, Belarus, and Uzbekistan) for which the formal process of ratification has not been completed.

6. EU Association Agreements

The United States has been strongly supportive of the integration of the Central European countries into Western Europe. Ten Central European countries (Poland, Hungary, Slovenia, the Czech Republic, Slovakia, Romania, Bulgaria, Estonia, Latvia, and Lithuania) have concluded Association Agreements (often called "Europe Agreements") with the EU which are meant to set the stage for eventual EU membership. The Europe Agreements provide for the reduction to zero of virtually all tariff rates on industrial products and preferential rates and quotas for many agricultural products. In 2000, the EU and all the candidate countries, as a follow-on to the Association Agreements, agreed to reduce their mutual tariff rates to zero for the vast majority of each other's agricultural products. The candidate countries' most-favored nation (MFN) tariff rates on industrial goods are generally higher than comparable EU rates while the MFN rates on agricultural goods are usually lower than EU rates. Consequently, U.S. exporters often face relatively high Central European MFN tariff rates on industrial goods in contrast with the zero or preferential rates faced by EU exporters. Much of this tariff differential problem with respect to industrial goods will disappear when the candidate countries formally join the EU (See Western Europe section above) and adopt generally low EU industrial tariff rates.

Until these countries' accession to the EU, the United States has been consulting with the Central European countries to address the tariff differential problem:

a. Poland – Tariff Reductions: In 2001, the United States and Poland concluded a comprehensive trade package designed to lower tariffs on key U.S. exports to Poland. The agreement, which was implemented by Poland in September 2002, creates a bilateral working group where these issues can be addressed. The industrial products for which tariff reductions were negotiated include: certain chemicals and chemical products, beauty products, personal deodorants and antiperspirants, gas turbines, centrifuge filters, machines for the preparation of food or drink, fiber optic cables, tractors, large engine autos and auto parts, certain medical supplies, and measuring instruments. With respect to agricultural products, Poland agreed to lower tariffs on grapefruit, non-sparkling wine, and almonds. Poland also agreed to an independent peer review of its phytosanitary measure on ragweed. In exchange for Poland's commitments, the United States expressed its intention to continue support for Poland's participation in the U.S. Generalized System of Preferences (GSP) program.

b. Hungary – Tariff Reductions: The United States and Hungary signed a comprehensive trade agreement in January 2002 which lowered tariffs on key U.S. exports to Hungary effective April

2002. The industrial products for which tariff reductions were negotiated include: steam and gas turbines, large engine autos and auto and tractor parts, automatic data processing machines, office machine parts, beauty products, various chemicals, plastics, medical instruments and equipment, laser disks, and telephone equipment. Hungary also agreed to lower tariffs on almonds and pecans, grapefruit, and bovine semen. In light of Hungary's commitments, the United States agreed to continue its support for Hungary's participation in the GSP program.

c. **The Czech Republic and Slovakia – Waiver of Tariffs on Civil Aircraft and Parts**: The Czech Republic and Slovakia, which have a customs union, impose a 4.8 percent tariff rate on large civil aircraft and parts from U.S. exporters, but allow duty-free access to their markets for EU exporters. This tariff differential posed a major impediment to the ability of U.S. firms to compete against EU firms for large aircraft tenders in the Czech/Slovak market. In late 2000, the Czech Republic and Slovakia, in response to U.S. Government requests, agreed to waive 2001 tariffs on large civil aircraft and key parts. This waiver was renewed for 2002 and has been renewed for 2003.

In October 2002, USTR began discussions with **Romania** on a similar tariff reduction agreement.

To facilitate trade with EU accession candidate countries, the EU is concluding Protocols to the Europe Agreements on Conformity Assessment and Acceptance of Industrial Products (called "PECAs"). The first PECAs, which entered into force with Hungary and the Czech Republic in 2001, eliminated the need for further product testing and certification of EU-origin products in designated product sectors. During 2002, the United States continued to press its concerns, both bilaterally and in the WTO, that the rule of origin provision in the agreements with Hungary and the Czech Republic unjustifiably discriminates against non-EU origin products and is inconsistent with WTO obligations. The European Union is now proceeding to remove this origin provision from its existing PECAs. New PECAs, without the problematic rule of origin provision, entered into force with Latvia and Lithuania in 2002. We will continue to monitor this issue.

7. Country Specific Issues

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

a. Russia – Market Access for Poultry

The United States was actively engaged with the Russian government throughout 2002 to ensure that U.S. poultry producers continue to maintain access to the Russian market. Following intense discussions in the wake of the Russian government's temporary ban on U.S. poultry exports in March 2002, the United States signed a protocol with the Russian government that led to the resumption of trade flows. This protocol established a framework for closer cooperation between U.S. and Russian veterinary officials and provided for improved certification and testing procedures. Following the negotiation of this protocol, the United States began intensive negotiations with Russia on a new veterinary certificate for U.S. poultry exports which was finalized in August 2002. The United States continues to monitor Russia's implementation of the new certification and testing requirements.

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

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

There has been some movement to eliminate duplication among regulatory agencies and to clarify categories of products subject to certification. However, businesses are still experiencing difficulties in getting product approvals in key sectors. Manufacturer declaration of conformity is now feasible under Russian law, but is not yet widely used. In 1998, the Russian State Committee on Standards adopted a new nomenclature of goods subject to mandatory certification, effective January 1, 1999, and the Russian government has been moving to revise problematic legislation, as provided under its Technical Barriers to Trade action plan.

Certification is a particularly costly and prolonged procedure in the case of telecommunications equipment. In many sectors, type certification or self-certification by manufacturers is currently not possible. Veterinary certification is often arbitrary and needs to be more transparent and based on science. Russian phytosanitary import requirements for certain planting seeds (notably corn, soybeans and sunflowers) appear to lack scientific basis and have blocked imports from the United States. Discussions to ease or eliminate burdensome Russian requirements are ongoing.

c. Russia – Aircraft Market Access

The United States and Russia concluded a joint Memorandum of Understanding (MOU) in 1996 which was designed to address U.S. concerns about access to the Russian civil aircraft market and the application of international trade rules to the Russian aircraft sector. Under the MOU, the Russian Federation confirmed that it will become a signatory to the WTO Agreement on Trade in Civil Aircraft, although thus far Russia has refused to make this commitment in its WTO accession negotiations. In the interim, before Russia accepts its full international trade obligations, the MOU also commits the Russian Federation to provide fair and reasonable access for foreign aircraft to its market. Russia agreed to take specific steps, such as the granting of tariff waivers and the reduction of tariffs, to enable its airlines to meet their needs for U.S. and other non-Russian aircraft on a non-discriminatory basis. In 2002, Russia announced a decision to reallocate existing tariff waivers in favor of Airbus. We continue to press the Russian government to join the WTO Agreement on Trade in Civil Aircraft as soon as possible and to take immediately other steps, including increasing the limited number of tariff-waivers currently available, to facilitate increased market access for U.S. aircraft.

E. Mediterranean/Middle East

Overview

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

2002 Activities

1. Morocco Free Trade Agreement

In April of 2002 President Bush and King Mohammed VI agreed to pursue a Free Trade Agreement (FTA) between the United States and Morocco. On October 1, 2002, USTR Zoellick notified Congress that trade negotiations would be initiated with the Moroccans in January of 2003. The FTA with Morocco will be comprehensive and is part of the Administration's effort to promote more open and prosperous Muslim societies. The FTA will support the significant economic and political reforms underway in Morocco, and create improved commercial and market opportunities for U.S. exports to Morocco by reducing and eliminating trade barriers. USTR Zoellick has had consultations with Congress on the FTA, and in November 2002, public hearings were held. In response to a notice in The Federal Register, 37 written submissions were submitted regarding the matters to be addressed. USTR is pursuing an aggressive negotiation schedule, and negotiations are expected to be finished by the end of calendar year 2003.

2. Egypt

In June 2002 USTR Zoellick traveled to Cairo in the first visit by a U.S. Trade Representative to Egypt. His visit underscored the importance the United States attaches to expanding bilateral trade and investment ties with this key Middle East partner. USTR Zoellick's trip to Egypt complemented efforts by the two countries throughout the year to use the U.S.-Egypt Trade and Investment Framework Agreement (TIFA) to strengthen the U.S.-Egyptian economic relationship and promote Egypt's economic reform program.

At the October 2002 meeting of the U.S.-Egypt TIFA Council, the two governments agreed to form four working groups to facilitate rapid progress on priority trade and investment issues in the areas of Customs Administration and Reform, Government Procurement, Sanitary and Phytosanitary Issues Related to Agricultural Trade, and Agricultural Tariff and Trade issues. They also discussed expanded U.S.-Egypt cooperation on issues related to the Doha Development Agenda. In addition, the two sides reviewed recent progress in Egypt's on-going economic reform program in which the United States plays a major role through assistance by the U.S. Agency for International Development. Resolution of problems affecting U.S. firms and investors in Egypt also continues to be a key focus of U.S. efforts in the TIFA process.

3. Israel

The United States and Israel held four formal rounds of negotiations throughout 2002 on a new bilateral agreement on trade in agricultural products. This new agreement would succeed the 1996 Agriculture Agreement which expired at the end of 2001 and was extended through 2002. At the time this report went to press, the two sides had not yet concluded a new agreement. The United States and Israel have undertaken negotiations on agricultural trade to address problems arising from the two sides' disagreement as to whether or not the 1985 U.S.-Israel Free Trade Agreement permits either party to apply restrictions on bilateral trade in this area.

4. Jordan – Implementing the Free Trade Agreement

The United States and Jordan cooperated in 2002 to help their business communities take advantage of the opportunities afforded by the U.S.-Jordan Free Trade Agreement (FTA) which went into effect in December 2001. These efforts included the first U.S.-Jordan Joint Committee meeting held under the FTA in December 2002 in Washington. The FTA established the Joint Committee to bring together senior U.S. and Jordanian officials to discuss and act on ways to further boost bilateral trade and investment.

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

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

These measures have played a significant role in boosting U.S.-Jordanian economic ties. In 1998, Jordan's goods exports to the United States totaled only $16 million. By 2002 U.S. goods imports had increased to an estimated $414 million, an 81 percent increase ($185 million) from 2001. In 2002 U.S. goods exports to Jordan were an estimated $420 million, up 24 percent ($81 million) from 2001[31].

5. Jordan – Qualifying Industrial Zones

Qualifying Industrial Zones (QIZs) continue to be a bright spot in Jordanian economic performance. Eleven Qualifying Industrial Zones (QIZ) have been established in Jordan since 1998. They played an important role in helping to boost Jordan's exports to the United States from $18 million in 1998 to a projected $400 million in 2002. Jordan estimates that QIZs have created up to 15,000 jobs. Peak QIZ employment is forecast at 40,000 to 45,000. Investment in the establishment of QIZs is approximately $85 million to $100 million, which is expected to grow to $180 to $200 million when all projects are completed.

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

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

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[31] 2002 estimates are annualized based on 11 months' data.

The steady growth of QIZs testifies to the economic potential of regional economic integration. In addition to the competitive benefit of duty-free status for QIZ exports to the United States, QIZs increasingly offer participating companies the advantages of modern infrastructure and strong export expertise and linkages. This evolution should serve to increase the economic benefits of QIZs.

6. Trade and Investment Framework Agreements

In 2002, the United States concluded Trade and Investment Framework Agreements (TIFAs) with Bahrain and Tunisia. TIFAs previously have been previously negotiated with Egypt, Jordan, Turkey, Morocco, and Algeria. Each TIFA establishes a bilateral Trade and Investment Council that enables USTR-chaired representatives to meet directly with their counterparts regularly to discuss specific trade and investment matters and to negotiate the removal of impediments and barriers to trade and investment.

7. WTO Accession

Negotiations on the accession to the WTO of Saudi Arabia and Algeria continued in 2002, and the first WTO Working Group on Lebanese WTO accession was held. The United States supports accession to the WTO on the basis of a new Member's implementation of WTO provisions immediately upon accession and of a new Member's commercially meaningful market access commitments for U.S. goods, services, and agricultural products.

8. Intellectual Property Rights

Protection of intellectual property rights remains a leading priority in the Middle East region. Egypt, Israel and Lebanon are on the Special 301 Priority Watch List, while Kuwait, Qatar, Turkey and Saudi Arabia are on the Watch List. An out-of-cycle review (OCR) was initiated for Israel in 2002 to further assess progress in its efforts to improve enforcement of copyright and trademark rights.

F. Asia and the Pacific

Overview

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

Highlights of the achievements in this region during 2002 include:

- *Conclusion of the Singapore FTA.* In January 2003, the United States and Singapore reached agreement on an FTA, the first comprehensive agreement between the United States and an Asian nation. The FTA's provisions cover not only goods and services, but customs procedures and cooperation, investment, competition policy, intellectual property rights, electronic commerce, transparency, labor and environment. The agreement with the United States' 11th largest trading partner is expected to eliminate trade barriers between the two countries and spur bilateral trade and investment. The agreement also will serve as a benchmark for possible free trade agreements with other countries in Southeast Asia. More detailed discussion regarding the negotiation of this agreement appears in Chapter IV, Section A.

- *Announcement of the Enterprise for ASEAN Initiative.* In October 2002, President Bush announced the Enterprise for ASEAN Initiative (EAI), a new initiative intended to further build U.S.-ASEAN trade ties. Under the EAI, the United States offered the prospect of bilateral FTAs with ASEAN countries that are committed to the economic reforms and openness inherent in an FTA with the United States.

- *Launch of the U.S.-Australia Free Trade Agreement.* In November 2002, the United States launched FTA negotiations with Australia. The United States expects an FTA with Australia to boost trade in both goods and services and enhance employment opportunities in both countries. Such and agreement will enhance commercial ties and address barriers that U.S. exporters face. The United States also sees the FTA negotiations as helping to further deepen the already close cooperation between the United States and Australia in the WTO.

2002 Activities

The United States announced major new regional and bilateral trade initiatives in the Asia Pacific region in 2002 to expand opportunities for U.S. industry, farmers, and ranchers. The United States pursued bilateral FTAs and undertook other bilateral work to strengthen trade ties with the Asia Pacific region and eliminate barriers faced by U.S. exporters in this region, began work on the EAI, and continued efforts with APEC Members to implement the Shanghai Accord, a series of specific commitments to ensure APEC reaches its free trade and investment goals. These initiatives are intended to complement our global trade priorities, particularly the successful conclusion of the Doha Development Agenda.

1. Australia

a. Free Trade Agreement

On November 13, 2002, the Administration notified Congress of its intent to launch FTA negotiations with Australia. In its notification letter, the Administration noted that the increased access to Australia's market that an FTA would provide would further boost trade in both goods and services, enhancing employment opportunities in both countries. An FTA also would encourage additional foreign investment flows between the United States and Australia, adding to the many jobs that the already significant investment flows between the two countries currently support. Moreover, the discussion of an FTA with Australia has strengthened our WTO partnership as well as the U.S. position in global trade negotiations. Australia was the first strong supporter of the United States WTO agriculture proposal made in July 2002. The United States expects the FTA negotiations to provide the opportunity for further cooperation on agriculture and other issues the United States is seeking to resolve through the WTO Doha Development Agenda negotiations, as well as deepen the broader ties between our countries and strengthen the foundation of our security relationship.

b. Bilateral Issues

The United States held extensive and detailed discussions with Australia on sanitary and phytosanitary (SPS) issues over the past year. The two sides made progress on specific issues, including opening the Australian market to U.S. table grapes. The two sides agreed that SPS measures must be based on science and be fully transparent. The Australian government implemented a new administrative framework in early 2002 to enhance the transparency of its SPS regime. Nonetheless, the United States continues to have concerns about the stringency of Australia's SPS regime, and the two sides agreed to continue discussion of SPS measures in parallel with the FTA negotiations.

2. New Zealand

The United States held a Trade and Investment Framework Agreement (TIFA) meeting with New Zealand in May, during which the two sides discussed the range of outstanding bilateral trade issues between them. Progress was made on several sanitary and phytosanitary (SPS) issues, including table grapes and pork, although the United States continues to have concerns about the stringency of New Zealand's SPS regime. The United States raised concerns about New Zealand's biotechnology labeling regime, its two-year moratorium on the release of genetically-modified organisms, and its approval process for biotechnology seeds. The U.S. Government also noted longstanding concerns on intellectual property, including parallel imports and trademarks, and pharmaceutical issues. The United States will continue working with New Zealand under the TIFA to address bilateral trade issues, as well as in APEC and the WTO to advance our common trade interests.

3. The Association of Southeast Asian Nations (ASEAN)

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

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

Under the EAI, the United States also committed to support the efforts of the three ASEAN members that do not yet belong to the WTO to complete their accessions successfully. The United States offered to assist countries needing help to develop the capacity to participate in and implement FTAs, as well as to connect openness and trade liberalization to other reforms.

In November 2002, the United States and ASEAN trade ministers met to discuss the EAI in greater detail. The ministers agreed to intensify their efforts to make progress under the initiative (as well as the U.S.-ASEAN work program established in April 2002) including efforts on intellectual property rights, customs and trade facilitation, biotechnology, standards, agriculture, human resource development and capacity building, small and medium enterprises, and information and communications technology.

a. Indonesia

i. General

The United States has worked to bolster its trade and investment relationship with Indonesia, seeking to help strengthen Indonesia's economy and encourage liberalization and other economic reforms that would generate additional trade and foreign investment. The United States and Indonesia held their fourth Trade and Investment Council meeting under the bilateral TIFA in Bali in November, 2002, during which the trade ministers discussed the range of outstanding issues affecting U.S.-Indonesian trade. The United States urged Indonesia to eliminate its ban on poultry parts and new regulations impeding exports of textiles to Indonesia. The two sides also discussed ways to improve Indonesia's investment climate and facilitate trade, including capacity building. They discussed the need to hold regular consultations under the TIFA to resolve bilateral issues and other steps to help lay the groundwork for a free trade agreement, as envisioned by the Enterprise for ASEAN Initiative. Indonesia is the United States' 26th largest trading partner, with $13 billion in two-way trade.

ii. Intellectual Property Rights (IPR)

On IPR, the U.S. Government reiterated longstanding concerns and urged Indonesia to take steps to strengthen its IPR regime. USTR placed Indonesia on the Special 301 Priority Watch List in April 2001 because of concerns over increased optical media piracy and weaknesses in Indonesia's IPR enforcement. To help Indonesia address these concerns, the U.S. Government in May 2002 provided Indonesia with an IPR Action Plan. In July, the Indonesian government passed a new copyright law, which took some initial steps in areas of concern to the United States, including circumvention of technological protection measures and penalties for corporate end-user piracy, as well as regulations on optical disc production. However, the legislation failed to address other areas of concern, particularly deficiencies related to enforcement. U.S. industry estimates that the weak IPR environment in Indonesia resulted in $188 million in losses last year. The U.S. Government will continue to work with Indonesia under the TIFA to achieve progress on IPR issues.

b. Malaysia

i. General

During 2002, the United States and Malaysia consulted, including at the ministerial level, on their trade relationship and ways to enhance cooperation in regional and multilateral fora. The United States will continue to encourage Malaysia to further open and liberalize its economy, which is heavily trade-dependent. Malaysia is the United States' 12th largest trading partner, with $32 billion in two-way trade.

ii. Intellectual Property Rights

Malaysia has made strides in strengthening its IPR regime, including determined efforts to eliminate optical media piracy. It passed strong copyright legislation and increased its resources aimed at copyright enforcement. Although progress has been steady, Malaysia remained on the Special 301 Watch List in April 2002 because of continuing concerns over its failure to fully implement all provisions of the Optical Disk Act and the inability to establish a climate of deterrence by prosecuting IPR offenders and imposing deterrent penalties. U.S. industry estimates that the deficiencies in Malaysia's IPR regime cost it $316 million last year. The U.S. Government will continue to work with Malaysia to further strengthen its IPR environment.

iii. Automotive Measures

Malaysia continues to promote the development of domestic automobile manufacturers under its "national automobile" program through high tariffs, quotas, and other measures. In addition, it maintains local content requirements on investment in the auto sector. As required by the WTO Agreement on Trade-Related Investment Measures, Malaysia was scheduled to eliminate its incentives for local production by January 1, 2000, but it received an extension to December 2003 to phase out these measures. Malaysia also received a delay from its ASEAN partners to lower tariffs in this sector as it committed to do under the ASEAN Free Trade Area (AFTA). The United States will continue to urge Malaysia to eliminate measures that protect its auto industry, which undermine the benefits the heavily trade-dependent country stands to gain from further liberalization, as well as investor confidence and the success of AFTA.

c. Philippines

i. General

The United States sought to further enhance its trade and investment relationship with the Philippines in 2002, urging additional trade liberalization and facilitation and other steps to encourage trade and investment. The United States and the Philippines held a Trade and Investment Council (TIC) meeting under the bilateral TIFA in November, during which the trade ministers discussed the range of outstanding U.S.-Philippines trade. The two sides agreed on the need for regular consultations under the TIFA to resolve bilateral issues and to consider other steps to help lay the groundwork for a free trade agreement, as envisioned by the Enterprise for ASEAN Initiative. The Philippines is the United States' 23th largest trading partner, with $19 billion in two-way trade.

ii. Intellectual Property Rights

The Philippines intensified its efforts to strengthen IPR protection in the last year, including measures to stop imports of pirated products and increase the number of raids, resulting in the seizure and destruction of millions of dollars worth of pirated products. However, the Philippines so far has failed to pass an optical media law that would curb the still rampant pirate production of optical media or to pass legislation on electronic commerce piracy. Moreover, while it has increased the number of raids, the Philippines has been slow to prosecute IPR offenders and reluctant to impose deterrent penalties. U.S. industry estimates that the weak IPR environment in the Philippines resulted in $116 million in losses in 2001.

To help the Philippines strengthen its IPR regime, the U.S. Government in August 2002 provided it with an IPR Action Plan that included specific steps on judicial, legislative and regulatory, and enforcement issues. The Philippines has made limited progress in implementing these recommendations. The U.S. and Philippines trade ministers discussed U.S. IPR concerns during the November 2002 TIC meeting, and the U.S. Government reiterated its offer to provide the Philippines support in this area. The United States will hold an out-of-cycle review in early 2003 to assess the Philippines' progress in strengthening its IPR regime.

iii. Sanitary and Phytosanitary (SPS) Issues

The Philippines proposed a new requirement of quarterly mandatory third-party inspections of meat and dairy production facilities overseas. The measures, if implemented as proposed, would disrupt U.S. meat and dairy exports to the Philippines, estimated at $56 million. The United States, EU, Canada, Australia, and New Zealand raised objections to this proposed regulation at a meeting of the WTO SPS Committee in Geneva on November 7, 2002. In addition, U.S. and Philippine trade ministers discussed the issue at their November 20, 2002, TIC meeting. The measure originally was to be implemented on January 1, 2003. The Philippines announced in early December 2002 that the requirement will be implemented on April 1, 2003, and it will be conducted biannually in the first year and annually thereafter. The U.S. Government will continue to urge the Philippines not to implement this requirement.

iv. Automotive Sector

The Philippines is revising its auto excise tax system to a value-based structure. The U.S. Government supports this change, but has expressed concerns to the Philippine government about certain details of the proposal. In addition, the United States has raised serious concerns about proposals the Philippines reportedly is considering to significantly raise import duties on automobiles to help develop its automotive industry. Such increases would raise questions about previous Philippines announcements that tariff reductions in this sector would occur in 2004. The U.S. Government will continue to monitor this issue closely.

d. Singapore

In November 2000, the United States and Singapore announced the launch of negotiations for a bilateral Free Trade Agreement (FTA), which concluded in early 2003. Discussion of U.S.-Singapore trade issues had been handled in the context of these negotiations (see U.S.-Singapore FTA).

e. Thailand

i. General

The United States sought to bolster its trade ties with Thailand in 2002, signing a Trade and Investment Framework Agreement (TIFA) in October. The two sides agreed to hold a first Trade and Investment Council meeting in February 2003 in order to resolve outstanding bilateral issues and consider other steps to help lay the groundwork for a free trade agreement, as envisioned by the Enterprise for ASEAN Initiative. Thailand is the United States' 19^{th} largest trading partner with $21 billion in two-way trade.

ii. Intellectual Property Rights

Thailand heightened its efforts to strengthen its IPR regime in 2002, including new legislation and stepped-up enforcement efforts, resulting in some improvements, but significant and sustained progress is still needed. On March 1, the Thai Parliament passed a Trade Secrets Act; the U.S. Government has concerns about some provisions of this measure. In addition, the Thai government drafted an Optical Disk Plant Control Act, which is intended to enhance the authority and capabilities of enforcement authorities to take action against pirate optical disk producers. The Thai government has committed to introduce the bill into Parliament in 2003; however, key provisions remain under debate and timely passage of a strong law remains uncertain. There appears little chance that the Thai government will amend its copyright law to deal with electronic commerce piracy, despite indications earlier in the year that it would do so.

Weak and uncoordinated enforcement efforts, resource limitations, and corruption and other problems led to continued increases in IPR piracy. U.S. industry estimates losses due to piracy at over $130 million last year. Thailand has acknowledged the gravity of the piracy situation and in December, a Memorandum of Understanding (MOU) on the Cooperation of the Relevant Government Agencies on the Enforcement of IPR was signed by 13 government agencies. In this MOU, Thailand called on agencies to intensify and further cooperate in their enforcement efforts and consider other measures to curb piracy. The U.S. Government will closely monitor the results of this new effort and will conduct an out-of-cycle review in early 2003 to assess Thailand's progress in strengthening its IPR regime.

iii. Customs

Thailand's customs rules and procedures are non-transparent and inconsistently applied, serving as a serious barrier to trade. A customs valuation law passed in 2000 has alleviated to some degree our longstanding problems in this area, but implementation has been uneven, and discretionary application of minimum import prices in lieu of transaction values continues. Thailand's customs procedures cause undue and costly processing delays. The system continues to involve excessive paperwork and formalities, and lacks coordination between custom and other import regulating agencies as well as modern, computerized processes. Moreover, the appellate process for customs determinations is non-transparent and ineffective. The U.S. Government will continue to monitor Thailand's implementation of its customs valuation law and urge it to improve its customs regime.

iv. Market Access

Thailand maintains relatively high tariffs and a complicated tariff regime, which serve to protect Thailand's agricultural, automotive, alcoholic beverage, textile, and electronics industries. While it continues to reduce selected duties in line with its WTO and ASEAN Free Trade Area commitments, it is behind schedule in implementing its own tariff reduction goals. U.S. industry also has faced tariff reclassifications, including of motion pictures, that raise duties to prohibitive levels. Tariff-rate quotas and arbitrarily applied phytosanitary standards serve as constraints to the import of certain agricultural products. In addition, Thailand has implemented non-transparent price controls on some products, including pharmaceuticals, which impede market access. Thailand's uneven application of Buy Thai policies has also has hurt U.S. bidders. The U.S. Government will continue to raise its serious concerns over these issues with the Thai government.

f. Cambodia

On December 31, 2001, the United States and Cambodia reached agreement extending the Bilateral Textile Agreement for an additional three years, through December 31, 2004. In the renewed agreement, the quota for most textile exports from Cambodia in 2002 was 15 percent higher than in 2001. This increase reflected the normal quota increase of 6 percent as well as a 9 percent increase in recognition of Cambodia's progress in reforming labor conditions in textile factories and ensuring that these conditions were in "substantial compliance" with internationally recognized labor standards and provisions of Cambodia's labor law. The increase followed recent formal U.S.- Cambodian labor consultations. The

International Labor Organization also has two projects underway assisting Cambodia in the implementation of its labor law.

As in the original agreement, Cambodia is eligible for future additional quota increases if working conditions in the garment industry substantially comply with internationally recognized core labor standards. The U.S. and Cambodian Governments have agreed to increase this potential quota reward for full compliance from 14 percent to 18 percent. Following two rounds of consultations on labor issues in 2002, Cambodia was granted a 12 percent increase in all of its quotas pursuant to the Agreement.

g. Normalization of Trade Relations with Vietnam and Laos

i. Vietnam

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

At present, for Vietnam to receive NTR status, a bilateral trade agreement must be completed and approved by Congress, and the President must "waive" the "Jackson-Vanik" provision, indicating that Vietnam is making sufficient progress on the issue of free emigration. Since 1998, the President has granted a Jackson-Vanik waiver for Vietnam. Thus, completion of the BTA and its subsequent approval by Congress have cleared the way for Vietnam to receive annually renewed (as opposed to permanent) NTR treatment from the United States.

On June 8, 2001, President Bush signed Proclamation 7449 and transmitted the BTA to Congress on that date for its approval. In the proclamation, the President directed the USTR to publish notice of the effective date of the BTA. Congress approved the BTA on October 3, 2001 and the President signed the legislation approving the BTA on October 16, 2001. The National Assembly of Vietnam approved the resolution ratifying the BTA on November 28, 2001 and the President of Vietnam signed the legislation on December 4, 2001.

On December 10, 2001, U.S. Trade Representative Robert B. Zoellick and Vu Khoan, Minister of Trade of the Socialist Republic of Vietnam, exchanged written notices of acceptance, implementing the BTA. Thus, in accordance with the terms of the BTA, NTR tariff treatment for products of Vietnam became effective on December 10, 2001.

The first meeting of the Joint Committee established by the BTA was convened at vice-ministerial level on May 6, 2002, in Hanoi, during which the two sides assessed progress toward implementation of the BTA. While applauding Vietnam's commitment to economic reform, the United States underscored the importance of Vietnam moving quickly to meet the timetables contained in the BTA for implementation. The two countries also discussed Vietnam's pursuit of WTO membership and the negotiation of a textile agreement. The next meeting of the Joint Committee will be held in the first quarter of 2003 and will review the first year of implementation of the BTA.

ii. Laos

In 1997, the United States completed a comprehensive bilateral trade agreement with Laos aimed at normalizing trade relations. Laos, unlike Vietnam, is not covered by the "Jackson-Vanik" provisions of U.S. trade law. As with the Vietnam agreement, the Laos agreement requires separate legislation enabling the President to grant normal trade relations status to Laos once formal acceptance of the agreement is completed.

3. Republic of Korea

a. Macroeconomics and Trade

At the end of 1997, Korea experienced a financial crisis brought on by a major mismatch in the maturity structure of its external assets and liabilities. The crisis, and the IMF stabilization program that followed which included credit from the IMF, the World Bank, and the Asian Development Bank, resulted in significant restructuring of the Korean economy.

While the Korean government still maintains a majority ownership in several of the largest commercial banks in Korea and a significant stake in a number of others, the government has made progress on implementing some of its reform commitments during the past five years. Key reforms were carried out in the financial sector, through the rationalization and recapitalization of its banks, and by consolidation of the regulatory authority over the financial sector in a new, independent Financial Supervisory Commission. The fiscal, monetary, and restructuring policies laid out by the Administration of President Kim Dae Jung have contributed to a resumption of foreign and domestic consumer confidence in Korea's economy. In 2001 Korea's economy grew about 2.6 percent, despite the global downturn, and in 2002 grew approximately 6 percent. However, Korean authorities are seeking to further strengthen commercial bank balance sheets and restructure merchant banks, investment trust companies and the insurance industry.

The United States and Korea consult regularly on a variety of trade issues. Meetings held on a quarterly basis serve as the primary forum for bilateral discussion. During quarterly trade meetings held in 2002, the United States and Korea focused on addressing issues in the following areas: automotive, telecommunications, pharmaceuticals, intellectual property rights, and agriculture. The United States and Korea also continue to cooperate effectively in regional and multilateral fora. These cooperative efforts helped lead to the successful launch of new multilateral trade negotiations at the Doha Ministerial in November 2001 and subsequent movement forward on a number of Doha Development Agenda issues.

b. Motor Vehicles

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

Section 301 investigation and began monitoring the Korean government's implementation of these measures through formal reviews.

During the 2002 MOU reviews, held in January, April, August and November, the United States and Korea assessed progress under the agreement and discussed additional steps Korea will take to implement this agreement. The Korean government has implemented many of the specific provisions of the MOU. However, the U.S. Government remains concerned about the lack of more substantial import penetration in the Korean automotive market. Despite a notable increase in U.S. vehicle sales in Korea in 2002, the share of foreign vehicles in the Korean market is approximately one percent as a result of continued high taxes and tariffs, anti-import sentiments among many Korean consumers, and ROKG positions vis-a-vis several important standards and certification issues.

Over the last year, the United States has made specific proposals for addressing these concerns and achieving further progress under the agreement. At the most recent MOU review, held in November, U.S. proposals focused on addressing a tax classification issue related to U.S. pickup truck imports and improving transparency in the implementation of Korea's self-certification system for motor vehicle safety and environmental regulations. The U.S. Government also made specific proposals to address outstanding standards and certification issues, simplification of automotive taxes, overly high automotive tariffs and the need for further Korean government action to improve the generally negative perception of foreign vehicles among Korean citizens.

In November 2001, the Korean government reduced one auto-related consumption tax which had a positive effect on foreign auto sales. With the U.S. Government and U.S. industry joining a number of domestic voices calling for the extension of this reduction, the ROKG continued this useful program through August 2002 (extended from the original June cut-off date). The Korean government also announced that it plans to simplify and reduce this tax, with the modification set to be introduced in January 2004. The U.S. Government views this as one step forward in Korea's fulfillment of the automotive MOU commitment to "steadily reduce the tax burden on motor vehicle owner in the ROK in a way that advances the objectives of this MOU." Further, while negative consumer perception of foreign products remains the single most significant barrier to foreign vehicle sales, the Korean Government has taken a few steps in this area. The Korean government completed the purchase of 50 U.S. produced cars for its Police Agency fleet, and committed to a similar purchase in 2003. Nonetheless, it has refused to consider lowering tariffs outside of the Doha WTO negotiations, despite its own study that showed that tariff reductions would lead to significant increases in foreign car sales.

c. Steel

A discussion of the overall situation facing the steel industry in the United States and the initiatives of the Administration during 2002, including those affecting Korea, is contained in Chapter V of this report.

d. Pharmaceuticals

Over the past year U.S. concerns regarding pharmaceuticals trade relate mainly to the pricing of innovative pharmaceuticals under Korea's national health insurance reimbursement system. In 1999 and 2000, the Korean government took a number of positive steps to address U.S. concerns in this sector, and since then the U.S. Government has been closely monitoring Korea's implementation of these changes. In 2002 the Korean government began backing away from its previous actions and commitments.

The U.S. Government has three distinct concerns regarding Korean government actions related to pharmaceutical pricing: (1) The change from an Actual Transaction Pricing (ATP) to a Lowest Transaction Pricing (LTP) system. In August 2002, Korea adopted a ministerial ordinance establishing LTP. The United States had urged Korea to take steps to ensure the full implementation and enforcement of the ATP system whereby both imported and domestically manufactured pharmaceuticals are reimbursed without hospital margins. Korea announced in August 2002 plans to discard the ATP system and adopt on a one-year trial basis an LTP system in which the reimbursement price of a drug will be based on the lowest transaction price from the previous quarter rather than the actual transaction price. This change to LTP will likely lower the reimbursement prices for U.S.-made drugs. The U.S. Government has strongly urged Korea to ensure that any changes to its pricing system do not undermine its previous commitments on this issue or lead to a distortion of the incentives needed to promote innovation and the availability of innovative pharmaceutical products. The U.S. Government has therefore urged Korea to seek meaningful discussions with stakeholders including U.S. industry, which can provide valuable input on pricing. Korea's failure to state how it will handle companies' appeals of government pricing decisions is also of concern.

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

(3) Adoption of a Reference Pricing System: In October 2002, Korea proposed a plan for the adoption of reference pricing, a system whereby the health ministry groups drugs into various categories and sets reimbursement prices for the group rather than taking into account distinct differences among drugs. Interested parties, including physicians, patients, pharmacists, and pharmaceutical makers expressed opposition to reference pricing at a November 2002 public hearing. The U.S. Government also opposes the reference pricing plan because it discriminates against the most effective and innovative drugs. These drugs tend to be relatively expensive (due to high research and development costs) and represent a high proportion of U.S.-made products in the Korean market. Reference pricing also limits the affordability of innovative medicines for low- and middle-income patients. This fosters the creation of a two-tier health system consisting of the relatively wealthy, who can buy the most advanced, effective drugs, and patients who cannot afford the additional co-payment for these drugs. Korea has not made a final determination on whether to adopt reference pricing.

The U.S. Government raised these issues on numerous occasions during trade consultations with Korea in 2002 and will continue to closely monitor developments in this sector. Of particular interest will be the extent to which the Ministry of Health and Welfare fully involves all relevant stakeholders, including U.S. industry, as it develops and implements new plans.

e. Intellectual Property Rights

In 2000, USTR placed Korea on the Special 301 Priority Watch List as a result of serious concerns over legal protection and enforcement of intellectual property rights (IPR). Based on commitments made in April 2002 bilateral trade meetings, USTR downgraded Korea to the Watch List in 2002. To date, some progress has been made by the ROKG toward fulfilling its April 2002 commitments; however, more needs to be done, including passage of legislation granting the Korean Standing Inspection Team (a key body charged with investigating software piracy) police powers and provision of additional data to the U.S. Government by the ROKG on its IPR enforcement efforts. Further, new enforcement concerns have arisen concerning authorization of the distribution of U.S. films in Korea without the permission of the U.S. copyright owner. The U.S. Government continues to monitor developments related to these issues in Korea closely.

In 2002, the Korean government submitted amendments to the Copyright Act of Korea. These amendments have not yet passed the Korean National Assembly. The U.S. Government remains concerned about outstanding issues in the Copyright Act, such as the lack of a transmission right for sound recordings and a reciprocity provision for database protection that will hurt U.S. database producers. The Korean government has not been willing to make changes to this set of amendments before they pass the National Assembly. In 2002, the Korean government also put forward amendments to the Computer Programs Protection Act, which addressed some U.S. Government concerns. These amendments successfully passed the National Assembly in late 2002. The U.S. Government has raised these and other inadequacies in Korean copyright laws, including the failure to protect temporary copies, insufficient protection against the circumvention of technological protection measures, and the failure to provide full protection for pre-existing copyrighted works as required under the TRIPS Agreement in detail with Korea on numerous occasions in 2002. The U.S. Government will continue to work with the Korean government to ensure its full compliance with its WTO obligations, including those on protection of copyrights. Resolution of these issues will be key to concluding a Bilateral Investment Treaty (BIT).

f. Telecommunications

Standard-Setting: Increasing Korean government intervention in the private sector, including in its selection of technologies, continued to be of significant concern to the U.S. Government in 2002. This governmental influence on the choice of sources of equipment and technologies is often apparent in the licensing process for operators and in localization policies for procurement. The Korean government may use its influence directly but often works indirectly through industry associations and quasi-governmental commissions or other entities. As a result, some U.S. firms with leading-edge technologies have continued to encounter resistance to their efforts to introduce new software and technologies to the market, and some U.S. firms that formerly had a dominant market share have lost significant market share to Korean firms in the past few years. By limiting competition in the Korean telecommunications market, the Korean government is hampering the ability of Korean firms to develop state-of-the-art, globally competitive products as well as Korea's goal of becoming an economic hub in Northeast Asia.

A key new concern for U.S. industry and the U.S. Government that has been the focus of a number of bilateral meetings in 2002 relates to Korea's pursuit of domestically-created standards in the telecom sector which the Korean government has suggested that it intends to make mandatory . Of prime interest were developments related to the "wireless internet platform for interoperability ("WIPI") standard for mobile phone applications. The U.S. Government has a number of concerns related to the ROKG's plans related to WIPI, including: inappropriate government involvement in the creation, standardization and deployment of WIP; recent actions taken by the ROKG to discourage Korean telecommunications service providers from subscribing to competing foreign standards; overly-restrictive WIPI specifications which appear to be designed to keep competing foreign systems out of the market; and plans to make the standard mandatory without proper notification to, and consultation in, the WTO. The Korean government has also announced plans to reallocate the 2.3 gigahertz spectrum to a new wireless Internet system and appears to be planning to mandate a new standard in this area as well. The U.S. Government has repeatedly expressed its expectation that Korea, in launching any new telecommunications standards, will fulfill its bilateral and multilateral obligations and that all efforts will be made to avoid creating unnecessary obstacles to international trade in the telecommunications sector. In this vein, the U.S. Government was pleased when in November 2002, the ROKG announced that it would not make any decisions on whether to make WIPI mandatory until it had fully consulted bilaterally and within the WTO.

Korea Telecom (KT) Privatization: On April 23, 2002 the ROKG officially requested that Korea Telecom (KT) be removed from coverage under the 1997 U.S.-Korea bilateral procurement agreement following the complete diverstiture of ROKG shares in the company, which took place in June 2002. Korea has made a similar request to WTO Members to remove KT from coverage under the WTO General Procurement Agreement (GPA).

In response, the U.S. Government has informed the Korean government that KT would remain covered under the bilateral agreement and the GPA until the United States and other interested governments, including Canada and the European Union, agree that all ROKG control and influence over the company have ceased (the GPA standard for removal from coverage) and that KT is behaving like a fully privatized company. Consultations on the matter continue.

g. Financial Services

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

h. Government Support for Semiconductor Production and Export

The U.S. Government continued to express strong concerns about instances of possible Korean subsidization of semiconductor production and export that could adversely affect U.S. trade interests. In particular, the U.S. Government raised concerns about the support by the Korean government of Hyundai Electronics, Ltd. (now, Hynix Semiconductor, Inc.), Korea's second largest semiconductor manufacturer. In late 2002, a new Hynix bailout package was accepted by Hynix creditors which included: a hefty debt forgiveness package in the form of a three-year-plus payback moratorium on 3 trillion Korean won of debt; a significant reductions in interest on the 3 trillion Korean won principal (from 6.7 percent to 3.2 percent); and a new 1.9 trillion Korean won debt-to-equity swap. This action comes after a series of steps taken to help the company in 2001 which included a $4 billion bailout instigated by the partially state-owned Korea Exchange Bank (KEB) and another $7 billion debt restructuring package and approximately $500 million in new loans organized by KEB in late 2001.

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

i. Cinema Screen Quotas

Korean Law requires that domestic films be shown in each cinema for a minimum number of days per year. Current law requires that Korean films be shown 146 days of the year, with a potential discretionary reduction to 106 days. The Korean National Assembly adopted a resolution on December 8, 2000, stating that the screen quota system must not be abolished until the domestic market share for Korean films maintains a 40 percent level. Although domestic films "maintained" a market share close to 50 percent in 2001 and 2002, there has been very little progress on the issue. In early 2002, hopes were raised that the issue could be resolved in time for President Bush's state visit to Korea. However, this effort was apparently blocked by a lack of flexibility on the part of the various Korean stakeholders and did not occur.

j. Bilateral Investment Treaty

Since 1998, the U.S. Government has sought to negotiate a bilateral investment treaty (BIT) with Korea aimed at securing Korean commitments on a balanced and open investment regime and providing protections for U.S. investors in Korea. Negotiations in 1999 made progress on Korean commitments to liberalize investment restrictions in a number of sectors, but several issues remained unresolved, including greater access for U.S. investors in telecommunication services, liberalization of the screen quota system, and resolution of IPR issues, specifically, with respect to retroactive copyright protection for pre-existing works and sound recordings. By 2001, both sides agreed that, without resolution of these issues it was not productive to continue negotiations. (See Screen Quotas).

k. Cosmeceuticals

The Korean Cosmetic Products Act, which became effective in July 2000, separates cosmetic products from cosmeceuticals or cosmetics with a function, such as sun screen, wrinkle cream or skin whiteners. The new regulations govern the sale and promotion of cosmeceuticals and require that these products be labeled as cosmeceuticals and not include claims that are beyond proven efficacy. In 2002, the Korean government took some steps to reform the approval process for marketing new cosmetics in Korea. However, the United States continues to have serious concerns related to this system, including the continued slow pace of approvals, and believes that Korea should simplify its cosmetics regulations and harmonize them with other cosmetics exporters such as the United States, the European Union, and Japan.

l. Agriculture

Implementation of the Biosafety Protocol: On March 28, 2001, the Ministry of Commerce, Industry, and Energy (MOCIE) issued legislation (the so called "LMO Act") to implement Korea's interpretation of the Cartagena Biosafety protocol. In June 2002, MOCIE announced a proposed Presidential Decree and Ministerial Ordinance to the LMO Act. However, these have not been notified to the WTO as required by the SPS Agreement. The U.S. Government has expressed concern that Korea's plans for implementation of the Biosafety Protocol, which will lead to mandatory environmental risk assessments of biotech crops, could disrupt an estimated $520 million in U.S. exports to Korea. The United States has urged Korea to make every effort to implement a regulatory approach to biotechnology that is rigorously based on science, transparent and predictable. Moreover, as Korea develops and implements new regulations, the United States has pressed Korea to fully involve all stakeholders, avoid duplication and adhere to international commitments.

Mandatory Food Safety Assessment: Under the Food Safety Act, issued by Korea's Ministry of Health and Welfare (MHW), the Korea Food and Drug Administration (KFDA) was given the authority to conduct mandatory safety assessments to evaluate biotechnology applications intended for human consumption. The Act, which was passed in August 2002, provides for an 18 month (grace) period during which technology firms must file and have completed applications for safety assessment. U.S. officials have urged their Korean counterparts to consult with both local and foreign industry to address concerns prior to finalizing the implementing regulations so as to avoid trade disruptions.

Additional U.S. Concerns Regarding Korea's Biotech Regulations: (1) biotechnology labeling requirements, and (2) special advertising requirements for biotech products. Related to biotechnology labeling requirements, after lengthy negotiations with the United States Korea finally permitted acceptance of a notarized self-declaration in-lieu-of the full, identity preserved (IP) documentation that was originally required. In response to U.S. concerns related to labeling requirements for fresh potatoes, Ministry of Agriculture and Forestry (MAF) officials have indicated that U.S. fresh potatoes will be exempt from biotechnology labeling requirements and will require no extra documentation as long as potatoes that are a product of biotechnology are not produced in the United States. Concerning biotech advertisement requirements, U.S. officials have pressed Korea to eliminate this non-science based requirement on the grounds that it duplicates existing labeling requirements and creates an unfounded negative perception of biotechnology products among consumers.

Organic Shipment Documentation Requirements: Absence of clearly written guidelines for documents that are required for organic foods often caused detention at Korean ports. While KFDA headquarters agreed to accept certain types of documents from exporters of organic foods, this list was not provided to port inspectors in writing which caused a number of detentions of quarantine inspection at port. The U.S. Government continues to work toward resolution of this issue.

Rice: Since the Uruguay Round Agreement on Agriculture went into effect, the United States has sold rice to Korea during two years (40,000 MT out of a TRQ of 171,023 MT in CY2002 and 30,000 MT, out of the 142,520 MT TRQ in CY2001). Such sales were only possible when Korea agreed to hold tenders for U.S. #1 grade medium rice. However, all rice including U.S. rice that is imported under the TRQ has severe restrictions on how it may be marketed. Currently, none of the rice imported under the TRQ is being sold to the general public for direct consumption. The United States has pressed Korea to eliminate restrictions on how the rice TRQ is administered.

Alcoholic Beverages Labeling: On October 1, 2002, the National Tax Service (NTS) of Korea implemented a regulation requiring that all alcoholic beverages, except canned liquor products, to be labeled to indicate where the product is to be sold. NTS now requires four different types of labels, and liquors for home use and discount stores must have a warning that states "not allowed to be sold in restaurants and bars" on the main label or supplementary label. Importers have serious concerns related to the additional cost associated with the new labeling requirements. The U.S. Government has urged Korea to allow less restrictive means of applying the usage label (i.e. stickers). The National Tax Service has agreed to continue to work with interested industry representatives and the U.S. Government to resolve this issue.

U.S. officials have also expressed concerns regarding Korea's customs classification of citrus pulp pellets, tariff rate quota administration for oranges, and prohibitively high tariff rates on croaker fish. After U.S. officials raised concerns regarding Korea's restrictions on the use of whey in fermented milk and prohibition against freezing meat sold as "fresh" or "chilled," Korea changed its regulations to address the issues.

m. Import Clearance Procedures, Food Standards, and Labeling

After WTO dispute settlement consultations with the United States between 1995 and 1999, the Korean Government revised its import clearance procedures to harmonize them with international practice including: (1) expediting clearance for fresh fruits and vegetables; (2) instituting a new sampling, testing, and inspection regime; (3) eliminating some non-science-based phytosanitary requirements; and (4) beginning revisions of food related regulations. However, additional work will be needed to bring Korea's food related regulations into conformity with international standards, specifically those related to limited classification of food categories and burdensome testing requirements.

U.S. firms continue to experience problems with import clearance in Korea associated with FSIS health certificates and non-science based and excessive criteria for heat treatment for meat products. USDA officials plan to hold discussions with the Korean Government on these concerns in early 2003. On the positive side, Korea's plant quarantine requirements were improved in 2002 to recognize industry fumigation practices for shelled walnuts. However, Korean's phytosanitary and sanitary certification requirements still continue to limit market access for a variety of products due to delays in Korea's review of documentation on pest mitigation provided by the United States.

In early 2002, U.S. fruit and grain exporters experienced delays in quarantine inspection with extra testing costs due to a policy change in the "same company, same product" treatment. Same company, same product treatment allows exemptions from laboratory tests if the same company had previously passed tests for the same product in an earlier shipment. In January 2002, the KFDA added 12 new chemicals to their list of chemicals subject to simultaneous residue testing and required all products to be tested (including products with same company, same product status from earlier tests). Those companies/products which passed the new test regained same company, same product status. However, re-testing will be required if KFDA adds additional chemicals to their list of chemicals subject to simultaneous residue testing.

The U.S. Government is also concerned about the extended clearance time resulting from the new chemical tests and the cost associated with the tests (over US$1,000 for each simultaneous multi-residue test). KFDA Headquarters maintained that same company, same product status will have to be renewed whenever there is a change in the chemical test requirements or standards. Since KFDA makes such changes at least once or twice each year, the new policy will burden traders with additional testing costs and extended clearance times.

In December 2002, MHW announced a proposed Ministerial Ordinance related to the Food Sanitation Act. This proposal includes a significant change to the current import inspection system to limit the same company same product status up to three years for processed food and one year for fresh produce. Along with KFDA's policy on renewal of the same company same product status whenever there is a change in test requirements or standards, this proposal will add excessive burdens to imported agriculture and food products when finalized. The U.S. Government will continue to work with the ROKG to address these concerns.

4. India

a. General

The United States and India continued their efforts to developing a constructive long-term trade relationship. Important events during the year included a U.S. success in its WTO challenge to India's automotive TRIMS regime and elimination of the measures in question. However, India continues to limit market access in various areas, including through high taxes and tariffs, minimum reference prices on steel and other products and onerous labelling requirements.

b. Trade Dialogue

USTR Zoellick and Indian Minister of Trade and Industry Murasoli Maran agreed in August 2001 to operationalize the United States-India Trade Policy Working Group (TPWG) at the Ministerial level. The TPWG will facilitate regular consultations on the range of trade issues between the United States and India. The ministers also agreed that their respective staffs would meet periodically to discuss trade issues of mutual interest. To that end, TPSC agencies, led by USTR, met with their Indian counterparts, led by the Ministry of Commerce, three times by video conference during 2002. Participants covered the full range of trade issues during these discussions.

c. Auto TRIMS

The United States considers India's measures affecting trade and investment in the motor vehicle sector to be inconsistent with India's obligations under Articles III and XI of the GATT and Article 2 of the Agreement on Trade-Related Investment Measures. Indian policies require manufacturing firms in the motor vehicle sector to achieve specified levels of local content; to achieve a neutralization of foreign exchange by balancing the value of certain imports with the value of exports of cars and components over a stated period, and to limit imports to a value based on the previous year's exports.

In June 1999, the United States requested consultations with the Government of India pursuant to the WTO Dispute Settlement Understanding (DSU), and these consultations were held on July 20, 1999. The United States and the EU requested panels, which subsequently were merged. On December 21, 2001, the final panel report was released, confirming that WTO Members cannot impose local content requirements or trade balancing requirements on companies doing business in their countries, thus rejecting India's defense of its regime.

India appealed the panel's report on January 31, 2002, but later dropped the appeal before the Appellate Body could rule. The United States and India agreed on a short period for India to implement the panel's findings. In September 2002, India implemented the panel's decision by removing the offending measures.

d. Intellectual Property Rights

As a signatory to the Uruguay Round of GATT trade negotiations, India was required to comply with most of the obligations of the TRIPS Agreement by January 1, 2000, and must introduce a comprehensive patent system for pharmaceuticals and agricultural chemicals no later than 2005. The Indian Government has announced its intention to conform fully with the IPR-related requirements of the Uruguay Round. In December 1999, Parliament successfully passed three IPR related bills: the Copyrights Amendment Bill, the Trademark Bill, and the Geographic Indicators Bill. While the copyright law is generally compliant with the TRIPS Agreement, the 1999 amendments undermine TRIPS requirements concerning protection for computer programs. In 1999, the Parliament failed to amend the Patents Act and, thus, apparently failed to meet fully its WTO TRIPS obligations by the January 1, 2000 deadline. The Patents Act was originally expected to pass the Parliament in July 2000, and subsequently in November. Finally, in June 2002, Parliament passed legislation amending the Patents Act.

While the new legislation recognizes some of the shortcomings of the 1970 Patents Act, the legislation contains numerous deficiencies and fails to comply with both the letter and spirit of the TRIPs Agreement. Most notably, the following problems pose significant concerns: numerous categories of inventions are not patentable; lack of protection for product-by-process inventions; failure to address the abusive government use and revocation provisions present in the 1970 Act; failure to comply with all of the safeguard of Article 31 of the TRIPs Agreement when granting compulsory licenses; and failure to recognize importation as satisfying the "working" requirement. Moreover, the law adds a new requirement to patentability, i.e., disclosure of the source and geographical origin of biological material used in an invention. To the extent that these types of requirements are unrelated to obtaining patent protection, they serve no legitimate purpose in a patent system and impose unnecessary burdens on patent applicants.

e. Reference Pricing

In August 2001, following allegations of under invoicing by vegetable oil importers, the Government of India imposed reference prices on imports of palm oil and palm products. In September 2002, India added soybean oil to its fixed reference price regime and in December 2002, raised the reference price to a level that substantially exceeds world prices for vegetable oils. The applied tariff for crude soybean oil was already at the WTO bound rate of 45 percent. Given fluctuations of world market prices, the effective tariff for crude soybean oil has exceeded India's tariff binding. The Indian Finance Ministry amends the reference price for soybean oil only when the world market price fluctuates above or below 10 percent of the reference price.

f. Export Subsidies

The Government of India supports producers of wheat (since October 2000) and rice (since April 2001) via the administration of a minimum support price-purchase program. Increased price supports (known as the "procurement price"), coupled with India's decision to raise the sales prices of wheat and rice to consumers through the public distribution system, has resulted in record level government-held stocks. The sale of government-held stocks of these products for export, at prices significantly lower than the domestic price, contradicts India's WTO commitments. U.S. exporters of wheat and rice are likely to be displaced in markets such as South East Asia and the Middle East where imports are highly sensitive to price.

5. Pakistan

In 2002, the United States began a dialogue with Pakistan on the issues affecting our trade and investment relationship. On December 10-12, 2002, the United States held an initial meeting of the U.S.-Pakistan Working Group. The Working Group provided an opportunity to exchange views on the Doha Development Agenda and to clarify issues of concern to both governments.

Further, both sides were able to air their concerns regarding the full range of trade and investment issues affecting both of our markets. Areas of discussion, clarification, and need for further work included tariff bindings, agricultural export subsidies, trade-related investment measures, and intellectual property rights, especially optical piracy. In the context of our bilateral agenda, the two sides exchanged views on cooperation with a view to enhancing bilateral trade, including by helping Pakistan expand its export base.

6. Afghanistan

A Trade Task Force, chaired by the State Department, was created to develop an Afghan Trade Initiative. This Initiative is designed to produce economic results in the near-term.

Effective June 6, 2002, the United States restored Normal Trade Relations (NTR) tariff treatment to the products of Afghanistan. NTR treatment had been revoked in 1986.

Soon after receiving NTR, the Bush Administration initiated an expedited review of a request from Afghanistan to be designated as a beneficiary under the U.S. Generalized System of Preferences (GSP). This required public comment and a finding that Afghanistan met the statutory designation requirements. On January 10, 2003, President Bush signed a proclamation designating Afghanistan a least developed beneficiary developing country. This will allow approximately 5,700 products from Afghanistan to enter the United States on a duty-free basis.

This GSP designation marked another important step in Afghanistan's return to the world trading system. It will provide increased opportunities for trade that will help Afghanistan build an economy that can offer its citizens a more prosperous future.

The Administration strongly supported in the last Congress, and presently supports in the current Congress, a legislative effort to remove the statutory exclusion of hand-made rugs from the list of articles eligible for duty-free treatment under the GSP. Hand-made rugs have been among Afghanistan's principal exports.

7. People's Republic of China

For much of the past two decades, the People's Republic of China (China) had been gradually transitioning toward a market economy from what in the late 1970's was a strict command economy. As part of its accession to the World Trade Organization (WTO), which became effective on December 11, 2001, China was required by the United States and other WTO members to agree to accelerate this process of market reform in order to comply with WTO requirements. Accordingly, China's WTO accession agreement embodies a set of extensive and far-reaching commitments on the part of China to change its trade regime, at all levels of government. Given the breadth and complexity of these commitments, assessing China's WTO compliance efforts is not a simple task.

Overall, during the first year of its WTO membership, China made significant progress in implementing its WTO commitments, although much is left to do. Progress was made both in making many of the required systemic changes and in implementing specific commitments. At the same time, serious concerns arose in some areas, where implementation had not yet occurred or was inadequate.

As expected, the principal focus of China's first year of WTO membership was on its framework of laws and regulations governing trade in goods and services, at both the central and local levels. China's trade ministry, the Ministry of Foreign Trade and Economic Cooperation (MOFTEC), reports that the central government has reviewed more than 2,500 trade-related laws and regulations for WTO consistency. By mid-2002, it had reportedly repealed 830 of these laws and regulations and amended 325 more. It had also reportedly drafted and adopted 118 new laws and regulations. Similar reviews are taking place at the local level, although the local governments are generally not as far along in their review process, in part because of the need to give effect to changes made by the central government. At the same time, some localities, particularly those in China's eastern provinces, are much further along in their review process than others.

Beginning early in 2002, China also devoted considerable resources to the restructuring of the various government ministries and agencies with a role in overseeing trade in goods and services. Some of these changes were mandated by China's accession agreement, while others were undertaken by China to facilitate its compliance with WTO rules.

Another significant focus for China during the past year involved education and training. China embarked on an extensive campaign to teach central and local government officials and state-owned enterprise managers about both the requirements and the benefits of WTO membership, with the goal of facilitating China's WTO compliance. The United States and other WTO members, along with many private sector groups, contributed substantial technical assistance and capacity building resources to this effort.

As a general matter, China took positive steps to implement many of its specific WTO commitments during the past year. It made required tariff reductions, notably for information technology products, chemicals, autos and auto parts, wood and paper products, and many agricultural goods, including beef, dairy products and citrus, among others. When discrepancies between committed and implemented rates were reported, China usually made necessary adjustments. China also began the process of removing numerous non-tariff trade barriers that had affected a range of industries, from chemicals to scientific equipment, and it continued to improve its standards regime. For the most part, these steps were managed without serious incident, and market access for U.S. products in the affected sectors has generally improved. In addition, although not without problems, China took the necessary legal steps to allow for increased market access for foreign service suppliers in a variety of sectors, including financial services, telecommunications, audio-visual services, tourism and travel-related services, constructions and engineering services, educational services and environmental services.

While the efforts of China's leadership to implement China's WTO commitments should be recognized, the Administration also found a number of causes for serious concern during China's first year of WTO membership.

One area of cross-cutting concern involved transparency. In particular, China implemented its commitment to greater transparency in the adoption and operation of new laws and regulations unevenly at best. While some ministries and agencies did take steps to improve opportunities for public comment on draft laws and regulations, and to provide appropriate WTO enquiry points, the Administration found China's overall effort to be plagued by uncertainty and a lack of uniformity. The Administration is committed to seeking improvements in China's efforts in this area.

Apart from this systemic concern, three other areas generated significant problems and warrant continued U.S. scrutiny – agriculture, intellectual property rights and services.

The area of agriculture proved to be especially contentious between the United States and China. While concerns over market access for U.S. agriculture products are not unique to China, particularly serious problems were encountered on many fronts, including China's regulation of agricultural goods made with biotechnology, the administration of China's tariff-rate quota (TRQ) system for bulk agricultural commodities, the application of sanitary and phytosanitary measures and inspection requirements. The United States and China were able to make progress toward resolving some of these problems, particularly with regard to biotechnology. Other problems remain unresolved, however, with the most troublesome being China's inadequate implementation of its TRQ commitments.

In the area of intellectual property rights (IPR), China did make significant improvements to its framework of laws and regulations. However, the lack of effective IPR enforcement remained a major challenge. If significant improvements are to be achieved on this front, China will have to devote considerable resources and political will to this problem, and there will continue to be a need for sustained efforts from the United States and other WTO members.

Meanwhile, concerns arose in many services sectors due to transparency problems and China's use of prudential requirements that exceeded international norms. In addition, Chinese regulators imposed particularly problematic restrictions in the insurance sector, where transparency issues, excessive capitalization requirements and restrictions on branching combined to present unique difficulties, and in the express delivery sector, where existing rights were placed in jeopardy. Nevertheless, progress was made in 2002 toward resolving the concerns associated with these two sectors.

China's compliance problems are occasionally generated by a lack of coordination among relevant ministries in the Chinese government. Another source of compliance problems has been a lack of effective or uniform application of China's WTO commitments at local and provincial levels. China is taking steps to address both of these concerns, through more effective inter-ministerial mechanisms at the national level, and through a more concerted effort to reinforce the importance of WTO-consistency with sub-national authorities. In other cases, however, compliance problems involve entrenched domestic Chinese interests that may be seeking to minimize their exposure to foreign competition, circumstances that require particular vigilance by the Administration and the private sector.

When confronted with compliance problems in 2002, the Administration used all available and appropriate means to obtain China's full compliance, including intervention at the highest levels of government. The Administration worked closely with the affected U.S. industries on compliance concerns, and utilized bilateral channels through multiple agencies, at all levels, to press these concerns. The Administration also initiated a regular dialogue on compliance issues between USTR and China's lead trade agency, MOFTEC, with the goal of bringing all involved Chinese ministries and agencies together when the resolution of particular problems warrants it. Where possible, the Administration also multilateralized its enforcement efforts, by working with like-minded WTO members on an ad hoc basis, whenever particular issues have had an adverse impact beyond the United States.

Despite the compliance problems that arose over the course of the past year, most U.S. industry representatives remain enthusiastic about the actual and potential benefits from China's WTO membership. They understand that the institutional, legal and regulatory changes demanded of China by its accession agreement are extraordinary and far-reaching and are complicated further by China’s highly decentralized administrative structure. At the same time, they want to see China comply fully with its WTO commitments, as does the Administration. The United States, working with fellow WTO members, will use all means at its disposal to ensure that China achieves full implementation.

For a more detailed discussion of trade-related issues involving China in 2002, see USTR's 2002 Report to Congress on China's WTO Compliance, issued on December 11, 2002.

8. Japan

In 2002, the United States continued to place a high premium on promoting structural and regulatory reform in Japan, improving market access for U.S. goods and services, and supporting the adoption and successful implementation of pro-competitive policies throughout the Japanese economy. The United States welcomed Prime Minister Koizumi’s unwavering commitment to “structural reforms without sanctuaries” and his continuing efforts to “implement bold regulatory reform across sectors.” Nonetheless, the Japanese economy is still underperforming in part because of the non-performing loans problem and deflation. Growth is also being significantly hampered by structural rigidities, excessive regulation, and market access barriers. Over the past year, the U.S. Government has therefore been working with the Government of Japan to develop and implement concrete measures to further open and deregulate Japan’s markets. These measures will help Japan revitalize its economy and generate sustainable economic growth in the medium and long-term.

The United States also utilized a wide range of regional and multilateral fora in 2002 to advance its trade agenda with Japan. The United States is working to ensure that our trade priorities in these fora, including on agriculture and services, are well coordinated with our bilateral agenda so that the various initiatives are mutually reinforcing and complementary.

Overview of Accomplishments in 2002

U.S.-Japan Economic Partnership for Growth

The United States promoted much-needed regulatory reforms and obtained improved access for U.S. goods and services in a number of areas in Japan in 2002. In addition, under the U.S.-Japan Economic Partnership for Growth ("the Partnership"), the United States continued to work with Japan to promote sustainable growth by addressing such issues as sound macroeconomic policies, structural and regulatory reform, financial and corporate restructuring, foreign direct investment, and open markets. The United States and Japan also addressed new and lingering trade issues in a variety of sectors while regulatory and structural reform remains of paramount importance.

The following provides a brief update on each component of the Partnership along with progress achieved in 2002:

Subcabinet Economic Dialogue: Co-chaired by the NSC/NEC and Japan's Ministry of Foreign Affairs (MOFA), the "Subcabinet" sets the tone and direction of the Partnership, with Deputy/Vice Ministerial level officials meeting on an annual basis to discuss a broad range of bilateral, regional, and multilateral issues. Recommendations from these meetings are given to the respective Governments for use in developing policy. At the meeting of the Subcabinet in May 2002 in Japan, participants covered a range of issues, including the problem of non-performing loans in Japan, bilateral cooperation on terrorist financing, and regional economic relations. The next meeting of the Subcabinet is expected to convene in the spring of 2003, coincident with the 2003 annual meeting of the Private Sector/Government Commission, which is described below.

Private Sector/Government Commission: The "Commission" is designed to integrate the U.S. and Japanese private sectors more fully into the economic work of the two Governments. Private sector delegates from Japan and the United States meet annually with the Subcabinet to discuss issues of key importance to both countries. The Commission convened its inaugural meeting in May 2002, addressing the topic "Creating an Environment for Sustainable Growth: Raising Productivity and Corporate Revitalization." That meeting provided the private sector the opportunity to draft recommendations for consideration by both Governments, including the need to more aggressively address Japan's non-performing loan problem, improve corporate governance, and speed deregulation in key sectors. The Commission convened a followup meeting in November 2002, which provided an opportunity for the Governments to respond to the recommendations put forward in May.

Regulatory Reform and Competition Policy Initiative: Co-chaired by USTR and MOFA, the "Regulatory Reform Initiative" aims to promote economic growth and open markets by focusing on sectoral and cross-sectoral issues related to regulatory reform and competition policy. Under this Initiative, the United States has made a concerted effort to focus on issues that the Koizumi Administration has identified as important areas for reform, such as information technologies, telecommunications, medical devices and pharmaceuticals, energy, and competition policy. Throughout 2002, Working Groups and a High-Level Officials Group met to discuss reform proposals that culminated in the First Report to the Leaders, which was conveyed to President Bush and Prime Minister Koizumi on June 25, 2002. It detailed numerous regulatory reform measures that Japan had implemented or would implement.

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

Financial Dialogue: The Financial Dialogue serves as a forum for the U.S. Department of Treasury, Japan's Ministry of Finance (MOF) and the Financial Services Agency (FSA) to exchange information on key macroeconomic and financial sector issues, including non-performing loans. The Financial Dialogue met in Tokyo in October 2002, and future meetings will be held annually.

Trade Forum: The Trade Forum, which is led by USTR and MOFA, was created to foster focused and substantive discussion on a wide-range of sectoral trade issues of interest and concern to both Governments. It also serves as an "early warning" mechanism to facilitate resolution of emerging trade problems. Issues raised at the first meeting of the Trade Forum, in July 2002 in Tokyo, included agriculture, public works, flat glass and transportation issues. The Trade Forum meets at least once a year.

a. Regulatory Reform and Competition Policy Initiative

Under the Regulatory Reform and Competition Policy Initiative ("Regulatory Reform Initiative") the United States and Japan issued the First Report to the Leaders wherein Japan agreed to undertake a myriad of important regulatory reform measures. Notable achievements were made in various sectors, including telecommunications, information technologies, energy, medical devices and pharmaceuticals, and financial services. Significant progress was also made in key areas such as competition policy, transparency and other government practices, legal system reform, revision of Japan's Commercial Code, and distribution.

Building on the success of the inaugural year of the Regulatory Reform Initiative, the United States presented Japan on October 23, 2002 with 45 pages of recommendations, which called on Japan to adopt sweeping regulatory reforms. Consistent with the overall objective of the Partnership, these recommendations include reform measures intended both to open markets and help Japan return to sustainable growth. Furthermore, the United States made a concentrated effort to focus on issues that Japan has identified as priorities for reform.

The October 2002 recommendations presented to Japan are acting as the basis for bilateral discussions in a High-level Officials Group and the various Working Groups. These discussions will in turn serve as the basis for a second annual report to the President and Prime Minister in mid-2003 detailing the progress made under this Initiative, including specific measures to be taken by each Government.

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

i. Sectoral Regulatory Reform

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

The June 2002 First Report to the Leaders highlighted measures taken by Japan to implement several 2001 legislative reforms intended to promote further competition in this sector. These measures included the introduction of asymmetric regulation to eliminate anticompetitive behavior in the mobile services market and other improvements to regulation over essential wireline facilities. In May 2002, Japan classified NTT DoCoMo as a carrier with market power and committed to ensure that the price of interconnection with DoCoMo's designated facilities be cost-oriented. The Telecommunications Business Dispute Settlement Commission created under the 2001 reforms issued an administrative judgment in October 2002 supporting the right of a particular wireline carrier to set retail rates for calls from its network to a DoCoMo customer. MPHPT, which previously opposed such a right, supported the finding and agreed to study how to set interconnection rates for mobile services. As a result, there is now an opportunity for wireline originating carriers to overturn a longstanding discriminatory practice of price-setting. Japan completed its two-year study on pro-competitive reforms in August 2002. The final report advocated measures to promote the opening of the telecommunications network, stronger policies for consumer support, and the introduction of a new framework for competition policy which eliminates the outdated and cumbersome classification of carriers by whether they own or lease facilities.

In the First Report to Leaders, Japan also committed to recalculate rates for interconnection to NTT East and West networks with a view to further reductions of those rates and the removal of non-traffic sensitive costs from the rates paid by competitors to NTT. Work to revise the interconnection costing model was concluded in the first quarter of 2002, and in August an advisory panel provided guidance for calculating cost-oriented rates. The United States and Japan discussed in October and December 2002 the extent of the progress to be expected pending final decisions on several issues. Japan also pledged to continue efforts to facilitate access to rights of way for carriers by maintaining guidelines for non-discriminatory, cost-based access to poles, ducts and conduits; relaxing restrictions on attaching cables to poles and on road construction; and improving cooperation with local authorities.

In the October 2002 Regulatory Reform submission, the United States urged Japan to complete the process of instituting and implementing a pro-competitive regime. In recommendations toward this goal, the United States suggested that Japan promote transparency and strengthen regulatory independence by separating regulatory functions from ministry control and allowing fully private ownership of NTT. In addition, the United States suggested Japan exercise oversight over industry organizations with quasi-regulatory functions. The United States also asked Japan to deregulate competitive carriers and to implement dominant carrier regulation and competition safeguards. In keeping with dominant carrier regulation, the United States called on Japan to correct problems which raise the payments competitors make for interconnection to the NTT network to a level considerably above cost, for non-discriminatory access to basic NTT services, and to ensure competitive rates for interconnection to the wireless network. The United States also proposed that the two countries work together to identify and explore ways to address issues of mutual concern related to the promotion of advanced technologies and services. The first meeting of the Telecommunications Working Group took place in November 2002 to discuss the U.S. recommendations.

Information Technologies: The primary objective of the Information Technologies (IT) Working Group under the Regulatory Reform Initiative is to work with Japan to establish a vibrant and competitive IT sector which can benefit both our economies, as well as provide global leadership in this area. Although Japan's electronic commerce market is one of the largest in the world, its tremendous potential for growth remains unfulfilled because the IT sector is burdened by regulatory and other barriers. Japan has taken significant steps towards, and continues to make progress on, realizing its ambitious plan to become a global leader in IT. Even so, the Japanese government itself has recognized through the "2002 e-Japan Priority Policy Program" that legal and other barriers persist which hinder growth in the IT sector. As Japan responds to the challenges that lie ahead in this pivotal sector, the U.S. Government is working with Japan to establish a regulatory framework that ensures competition, promotes innovation, allows private sector-led regulation where appropriate, and protects intellectual property rights in the digital age. Establishing such a framework will promote the development of IT-related businesses and electronic commerce, and thus provide significant opportunities for U.S. firms and their leading technology products and services in a market that is expected to reach nearly $125 billion by 2005.

Through the first IT Working Group meeting under the Regulatory Reform Initiative, the United States raised and discussed key recommendations submitted in October 2001 to address IT sectoral issues and concerns with Japan. These recommendations focused on protecting intellectual property, increasing user confidence in electronic commerce, and reinforcing the leadership role of the private sector in IT, as well as on proposals for cooperative efforts in the areas of electronic education, the promotion of electronic commerce and IT in the private sector, and network security. In response to the discussions related to these recommendations, Japan agreed to take significant steps to promote growth in the IT sector.

The specific measures Japan has taken are summarized in the June 2002 First Report to the Leaders under the Regulatory Reform Initiative. Among the major highlights of the Report are the three "e-initiatives" which the United States and Japan agreed to work on in the areas of electronic commerce, e-government, and cybersecurity. In recognizing the importance of establishing global leadership in these important areas, the United States and Japan agreed to work together to recognize and support important principles and objectives in the multilateral framework for liberalizing trade of digital products, to promote the expansion of e-government services, and to strengthen cyber-security by cooperating to facilitate broader acceptance and use of the Council of Europe Convention on Cybercrime.

With regard to strengthening the protection of intellectual property in the digital age, Japan ratified and acceded to the WIPO Performances and Phonograms Treaty (WPPT), which protects performances and sound recordings online. This will significantly strengthen protection of intellectual property rights on the Internet. In addition, Japan recognized that "temporary storage" of digital content (such as software and music held in the random-access memory, or RAM, of a computer) may be a reproduction so that the right holder's reproduction rights are preserved. Japan also took steps to increase user confidence in electronic commerce by confirming that all technologies for secured electronic signatures will be treated equally, that electronic records will have the same legal effect as written documents, and that certification providers do not have to be accredited by the government. Japan reinforced the leadership role of the private sector by agreeing to support the development of private sector self-regulatory mechanisms for online consumer protection and management of personal data. In addition, Japan recognized the important role of e-government in expanding the use of electronic commerce by accelerating the use of interactive online procurement in both central and local governments. This was one of several measures to improve the openness, fairness, and transparency for government procurement of information systems. Japan also agreed to cooperate with the U.S. Government in the areas of e-education, network security, and the promotion of IT and electronic commerce technologies for start-ups and small firms.

Building on these accomplishments and the progress achieved over the past year, the United States made several recommendations in the October 2002 Regulatory Reform submission to reinvigorate Japan's IT sector. These recommendations included removing regulatory and other barriers, strengthening the protection of digital content, promoting the use of electronic commerce in the public and private sectors, and expanding IT procurement opportunities. An overarching objective of this year's IT Working Group, incorporated throughout the specific recommendations, is to promote and expand private-sector input and the use of public comment opportunities in the Japanese policy-making and regulatory processes. Specific recommendations include removing existing barriers that impede business-to-business and business-to-consumer electronic commerce, and allowing non-attorneys to provide mediation and arbitration services for profit. With regard to strengthening the protection of intellectual property, the United States made several recommendations to extend Japan's terms of copyright protection, strengthen the enforcement system against infringement and provide security for commerce in the digital age. To promote the use of electronic commerce, the United States has urged Japan to support private sector self-regulatory mechanisms for privacy and alternative dispute resolution, as well as to ensure that laws governing electronic transactions are technology-neutral. The United States has also called on Japan to support fair and open procedures for e-government and e-education procurement by ensuring transparency, efficiency, security, and private sector-led innovation. The United States conveyed and discussed these recommendations in detail during the first round of talks of the IT Working Group, which took place in December 2002.

Energy: Dominated by ten regional utilities, Japan's energy market is the third largest in the world after the United States and China. Through continued regulatory reform, Japan aims to increase efficiency in its power sector and reduce its energy prices, still the highest among OECD members. Since the March 2000 liberalization of one-third of its electricity market (which has yielded little new entry by competitors), Japan gradually has been moving toward another phase of reform to further its goals of increased efficiency and lower prices. A truly competitive Japanese energy sector would not only spur economic growth domestically, but also would expand opportunities for U.S. firms to produce, sell and trade energy products and services in Japan's electricity and gas markets. In addition, regulatory reform will help generate new opportunities for U.S. firms to export to the electricity generation equipment market.

During the inaugural year of the Regulatory Reform Initiative, the United States urged Japan to take bolder steps to promote a regulatory and competitive environment in both its wholesale and retail energy sectors. This would enable Japan to achieve its goals of reducing electricity costs to internationally competitive levels, encouraging innovation and efficiency, and increasing the share of natural gas in its primary energy supply. The United States also called on Japan to remove impediments that discourage market entry.

Toward addressing these problems, Japan agreed in the First Report to the Leaders to work actively to establish important principles and objectives for reforming the electricity sector, such as ensuring that the electricity network guarantees transparent and fair competition; considering the establishment of a wholesale power exchange over a broad geographic market; and examining existing transmission capacity and interregional transmission links to facilitate power transactions nationwide. Other principles and objectives included in the Report were establishing a retail market environment where consumers can choose from multiple suppliers through competition, and clarifying a plan and schedule for expanded retail choice.

Similarly, the Report includes important objectives for reforming the gas sector, such as creating an efficient, transparent, fair, and competitive gas market, fostering third-party usage of gas infrastructure, and promoting incentives for investing in gas infrastructure. Also included were principles and objectives for promoting construction and interconnection of gas pipelines, fostering transparency measures to enhance third-party usage of pipelines and Liquified Natural Gas (LNG) terminals, and expanding the scope of retail liberalization in the gas sector.

In addition, to promote competition in the electricity sector and to clarify the conduct by incumbent utilities and other enterprises that may contravene the Antimonopoly Act or the Electricity Utilities Industry Law, the Japan Fair Trade Commission and METI agreed in the Report to review their joint Guidelines on Fair Transaction and issue new guidelines in 2002. Those guidelines were finalized in July 2002.

In October 2002, the United States made numerous energy sector recommendations under the Regulatory Reform Initiative. Initial Energy Working Group meetings were held in mid-November 2002 in Tokyo to discuss the recommendations, which refined and reinforced the reform principles and objectives detailed in the First Report to the Leaders.

Consistent with this year's discussions, the Electricity Industry Subcommittee issued a draft report on electricity sector reform in December 2002. This draft report was open to public comment. METI has said the final version of this report will serve as a basis for reform legislation. Key elements of the draft plan include: (1) establishing a neutral body to set transmission and distribution rules; (2) securing fairness and transparency of transmission and distribution systems through information firewalls, monitoring, and prevention of cross-subsidization; (3) reviewing the transmission pancaking system; (4) preparing for a nationwide wholesale power exchange; (5) organizing and strengthening the governmental structure responsible for market monitoring and dispute resolution; and (6) setting forth a plan and schedule for expanded retail choice.

Regarding gas sector reform, the Urban Heat Subcommittee issued a draft report, which was also released in December 2002 and open to public comment. Like the electricity report, the final version will serve as a basis for legislation to reform the gas sector. Key elements of the draft report include: (1) taking special measures to increase pipeline investment incentives and promote interconnection of pipeline networks; (2) securing fair and transparent competition between the gas companies that maintain and operate the network and other companies that use the pipelines; (3) taking necessary measures to separate accounts and prohibit discriminatory treatment towards certain businesses to which gas companies supply gas; (4) promoting third-party usage of LNG terminals by, for example, establishing rules for resolving disputes over negotiations; (5) setting forth a plan and schedule for expanded retail liberalization; and (6) developing guidelines and establishing a neutral and fair system for conducting market monitoring and dispute resolution.

These reforms are designed to foster Japan's economic recovery, help U.S. firms compete in the Japanese electricity and gas markets, and create new opportunities for competitively priced, high-quality exports to the Japanese market for electrical generation equipment. The United States welcomes Japan's current undertaking to embark on another round of reform in the electricity and gas sectors.

Medical Devices and Pharmaceuticals: Continued over-regulation, inefficiencies, and an over-emphasis on short-term budget savings have slowed the introduction of innovative and cost-effective products into Japan's medical device and pharmaceutical markets. Increasing the availability of these products is key to helping Japan meet the challenge of providing increased quality health care to its aging population while containing overall health care costs.

In the First Report to the Leaders, Japan agreed to take numerous concrete deregulation measures that are critical to ensuring that the steady stream of innovative medical devices and drugs being developed by U.S. firms gain timely access to the Japanese market.

Severe fiscal pressure on Japan's national healthcare system led Japan to implement various pricing reforms, including price cuts on medical devices, pharmaceuticals and doctors' technical fees, and increases to patients' premium payments and co-payments. The United States actively engaged Japan at all levels to ensure that Japan did not implement these steps in manners that arbitrarily targeted U.S. products for price reductions. As a result, the overall adverse impact of medical device and pharmaceutical pricing reforms was less than anticipated. However, there is still significant opportunity for Japan to reform its pricing systems to better recognize and reward the value of innovative medical devices and pharmaceuticals. This matter will continue to be addressed within the context of Japan’s ongoing comprehensive healthcare reform process.

Although pricing issues were a source of trade friction, progress was made in resolving issues relating to the regulatory approval of medical devices and pharmaceuticals. Japan took steps to harmonize its application review and approval processes and improve and expand the use of foreign clinical data. These steps are critical to enhancing the transparency and consistency of regulatory approvals, which are helping to reduce approval times, lessen burdens on applicants, and expedite patient access to new treatments. The Pharmaceutical Affairs Law, which governs the entire regulatory system for medical devices, is being revised for the first time in more than 40 years. In addition, the regulatory bodies that conduct product reviews and regulate clinical trials are being restructured into one agency that will oversee the regulation of medical devices and pharmaceuticals from development to final market approval. These steps are expected to further improve the speed and efficiency of Japan’s regulatory system.

Building on these steps, the United States in its October 2002 Regulatory Reform Initiative submission proposed that Japan: (1) establish a Prime Minister's council on comprehensive healthcare reform that would provide meaningful access for all stakeholders, including foreign industries, to present and discuss ideas; (2) ensure that innovative medical devices and pharmaceuticals are introduced into the healthcare system in a timely manner, and that such products receive appropriate evaluations in a transparent and predictable pricing process; (3) continue to reform the regulatory systems for medical devices and pharmaceuticals to ensure faster, more efficient product approvals that give maximum consideration to common international practices; and (4) ensure that the pricing process for biological products (medical devices and pharmaceuticals) reflects the investment costs needed to meet the regulatory requirements of such products, and that treatment of such products takes place in a nondiscriminatory, science-based manner. The United States elaborated on these recommendations at the first meeting of the Medical Devices and Pharmaceuticals Working Group, which met in November 2002 in Washington, D.C.

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

In January 2002, rules governing Money Management Funds (MMFs) were improved, although an exception from mark-to-market valuation still remains. Legislation eliminating the requirement for physical certificates for Japanese government bonds and corporate debentures passed the Diet in June 2002 and is set to be implemented effective January 6, 2003. This follows legislative action to eliminate a similar requirement for commercial paper that took effect in April 2002. Banks were granted limited entry into the insurance business in April 2001 (initially non-life only). Further restrictions were lifted in October 2002, including allowing bank sales of variable annuities.

In mid-August 2002, the Financial Services Agency (FSA) announced a package of securities market reforms, including the possible submission to the January 2003 ordinary Diet session of legislation to reduce minimum capital requirements for securities companies, investment trust management companies, and investment advisory companies in order to facilitate new entry. The FSA also seeks to introduce a sales agent system to permit certified public accountants, licensed tax accountants, and financial planners to sell corporate stocks to investors as an agent of a security brokerage house. The FSA package included permission for banks and securities firms to share business space beginning mid-September 2002 and the relaxation of restrictions on discretionary execution of customer orders by securities firms. The GOJ has also promised reform of government financial institutions to avoid competition with the private sector.

The United States welcomes Japan's progress in increasing the efficiency and competitiveness of its financial markets. In its October 2001 submission, the United States put forward proposals to support further opening and development of the Japanese financial markets, which will allow Japan to take full advantage of international financial expertise and support future Japanese growth. These include: (1) permitting postal financial institutions to employ investment advisory companies on terms similar to those for public pensions; (2) granting regulatory approval to prototype plans for defined contribution (DC) pensions; (3) increasing the DC pension plan contribution limits; (4) permitting multiple classes of shares for investment trusts; (5) further improving rules governing MMFs; (6) revising the E-Notification Law to include lenders subject to the Moneylending Business Law; (7) working closely with the private financial services community to review current reporting and record-keeping requirements; and (8) subjecting any legislative action for the financial services activities proposed for the Postal Public Corporation (to be created April 2003) to full public notice and comment.

These issues were discussed on December 12, 2002 in the second meeting of the U.S.-Japan Financial Services Working Group, a component of the Financial Dialogue of the U.S.-Japan Economic Partnership for Growth.

For information on deregulation in the insurance sector, please see the Insurance entry under "Existing Bilateral Agreements."

ii. Structural Regulatory Reform

Competition Law and Policy**:** A key goal of our regulatory reform efforts is to ensure that steps to deregulate and introduce competition into Japan's economy are not undone by anticompetitive actions by firms and trade associations resistant to such steps. An active and strong antitrust enforcement policy in Japan is needed to restrain anticompetitive behavior, including by incumbent firms in once heavily regulated sectors.

In the First Report to the Leaders under the Regulatory Reform Initiative, Japan agreed to review the status of the Japan Fair Trade Commission (JFTC) with a view to ensuring its independence and neutrality from other regulatory agencies, and to increase the JFTC's staff levels by more than 6 percent to 607 people. To strengthen the JFTC's enforcement effectiveness, the Antimonopoly Act (AMA) was amended in May 2002 to increase five-fold the maximum criminal fine for corporate offenders and to expand the JFTC's power to issue cease-and-desist orders with respect to AMA violations by trade associations and violations of the AMA's international contract prohibitions. The JFTC agreed to devote a sizable portion of its staff to monitor markets undergoing deregulation, and MPHPT and METI committed to work with JFTC to promote competition in the telecommunications and energy sectors, respectively. With respect to measures to combat bid rigging, Japan enacted legislation to address the problem of so called bureaucrat-led bid rigging. That legislation empowers the JFTC to require corrective measures by government ministries and agencies in which complicity by government officials has been found. In addition, Ministry of Land, Infrastructure, and Transport (MLIT) agreed to prepare and publish on its website a bid rigging countermeasures booklet for use by central government, local government and quasi-governmental commissioning entities.

In its October 2002 Regulatory Reform submission, the United States recommended that Japan introduce legislation to make the JFTC an independent agency under the Cabinet Office. The submission also called on Japan to increase the budget and staff of the JFTC substantially, and to establish an office within the JFTC composed of graduate-school level economists to provide economic analysis and expertise to the JFTC's enforcement and competition advocacy activities. The United States urged Japan to strengthen the JFTC's investigative and enforcement powers, including by giving the JFTC criminal investigation powers, substantially increasing administrative surcharge levels and making cartel activity *per se* illegal. The United States also recommended that Japan take further measures to address prolific bid rigging, including instituting procedures for collecting overcharges from bid rigging and assisting citizen lawsuits aimed at recovering overcharges suffered by local governments as a result of bid rigging. The submission urged that the Government of Japan actively solicit and fully consider the JFTC's views before implementing plans for deregulation in the energy and telecommunications sectors and for the restructuring and privatization of public corporations and other public entities. These recommendations were discussed in detail at a meeting of the Cross-Sectoral Working Group in November 2002.

Transparency and Other Government Practices: Despite improvements in recent years, Japan's regulatory system continues to lack the transparency and accountability necessary to ensure that all entities have the same access to government information and the policymaking process. Reforms that increase the transparency of the regulatory process and make the bureaucracy more accountable help curb burdensome discretionary powers of the bureaucracy and shift power to the general public. Such reforms also help level the playing field for foreign firms, reducing the special advantages traditionally enjoyed by Japan's domestic firms.

In 2002, Japan took several steps to increase the transparency and accountability of its regulatory system. As detailed in the First Report to the Leaders, Japan implemented an information disclosure law in October 2002 that provides the public the right to request the disclosure of information held by Independent Administrative Institutions (*dokuritsu gyosei hojin*), public corporations (*tokushu hojin*), and similar entities. Japan is also taking active steps to increase the use of the "No Action Letter" (NAL) system. That system allows businesses to submit inquiries to ministries and agencies on the interpretation and application of laws and ordinances. The ministries and agencies respond in writing to inquiries and make their responses public. In addition, Japan implemented a Government Policy Evaluation Act in April 2002 aimed at enhancing the effectiveness of its policy evaluation system and government accountability.

Building on these measures, the United States recommended in its October 2002 submission that Japan undertake additional improvements in its regulatory system to support its reform efforts and ensure that all partners have the same access to government information and the policymaking process. The United

States urged Japan to: (1) improve the effectiveness of the Public Comment Procedures (PCP) by establishing a centralized system that would allow parties to find solicitations of public comments in one location, requiring a minimum 30-day comment period, and strengthening the PCP from being mere guidelines to being a law; (2) ensure that establishment of Special Zones for Structural Reform is done in a transparent, non-discriminatory manner, with a focus being placed on encouraging market entry and an understanding that successful measures used in the zones should be applied on a national basis as expeditiously as possible; (3) take steps to facilitate public input into draft legislation while it is being developed by the government before it is submitted to the Diet; and (4) ensure that the process to restructure and privatize public corporations is transparent and that the private sector has opportunities to provide input. Further discussions on transparency issues took place in mid-November 2002 during the inaugural meeting of the Cross-Sectoral Working Group.

***Legal Services and Judicial System Reform*:** The creation of a legal environment in Japan that supports regulatory and structural reform and that meets the needs of international business is a critical element of successful regulatory reform in Japan. Of particular concern has been a number of outmoded restrictions on the delivery of international legal services in Japan that interfere with the ability of foreign lawyers to practice in Japan in an effective manner.

In 2002, Japan took some important steps toward modernizing its legal system. Most significant was the adoption by the Japanese Cabinet of a Program for Promoting Justice System Reform in March 2002, which set out the timetable for introducing legislation to implement Japan's plans for judicial system reform. These plans include introduction of legislation in early 2003 to, among other things, liberalize restrictions on partnership and employment relationships between Japanese and foreign lawyers, reduce by 50 percent the time required to complete court trials and modernize Japan's arbitration law to improve the legal framework for domestic and international commercial arbitration.

In its October 2002 submission, the United States urged Japan to implement wide-ranging measures to liberalize restrictions on the practice of law by foreign lawyers in Japan. These recommendations include eliminating all prohibitions against freedom of association between Japanese and foreign lawyers; allowing foreign lawyers to form professional corporations and to establish branch offices throughout Japan, just as Japanese lawyers are currently permitted to do; and eliminating needless restrictions and requirements, and unnecessary delays, on foreign lawyers desiring to practice in Japan as foreign legal consultants. The United States also urged Japan to act expeditiously in implementing measures to ensure effective judicial oversight of administrative agencies. The United States strongly advocated the adoption of these recommendations during the November 2002 meeting of the Cross-Sectoral Working Group.

***Commercial Law*:** Reform of Japan's commercial law is important for introducing necessary flexibility into the organization, management and capital structure of Japanese companies and to facilitate merger and acquisition activities by both foreign and domestic firms in Japan. The Japanese economy will also benefit from additional measures to improve corporate governance, since good corporate governance systems will encourage increased productivity and economically sound business decisions as management strives to maximize shareholder value.

In 2002, Japan made substantial revisions to its Commercial Code that will introduce greater flexibility to the capital structure of Japanese corporations and strengthen corporate governance mechanisms. Specifically, Japan's Commercial Code was amended to liberalize substantially restrictions on the issuance of stock options; permit companies to issue tracking stock and shares with limited voting rights; eliminate the requirement that foreign companies must set up a branch office in Japan; and provide companies the option of adopting an American-style executive committee (audit, nominating and compensation committee) system, composed of at least a majority of outside directors, as an alternative to appointing statutory auditors. Japan also undertook to examine the possible introduction of modern merger techniques, such as triangular mergers and cash mergers, into its commercial law.

The United States has commended Japan's broad-ranging reforms of its commercial law. In its October 2002 Regulatory Reform submission, the United States encouraged Japan to build on these reforms by taking further measures to improve commercial law and corporate governance in Japan. Specifically, the United States recommended that, while it is examining the general introduction of modern merger techniques into its commercial law, Japan revise the Industry Revitalization Law to permit firms seeking to restructure to use such merger techniques immediately. The United States also urged Japan to improve corporate governance by requiring pension fund managers to vote proxies for the benefit of fund beneficiaries and by providing for increased disclosure on a more timely basis of information necessary for shareholders to exercise their voting rights in an effective manner. These recommendations were discussed in more detail at a meeting of the Cross-Sectoral Working Group in November 2002.

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

In the First Report to the Leaders, the Japanese agreed to consult with U.S. express carriers before deciding on measures to be adopted to replace the current temporary fee structure employed by the Nippon Automated Customs Clearance System (NACCS) Center; to undertake to use the Public Comment Procedure whenever the Air-NACCS fee structure is revised in the future; to ensure that the NACCS Center will in the future provide information to the public about its operations in a timely fashion when requested to do so; to implement the Pre-Arrival Examination System for import cargoes (the system that allows the instant issuance of import permits for air cargo upon arrival) and the manifest declaration system for express consignments of a certain value; and to continue to simplify Japan's customs procedures.

Our reform recommendations to the Government of Japan in October 2002 recognized that Japan has implemented, and plans to implement, additional positive measures to simplify and automate customs processing, but contained several further recommendations dealing with customs clearance. The submission again recommended raising the *de minimis* level for customs duties from 10,000 yen to 30,000 yen. To promote financially healthy airline and air-freight industries, the submission recommended that Japan formulate the level of landing fees in an open and transparent manner, using internationally accepted accounting standards, and base those fees on the actual cost of providing services. The U.S. Government continues to monitor progress on customs processing procedures and the fair and uniform implementation of the Large Store Location Law. In November 2002, the Cross-Sectoral Working Group met to discuss these and other issues.

b. Bilateral Consultations

i. Insurance

Under the 1994 and 1996 bilateral insurance agreements, Japan took significant steps to deregulate its insurance market. These steps included sweeping measures that resulted in meaningful improvements in the product approval process, greater use of direct sales of insurance products, and a diversification of allowable product offerings. As a result, U.S. insurance companies continue to visibly and substantially increase their presence in both the life and non-life insurance sectors in Japan. This progress notwithstanding, issues of concern to U.S. insurers remain. Prominent among these in 2002 were the future funding of the Life Insurance Policyholder Protection Corporation (PPC) and competitive concerns related to Kampo, Japan's postal insurance entity.

Bilateral consultations under the two insurance agreements were held in Washington, D.C. in August 2002. As has been customary in past years, the National Association of Insurance Commissioners participated in the talks as part of the long standing effort to promote U.S.-Japan regulator-to-regulator discussions. The talks covered a broad range of issues that had been highlighted by U.S. industry as key areas of concern.

The United States raised the issue of future funding for the Life Insurance Policyholder Protection Corporation (PPC). U.S. life insurers remain concerned that additional industry contributions to the PPC will be imposed following expiration of the Government of Japan's funding commitment to the PPC in March 2003. Private sector insurers, foreign and domestic, already face a mandate to provide 560 billion yen to the PPC. Failures of several Japanese insurers have expended approximately 538 billion yen of this amount. Given the serious financial implications of any additional PPC contributions, the United States urged the Japanese Financial Services Agency (FSA) to deliberate this matter in a transparent manner that afforded interested parties the opportunity to air their views and concerns. While noting the essential role of the PPC in ensuring consumer protection and market stability, the United States expressed the need for a sustainable and equitable funding decision that fairly allocates costs among industry, the government and policyholders. The FSA committed to "consulting" with industry, but did not commit to a formal transparent process in this matter, citing no legal requirement to do so. The FSA subsequently did hold meetings on this issue with private insurers but private sector representatives generally noted that these discussions typically did not include substantive two-way dialogue. Near the end of 2002, it appeared as if progress was being made towards a resolution of this issue. It remained unclear, however, if any such resolution would ultimately receive Diet approval. Until a resolution is reached, the U.S. Government will continue to monitor developments and raise this issue as necessary in bilateral and multilateral meeting and fora.

The United States again raised concerns regarding future plans for the postal financial institutions – the postal insurance system (*Kampo*) and the postal savings system (*Yucho*) – which currently fall under the purview of MPHPT but will be transferred to a Postal Public Corporation in April 2003. There has been longstanding concern over the effect these institutions have on the efficient operation of Japan's financial market. As such, the new Corporation provides an important opportunity for the Government of Japan to take concrete steps to address key transparency and competition issues related to these services. The U.S. Government put forward concrete recommendations regarding the transfer in its October 2002 Regulatory Reform submission to Japan. These recommendations included ensuring transparency throughout the process, requiring the postal financial institutions to operate under the same standards as its private sector competitors, and prohibiting these institutions from underwriting any new insurance products or originating any new non-principal-guaranteed investment products. As the April 2003 creation of the Postal Public Corporation draws near, the United States will closely follow the development of implementing rules and regulations that will govern this new entity to assess both the extent to which public comment procedures are used and their competitive affects on the financial services sector.

The United States and Japan discussed the FSA's implementation of recommendations to streamline Japan's product approval process and increase needed personnel and technical resources. In addition, the United States emphasized its concerns about the case agent system and restrictions on foreign currency investment assets. The two countries also addressed a number of new issues that have arisen as Japan continues to restructure its financial system, such as the implementation and supervision of Japan's new pension system, the expansion of sales of insurance by banks, and the possible reduction of guaranteed interest rates by insurers.

Over the past year, the Government of Japan has taken some steps to increase transparency in its decision-making processes related to the insurance sector, including use of public comment procedures by the FSA and MPHPT. For example, the United States welcomed efforts made by the FSA to involve interested parties in the development of "know your customer" guidelines. U.S industry representatives have generally commented favorably on the willingness of Japanese officials to meet with them. As noted previously, however, on some key issues, FSA's unwillingness to engage in substantive dialogue has the effect of leaving insurers in the dark on regulatory matters of great importance.

The next annual consultations are scheduled to be held mid-2003, at which time the United States anticipates a full discussion on a wide range of issues.

ii. Autos and Auto Parts

Improving access to the Japanese auto and auto parts markets remains an important objective of the Bush Administration. While there has been a trend toward closer integration as well as important technological advancements in the global automotive industry over the past several years, the effect of these changes on market access and competition in this sector remains unclear. Unfortunately, Japan's lingering economic slump, limited market access, and weak competitive environment have continued to disproportionately hurt foreign vehicle and auto parts manufacturers in Japan. The United States remains disappointed that, after rising steadily in 1995 and 1996, sales of North American made vehicles have fallen for the last six years, with sales in 2002 expected to be substantially less than in 1994. In an effort to contend with these economic conditions and position themselves to better compete in the future, U.S. auto companies have continued to consolidate distribution networks and rethink corporate strategies. The auto parts sector also remains problematic: the U.S. auto parts trade deficit with Japan increased from a record level of $9.5 billion in 1997 to an estimated $11.2 billion in 2002.

In order to address barriers in and improve U.S. companies' access to the domestic Japanese automotive market and Japanese auto plants in the United States, the United States and Japan established a new Automotive Consultative Group (ACG) in October 2001. The ACG will serve as the focal point for addressing lingering as well as new, emerging issues in this key sector of both countries' economies. More specifically, the group will assess trends in the industry based on a series of trade and economic data on autos and automotive parts to be provided by both countries and work to identify areas in which specific action can be taken by Japan to address U.S. concerns. This would include further deregulation (particularly with respect to the automotive parts aftermarket), increased transparency in rules and regulations governing this sector, and more rigorous application of Japanese competition laws. The group will meet at least annually and will be co-chaired by the Department of Commerce and USTR on the U.S. side, and METI and the Ministry of Land, Infrastructure and Transport on the Japanese side. The first meeting took place in January 2003.

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

iii. Government Procurement

Construction/Public Works: The U.S. share of Japan's $210 billion public works market has consistently remained well below one percent – a troubling fact given the competitiveness of U.S. design/consulting and construction firms throughout the rest of the world. Discriminatory practices in Japan's public works sector continue despite the existence of the 1994 U.S.-Japan Public Works Agreement, under which Japan is obligated to use open and competitive procedures for procurements valued at or above the thresholds established in the WTO Agreement on Government Procurement. These problematic practices include failure to address rampant bid-rigging, use of discriminatory qualification and evaluation criteria, unreasonable restrictions on the formation of joint ventures, and the structuring of individual procurements so they fall below thresholds established in international agreements. The United States is very concerned with these practices, which seriously impede U.S. companies' ability to participate in Japan's public works sector.

During the Trade Forum in July 2002, the United States urged Japan to eliminate the obstacles that prevent U.S. companies' full and fair participation in its public works sector. In addition, the United States welcomed Japan's decision to address a long-standing U.S. concern regarding joint ventures for design projects by allowing design firms to conduct "design architect" work as joint venture members. The United States also encouraged Japan to include U.S. firms in Construction Management, Urban Renewal, and Private Finance Initiative projects. In October 2002, Japanese private sector organizations hosted the fourth U.S.-Japan Construction Cooperation Forum (CCF), which focused on facilitating the formation of joint ventures between U.S. and Japanese design/consulting and construction companies for Urban Renewal projects.

iv. Investment

Changing Japanese attitudes toward inward foreign direct investment (FDI), depressed asset values, and improvement in the regulatory environment enabled U.S. and other foreign firms to continue to gain significant new footholds in the Japanese economy, mostly through mergers and acquisitions. As a result, although FDI in Japan remains the lowest among OECD countries, investment has been rising over recent years. The banking/insurance and telecommunications sectors showed particularly high growth rates. FDI in JFY 2000 in banking/insurance increased by more than 100 percent over JFY 1999 levels to approximately $9.2 billion and telecommunications showed healthy growth with FDI inflows of approximately $6.7 billion. U.S. direct investment into Japan mirrored these changes with increases in investment flows up to approximately $9.2 billion in JFY 2000, mostly due to transactions in the financial sector. More recently, however, FDI into Japan has slumped, as a result of continuing economic problems in Japan and a slowing global economy. In JFY 2001 (which ended March 2002), total FDI plunged to $17.3 billion (Yen 2.2 trillion), down 39.5 percent from the level of JFY 2000.
U.S. investment also shrank significantly to $5.1 billion. During the first half of JFY 2002 (April to September 2002) as well, this downward trend continued, as total FDI fell almost 60 percent from the level of the same period a year ago.

Japanese and foreign businesses continue to be significantly affected by the implementation of several recent legal changes. The Securities Exchange Law, for example, now mandates consolidated and market-value accounting for listed firms and the new bankruptcy law (Civil Reconstruction Law) encourages business reorganization, including spin-offs, rather than forced liquidation of assets. In addition, the concept of corporate governance, such as the role of boards of directors, is changing in ways that bode well for increased investments, mergers and acquisitions. Amendments to the Commercial Law passed by the Diet in May 2002, will allow, starting April 2003, large-scale corporations to choose either Japan's traditional statutory auditor system or executive committee system (i.e., U.S.-style corporate governance). In another promising development, METI plans to submit a bill amending the Industrial Revitalization Law (IRL) to the next ordinary Diet session, scheduled to convene in mid-January 2003. The bill would introduce triangular mergers, which allow the use of foreign parent company stock as merger consideration, for those companies covered by the IRL.

Nevertheless, government and business observers from both countries recognize that much more remains to be done and the U.S. and Japanese Governments have agreed to continue to consult on investment issues. The U.S.-Japan Investment Initiative, under the Economic Partnership for Growth, sets forth a framework for bilateral discussions on investment that highlights and resolves possible impediments. The Initiative meets regularly throughout the year and an annual report is given to the leaders on the year's accomplishments. During the talks, the U.S. private sector is given an opportunity to actively participate and directly present their investment concerns to the Government of Japan.

v. Housing/Wood Products

With just under 1.2 million housing starts in 2001, 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 materials markets range upward of $62 billion, not including materials going into the repair and remodeling market. According to the U.S. Department of Commerce, imports of building materials from the United States for use in the residential construction market decreased in 2001, because of continued weakness in the Japanese housing market. The housing market in Japan is expected to remain weak for the foreseeable future given that the number of dwellings exceeds the number of households.

Discussions over the past several years under the auspices of the U.S.-Japan Enhanced Initiative on Deregulation and Competition Policy (EI) have led to a number of significant changes, including amendment of the Building Standard Law to make it performance-based, approval of three-story, multi-family, wood-frame construction in urban areas, recognition of U.S. grademarked lumber, and amendment to the Japanese Agricultural Standards (JAS) Law to allow foreign testing organizations to function on an equal footing with their Japanese counterparts. The Ministry of Agriculture, Forestry and Fisheries announced on March 6, 2002, that it was recognizing the grading systems of certain wood products-related organizations in the United States as being equivalent to those of JAS, a prerequisite for U.S. testing organizations applying to function as registered certification organizations.

Discussions during the last year of the Initiative focused on ways to stimulate sales of existing homes, to expand the residential repair and remodeling market for U.S. building products. Unlike the new construction market, the repair and remodeling market is an area that is expected to experience strong growth (5 percent or more annually) over the remainder of the decade. Sales of existing homes in Japan are currently only a fraction (less than 15 percent) of existing home sales in the United States.

Restrictions on building size and designs, and products continue to constrain the use of some foreign building products and systems that are 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; discussions are ongoing. The United States has also notes the need for Japan to ensure that guidelines for volatile organic emission levels be developed through a transparent process and be based upon sound science.

As part of the Fourth Joint Status Report, the United States and Japan agreed that future discussions on wood/building products related issues would be under the auspices of the Wood Products Subcommittee and its two technical committees, the Building Experts Committee and JAS Technical Committee. (These committees were set up under the terms of the 1990 U.S.-Japan Wood Products Agreement). The Wood Products Subcommittee met in Tokyo in April 2002, and the Building Experts Committee and the JAS Technical Committees met in Seattle in September 2002. The discussions were deemed productive.

c. Sectoral Issues

i. Agriculture

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

Rice: The United States has expressed ongoing concerns over the U.S. market share of Japan's overall rice imports in recent years. Although U.S. market share in Japan's Simultaneous Buy-Sell (SBS) tenders showed some improvement in 2002, the Japanese were slow to fill the entire SBS allocation. At the end of 2002, it was still unclear how the Japanese would allocate 36,000 metric tons of the SBS portion that had gone unallocated. (SBS tenders are conducted by the Japanese Food Agency and are designed to allow Japanese rice wholesalers and retailers to purchase high value, identity-preserved rice from foreign suppliers for retail sale, and as such are desired by the U.S. rice industry). The United States will closely follow the remaining SBS tenders in Japan's fiscal year (April-March) to ensure that Japan fulfills its rice commitments and will continue to press Japan for increased access to its rice market.

The U.S. Government has also been concerned about the increasing percentage of low-quality broken rice in Japanese tenders of U.S. rice in recent years. Recent levels of broken rice imports from U.S. firms (17 percent -18 percent) exceed what the industry would view as a normal broken percentage of around 11 percent. However, in 2002, the percentage of broken rice purchased from the United States decreased compared to 2001. As with the U.S. market share of imported rice, the United States will also continue to press Japan to lower the percentage of low-value broken rice in Japanese tenders.

Beef Safeguard Measure: The United States is very concerned over indications that Japan will increase tariffs on beef next year through imposition of an emergency beef tariff measure. Japan is the United States' number one beef export market, purchasing over $1.2 billion worth of U.S. beef in 2001. While the U.S. acknowledges the technical trigger for imposing this measure, the United States considers its use under the existing circumstances to be improper. The U.S. position is that such measures were intended to aid domestic producers confronted with import surges; however, this is not the case in Japan where beef imports are merely recovering from severely depressed levels following the 2001 *Bovine Spongiform Encephalopathy* (BSE) scare. Imposition of this safeguard will threaten this recovery and harm not only U.S. beef producers but also a full range of Japanese beef consumers, including the food service, grocery, and restaurant industries.

In August 2002, the United States urged Japan to take the necessary steps to prevent the measure from being imposed. Consequently, the issue was raised in official correspondence and in a series of bilateral and multilateral meetings and fora. A final decision by Japan, through legislation, is expected in early

2003. Regardless of the outcome on this legislation, the United States will continue to urge Japan to suspend this measure for the coming fiscal year.

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

A prime example of this is Japan's fumigation requirement on U.S. fruits and vegetables for 10 species of cosmopolitan pests. These are pests that are widely distributed in Japan and are not under official control. The fumigation requirement is particularly detrimental to the quality of these products, many of which sometimes do not survive fumigation and must be destroyed. In addition to some forward movement with the United States and Japan entering into discussions on a pre-clearance protocol for lettuce, the United States has raised this issue in the WTO Committee on the Sanitary and Phytosanitary Measures.

Throughout 2002, Japan placed a series of nationwide bans on all U.S. poultry and egg products (cooked and uncooked) because of reports of *low pathogenic avian influenza* (LPAI). LPAI is a globally ubiquitous disease, and the International Office of Epizootics (the international standard setting body for animal health) has determined that it is not a reportable and actionable poultry disease. Following intervention by the United States, Japan lifted its national bans but maintained a series of state-wide, or in some cases, geographic bans. As of the end of 2002, Japan had eliminated all of the LPAI bans.

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

Organic Food: In March 2002, the United States reached an equivalence agreement with Japan to facilitate the export of all U.S. organic products to Japan, currently valued at over $100 million. This equivalence agreement became effective April 1, 2002. The equivalence agreement is facilitating the export of U.S. organic product to Japan as a result of Japan's acceptance of the USDA organic standards, accreditation procedures and conformity assessment requirements.

ii. Steel

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

iii. Flat Glass

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

The United States has engaged Japan in discussions of these concerns in various bilateral fora over the past decade, most recently in the 2002 Trade Forum under the U.S.-Japan Partnership for Economic Growth. During the Trade Forum discussion, the U.S. Government highlighted the continuing problems that prevent market entry, including the need for a stronger Japan Fair Trade Commission and tighter enforcement of rules against anticompetitive behavior. The U.S. Government also has highlighted the need to modify regulations that would facilitate use of energy efficient glass in Japan.

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

9. Taiwan

Taiwan became a member of the WTO on January 1, 2002. Taiwan's accession to the WTO has increased access over the past year for a broad range of U.S. goods and services, including agricultural exports. Highlights of Taiwan's WTO commitments include:

- Tariffs on industrial goods were reduced to less than 5 percent on average;
- Tariffs on construction and agriculture equipment, wood (except plywood), paper and paper products, furniture, distilled spirits, certain steel products, civil aircraft, dolls, toys and games were reduced to zero (some upon accession, most by 2004);
- Agricultural tariffs fell to 12 percent on average, with most of these reductions taking place upon accession;
- Taiwan's state trading monopoly on tobacco and alcohol was eliminated;
- Taiwan has increased foreign access to a number of service sectors, including professional services (architects, accountants, lawyers), audiovisual services, express delivery services, advertising, computer services, construction, wholesale and retail distribution, franchising, and environmental services; and
- Taiwan has the obligation to adhere to the WTO TRIPS Agreement to protect intellectual property rights.

However, we continued to work with the Taiwan government this past year to address shortcomings in several areas related to its WTO commitments, including increasing market access for agricultural goods, improving intellectual property rights (IPR) protection, further opening Taiwan's telecommunications services market, and ensuring market access for pharmaceuticals.

a. Agriculture

At the beginning of 2002, Taiwan was late in fully implementing the tariff-rate and market access quotas on rice, chicken, pork, fish, and other products specified in their WTO commitments. Tariff-rate quotas on chicken, pork, fish and other products for 2003 were announced as planned in the Fall of 2002.

The Taiwan government's management of its rice import system was particularly troublesome this past year and required several substantive discussions to ensure access for U.S. suppliers. Further, Taiwan agreed as a condition of its accession to the WTO to consult with the United States and other interested WTO members regarding its plans for management of rice imports beyond 2002. Following numerous attempts to hold substantive discussions this past year, the Taiwan government finally agreed to meet in November 2002. As 2002 came to a close, the United States continued efforts to ensure timely and full implementation of Taiwan's commitments on rice imports for 2003.

b. Intellectual Property Rights

The level of intellectual property (IP) piracy in Taiwan remains at a very high level. Minimal progress was made in strengthening its intellectual property rights protection regime during the past year. U.S. concerns were serious enough to warrant continued placement of Taiwan on the Special 301 Priority Watch List for the second year in a row. Although the Taiwan authorities declared 2002 to be the "action year for IPR protection,"continued pirating of optical media, failure to shut down counterfeit and IPR-infringing facilities, and the export of pirated and counterfeit goods overseas led the United States to urge the Taiwan government to further improve its enforcement and legal framework for IPR protection.

Taiwan is in the process of modifying its copyright law in response to U.S. concerns. Proposed amendments, which will require legislative approval, define public transmission and include Internet-related provisions, such as technological protection measures and electronic copyright for the management of information. U.S. Government and industry have expressed concerns that the latest drafts of these amendments may not adequately protect IPR in Taiwan if the authorities exempt some infringements from "public offence" status, thus requiring private complaints before law enforcement can initiate action against violators.

We will continue to monitor Taiwan's progress in combating its high IP piracy rates, focusing in particular on whether the Taiwan government aggressively enforces its laws, takes active measures to crack-down on pirate activities, and makes other efforts to reduce all types of IPR violations. We also look forward to working with the Taiwan government on further amendments to its copyright law to conform with existing international IPR norms.

c. Telecommunications

Taiwan committed as part of its WTO accession to fully open its telecommunications services market, with the exception of certain foreign equity limitations and board membership requirements. To date, the Taiwan government has not implemented the legal regime or licensing criteria to provide new licenses for local, domestic long distance, and international services despite repeated requests from the United States to fulfill these commitments.

The Taiwan government permitted the direct sale of fiber-optic submarine cable capacity to the four existing fixed-line license holders and other telecommunications businesses, including Internet Service Providers, in February 2002. While international submarine cable firms will be permitted to build their own backhaul facilities, or links from the cable landing site to network providers, they are limited to only one gateway.

Taiwan is in the process of developing new criteria regarding the issuance of new fixed-line telecommunications licenses, including those for domestic long-distance and international services, expected to be issued in March 2003. DGT plans to issue licenses not only for long-distance and international services but also for comprehensive networks and city call services. Capital requirements for comprehensive network services, city-call services and long-distance/or international services will be NTD 16 billion, NTD 12 billion and NTD 2 billion, respectively. Comprehensive fixed-line licensees will require a build-up of 400,000 lines but 60,000 lines will be sufficient for initiating basic services. We will continue to monitor whether such requirements are hindering Taiwan's progress toward full market opening of its telecommunications sector in a WTO-consistent manner.

d. Pharmaceuticals

Taiwan's pharmaceutical registration process continues to slow market entry for new drugs that have already been approved in other industrial countries. During 2002, Taiwan's Department of Health implemented a new requirement for firms to submit validation data as part of the registration and approval process for both new drugs and those already on the market. We continued to work closely with the Taiwan governmentas 2002 came to a close to ensure market access for U.S. firms.

10. Hong Kong (Special Administrative Region)

a. Intellectual Property Rights

Hong Kong continued enforcement actions during the past year to address piracy of copyrighted works. Hong Kong people are growing increasingly aware of the importance of IPR to their own industries, notably movies and toys. The unauthorized copying of computer programs, movies, music, television programs, and music remains illegal; but in June 2001, Hong Kong's Legislative Council (LegCo) suspended the criminal provision for unauthorized copying of publications. The Hong Kong government was preparing an amendment at the end of 2002 to refine the "fair use" rules for copyright publications and create new provisions to crack down on illicit copy shops. Another amendment currently being considered by LegCo will liberalize the parallel importation of computer software, while maintaining criminal penalties for such imports of "entertainment" copyrighted products like movies and music. The U.S. industry has expressed some concern about the adequacy of new legislation and continues to push for even stronger enforcement. We will continue to monitor this situation and other anti-piracy efforts closely.

b. Telecommunications

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

G. Africa

1. Overview

The United States enjoys a strong trade and investment relationship with the 48 countries of sub-Saharan Africa. Two-way trade between the United States and sub-Saharan Africa totaled $19.6 billion in the first ten months of 2002, down 21 percent from the same period in 2001, largely as a result of the weakness in the global economy. Sub-Saharan Africa is home to more than one-tenth of the world's population, supplies 14 percent of U.S. crude oil imports, and represents the largest regional bloc of WTO Members (38 countries). African Members of the WTO played an important role in the launch of the Doha Development Agenda in November 2001.

In February 2002, USTR Zoellick traveled to Kenya, South Africa, and Botswana – the first-ever visit to Africa by a sitting U.S. Trade Representative. During the stop in Kenya, he co-chaired the first meeting of the U.S.-COMESA Trade and Investment Council. In South Africa, he met with trade ministers from the sub-region and explored possible negotiations on a free trade agreement with the five member countries of the Southern African Customs Union (SACU). In November 2002, Zoellick notified Congress of the

President's intent to negotiate such an agreement with SACU. This would be the first U.S. free trade agreement with sub-Saharan African countries. Formal negotiations are expected to begin in the second quarter of calendar year 2003.

The African Growth and Opportunity Act (AGOA) is the centerpiece of U.S. trade policy for this important region and is helping to achieve key Administration objectives in sub-Saharan Africa, including promoting economic reform, growth and development; expanding bilateral and regional trade and investment relationships; and facilitating the region's full integration into the multilateral trading system. Meeting these objectives will open new markets for U.S. exports and create healthier economies and improved governance in sub-Saharan Africa. Significant progress was made in each of these areas in 2002 and plans are proceeding to continue this work in 2003. The Trade Act of 2002 contained several notable enhancements of AGOA.

2. Proposed Free Trade Agreement with Southern Africa

In November 2002, U.S. Trade Representative Zoellick notified Congress of the President's intent to initiate a free trade agreement (FTA) with the five member countries of the Southern African Customs Union (SACU): Botswana, Lesotho, Namibia, South Africa and Swaziland. In pursuing this FTA, the Administration is responding to Congress' direction, as expressed in the African Growth and Opportunity Act, to initiate negotiations with interested beneficiary countries to serve as the catalyst for increasing trade and investment between the United States and sub-Saharan Africa. The negotiations -- addressing trade topics such as market access, investment, services and intellectual property rights -- are scheduled to begin in the second quarter of 2003.

U.S. Trade Representative Zoellick first discussed the possibility of a U.S.-SACU FTA in meetings with SACU member country trade ministers during his February 2002 visit to South Africa. In October 2002, SACU Ministers formally communicated to USTR Zoellick their intent to pursue FTA negotiations with the United States. After notifying Congress of the President's intent to negotiate an FTA with SACU, in accordance with the provisions of the Trade Act of 2002, Zoellick requested the International Trade Commission to prepare a report on the probable economic effects of an FTA. USTR consulted with Congress and the private sector and also solicited public comment on the prospective FTA. More than a dozen business associations and NGOs testified at a December 16, 2002 public hearing convened by USTR on the planned negotiations. Several more organizations submitted written comments. These consultations demonstrated broad support for a prospective FTA and helped to identify priorities for the negotiations.

This FTA is a vital part of the Administration's broader effort to drive global trade liberalization, to create new commercial opportunities for U.S. companies, farmers and workers in fast growing regions of the world, and to draw developing countries into the mainstream of the global economy. It offers a chance to craft a groundbreaking agreement that will serve as a model for similar efforts in the developing world. The SACU countries are strong economic reformers and leading AGOA beneficiaries. They have seen the positive role that trade can play in promoting economic growth and development and are now taking an important step toward deeper commercial engagement with the United States.

Through an FTA with SACU, U.S. businesses will gain preferential access to their largest export market in sub-Saharan Africa, worth more than $3.1 billion in 2001. An agreement will also help to address longstanding regulatory barriers in the region and to level the playing field in sectors where U.S. exporters were disadvantaged by the European Union's free trade agreement with South Africa. By building on the success of AGOA, the SACU countries would secure the kind of guaranteed market access that supports long-term investment and economic prosperity. The FTA would also reinforce ongoing regional economic reforms and lower the perceived risk of doing business in southern Africa.

3. Implementing the African Growth and Opportunity Act

AGOA, which is authorized through September 30, 2008, provides powerful incentives for economic growth in one of the poorest regions of the world by granting quota- and duty-free access to the $10 trillion U.S. market for nearly 6,500 products. The Act also institutionalizes a process for strengthening U.S. trade relations with sub-Saharan African countries by establishing an annual ministerial-level forum with AGOA-eligible countries co-hosted by the U.S. Trade Representative and the Secretaries of State, Treasury and Commerce.

The Trade Act of 2002 included several enhancements to AGOA, including 1) a doubling of the annual quantitative limit on apparel produced in the region from regional fabric; 2) the extension of lesser developed country benefits to Botswana and Namibia, allowing producers there to use third-country fabric in qualifying apparel; 3) the inclusion of knit-to-shape apparel in the list of goods eligible for quota- and duty-free treatment under AGOA; and 4) correction of a technical definition for the use of fine merino wool.

The second U.S.-Sub-Saharan Africa Trade and Economic Cooperation Forum was held in Mauritius on January 15-17, 2003. U.S. Trade Representative Zoellick led the U.S. Government delegation, which included senior-level officials from the Departments of State, Treasury, Commerce, Agriculture, the U.S. Agency for International Development, the National Security Council, and several other agencies. Ministerial delegations from almost all AGOA-eligible countries also participated. The Forum provided an opportunity for participants to discuss strategies for promoting regional economic reforms and strengthening U.S.-sub-Saharan African trade and investment ties. Parallel forums involving the private sector and non-governmental organizations from the United States and sub-Saharan Africa were also held in Mauritius at the same time. The first Trade and Economic Cooperation Forum was held in Washington, DC on October 29-30, 2001.

AGOA requires the President to determine annually whether sub-Saharan African countries are, or should remain, eligible for benefits based on their continued progress in meeting criteria set out in the Act. The Assistant USTR for Africa chairs the interagency AGOA Implementation Subcommittee responsible for advising the USTR on country eligibility. Based on the U.S. Trade Representative's recommendation the President determined in December 2002 that 38 countries[32] meet the Act's requirements for eligibility, including all 36 countries previously eligible and two additional countries, the Democratic Republic of the Congo and The Gambia.[33]   In addition, in October 2002, USTR determined that implementation of AGOA benefits could begin for Sierra Leone. Previously, Sierra Leone had been eligible for AGOA, but

[32] The AGOA-eligible countries are Benin, Botswana, Cameroon, Cape Verde, Central African Republic, Chad, Republic of Congo, Cote d'Ivoire, Democratic Republic of Congo, Djibouti, Eritrea, Ethiopia, Gabon, Ghana, Guinea, Guinea-Bissau, Kenya, Lesotho, Madagascar, Malawi, Mali, Mauritania, Mauritius, Mozambique, Namibia, Niger, Nigeria, Rwanda, São Tomé and Principe, Senegal, Seychelles, Sierra Leone, South Africa, Swaziland, Tanzania, The Gambia, Uganda and Zambia. Cote d'Ivoire became eligible in May 2002 after an interim eligibility review recommended by the AGOA Implementation Committee in December 2001.

[33] The Presidential proclamation formally adding these two new countries to the list of AGOA beneficiaries is expected to be issued in early 2003.

implementation of its benefits was delayed while the country made the transition from civil war, and government authority was re-established throughout the country.

Under AGOA, eligible countries may also receive preferential quota- and duty-free treatment for certain textile and apparel articles if they have instituted customs measures to prevent illegal transshipment. In 2002, USTR approved submissions for AGOA textile and apparel benefits from six additional countries -- Cameroon, Cape Verde, Ghana, Mozambique, Tanzania, and Senegal -- bringing to 18 the number of countries eligible for such benefits.[34] Of these, four countries have been approved for duty and quota-free treatment for handmade, hand-loomed, or folklore articles (Botswana, Lesotho, Kenya, and Malawi).

As part of its ongoing AGOA implementation efforts, USTR has coordinated more than 20 regional and national technical assistance seminars on AGOA across sub-Saharan Africa. These seminars, designed to help ensure that the sub-Saharan African public and private sectors are equipped to fully utilize AGOA benefits, have been organized in conjunction with U.S. Customs, USAID and the Departments of State and Commerce. In 2002, USTR and the Commercial Law Development Program of the Department of Commerce conducted four highly successful regional AGOA seminars in Cameroon, Ghana, Senegal, and Uganda. Over two thousand public and private sector participants from more than 30 African countries participated in these two-day seminars led by government and private sector experts from the United States. USTR also worked closely with the Overseas Private Investment Corporation, the U.S. Export-Import Bank and the U.S. Trade and Development Agency, which continue to provide technical assistance, loans, and guarantees to address regional infrastructure and supply-side constraints.

The Administration recognizes that outreach to the private sector, civil society, and to African governments is critical to the success of AGOA. Accordingly, USTR and other U.S. agencies have made outreach -- on both sides of the Atlantic -- a priority in their efforts to implement AGOA. In the region, outreach efforts have included seminars, speaker programs, media programs, and information dissemination. In the United States, outreach has included extensive briefings and consultations with the African diplomatic corps, the private sector, and leading non-governmental organizations, including an AGOA Business Roundtable hosted by the Department of State on November 7, 2002. AGOA was a major theme of USTR Zoellick's February 2002 visit to Kenya, South Africa, and Botswana, the first ever visit to sub-Saharan Africa by a sitting U.S. Trade Representative. USTR and other members of the interagency AGOA Implementation Subcommittee have also produced a matrix of steps involved in AGOA implementation and a comprehensive *AGOA Implementation Guide*, and continue to maintain a website dedicated to disseminating AGOA information (www.agoa.gov).

4. Promoting Economic Reform, Growth and Development

Since being signed into law in May 2000, AGOA has prompted important economic and social reforms across sub-Saharan Africa and delivered new jobs and opportunities for economic growth and development to the region. AGOA's eligibility requirements create incentives for countries to reform their economies and create an environment conducive to increased trade and investment. To receive benefits, countries must demonstrate the existence of, or progress toward establishing, a market-based economy, the rule of law, reduction or elimination of barriers to trade and investment, policies to reduce poverty, and systems to combat corruption and protection of worker rights. These criteria represent global best

[34] The other 12 countries eligible for textile and apparel benefits are Botswana, Ethiopia, Kenya, Lesotho, Madagascar, Malawi, Mauritius, Namibia, South Africa, Swaziland, Uganda, and Zambia.

practices to attract and maintain trade and investment, are essential for the transfer of technology, and help to promote competition and to increase exports.

In 2002, the United States again consulted extensively with sub-Saharan African countries on AGOA eligibility requirements. As a result of these consultations, many eligible countries are implementing needed reforms, including measures to combat corruption, accelerate privatization, deregulate key industries, promote more open trade, and strengthen intellectual property and labor law protections. Many countries have ratified ILO Convention 182 on the elimination of the worst forms of child labor, and several are working to change, or have changed, laws on child trafficking and/or worker rights.
By bringing increased investment to, and creating new jobs in, sub-Saharan African countries, AGOA is also demonstrating how trade can benefit developing countries. For example, in the last two years, Lesotho has seen the opening of eleven new factories and the expansion of eight additional ones, resulting in the creation of at least 15,000 new jobs attributable to AGOA. In Malawi, an estimated 4,350 jobs have been created. A planned $20 million foreign investment in a Ugandan mill will employ 500 people and benefit local agricultural producers. In South Africa, AGOA exports directly and indirectly support approximately 38,000 jobs.

While most U.S. imports continued to be in the energy sector, AGOA has begun to encourage the diversification of the U.S.-African trading relationship. For example, in the first ten months of 2002, the value of non-fuel goods imported under AGOA (not including GSP) increased by 125 percent, to $1.3 billion. During the same period, imports of textile and apparel articles under AGOA increased 164 percent; leather product and hides increased 449 percent; and imports of automobiles and parts grew by more than 123 percent.

5. Expanding Bilateral and Regional Trade and Investment Relationships

AGOA successes are helping to strengthen and expand U.S. bilateral and regional trade and investment ties with sub-Saharan Africa. Growing interest in trade with the United States led to negotiation of a new Trade and Investment Framework Agreement (TIFA) with the eight-member West African Economic and Monetary Union (WAEMU)[35]. The U.S.-WAEMU TIFA was signed in April 2002 and the first TIFA Council meeting was subsequently held in Dakar, Senegal in July 2002. Among the topics discussed at this meeting were implementation of AGOA, obstacles to increased US-WAEMU agricultural trade, issues in the WTO and trade capacity building activities. In June 2002, USTR and USAID convened a seminar in Washington, DC on regional integration in WAEMU. Forty officials from WAEMU and its member countries participated, along with an equal number of U.S. Government officials.

The U.S.-WAEMU TIFA followed the conclusion of a similar agreement with the twenty-country Common Market for Eastern and Southern Africa (COMESA) in October 2001. U.S. Trade Representative Zoellick co-chaired the first meeting of the U.S.-COMESA TIFA Council during his visit to Nairobi in February 2002. Most of the discussion at this meeting revolved around ways to strengthen implementation of AGOA.

Two other TIFA Council meetings were held in 2002: with Nigeria in June and with Ghana in July. Topics discussed at these meetings included AGOA, issues related to the WTO Doha Development Agenda, commercial disputes, challenges related to trade financing, and trade capacity building needs.

[35]The members of WAEMU are Benin, Burkina Faso, Cote d'Ivoire, Guinea-Bissau, Mali, Niger, Senegal, and Togo.

AGOA successes are also creating new commercial opportunities for U.S. exporters, as African exporters explore new input sources in the United States. Although the global recession contributed to a 17 percent decrease in U.S. exports to sub-Saharan Africa in the first ten months of 2002, the multi-year trend remains positive. U.S. exports to the region increased in 2001 and 2000 and, in the first ten months of 2002, were 7 percent higher than in the comparable period in 1999. Through the third quarter of 2002, South Africa was the largest regional consumer of U.S. exports, followed by Nigeria, Angola, Kenya, Ghana, Cameroon, and Chad.

a. South Africa

The United States and South Africa enjoy a broad and mutually beneficial trade and investment relationship. The weakening of the global economy contributed to a 15 percent decrease in two-way trade, to $5.4 billion in the first ten months of 2002, down from $6.4 billion during the same period in 2001. Nonetheless, during the same period, U.S. imports from South Africa under AGOA and related GSP provisions increased by 41 percent, led by increases in motor vehicles, apparel, and agricultural goods. South Africa is the largest U.S. supplier of non-fuel AGOA-eligible products (including GSP items), with sales worth more than $1 billion in the first ten months of 2002. Other leading imports include platinum group metals, diamonds, machinery, chemicals and apparel. Leading U.S. exports to South Africa include aircraft, computers and components, integrated circuits, television and radio parts, and medical equipment. South Africa is a valued partner in the WTO, and the United States continues to consult closely with the South African government on issues related to the Doha Development Agenda.

As with many diverse and vibrant bilateral trading relationships, certain disputes have arisen between the United States and South Africa. These include concerns related to South Africa's December 2000 antidumping order against imports of certain U.S. poultry products, as well as ongoing problems related to South Africa's basic telecommunications monopoly, Telkom, and its failure to provide facilities necessary for U.S. value-added network services (VANS) providers to operate and expand. USTR held extensive discussions with the South African government in 2002, including during the February visit to South Africa of Ambassador Zoellick, in an effort to resolve both of these disputes. The United States is the largest source of new foreign investment in South Africa since the country's 1994 transition to democracy. More than 900 U.S. companies and more than 400 U.S. subsidiaries and franchises are operating in South Africa.

b. Nigeria

Nigeria is the United States' largest trading partner in sub-Saharan Africa, based primarily on the high level of U.S. petroleum imports from Nigeria. Total two-way trade was valued at $5.7 billion in the first ten months of 2002, a 35 percent decline over the same period in 2001, due to the weakening in the global economy and lower demand for oil imports. Nigeria was the United States' fifth largest supplier of petroleum and the fifth largest purchaser of U.S. wheat in 2001. Nigeria is seeking to utilize AGOA to diversify its export base, especially in the area of manufactured goods. Nigerian exports to the United States under AGOA, including its GSP provisions, were valued at $4.3 billion during the first ten months of 2002, a 13 percent decline over the same period in 2001, largely due to the decrease in the value of oil exports. The United States is the largest foreign investor in Nigeria, with significant oil interests.

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

c. Ghana

Total two-way trade between Ghana and the United States was valued at $254 million in the first ten months of 2002, a 27 percent decrease over the same period in 2001. Ghana is the sixth largest sub-Saharan African market for U.S. goods. The leading U.S. exports to Ghana are heavy equipment and machinery, building materials, and agricultural products. U.S. imports from Ghana are primarily cocoa, mineral fuel, and timber. Ghana was approved for AGOA's textile and apparel benefits in March 2002, the first country in West Africa to gain this certification. As of September 2002, U.S. imports from Ghana under AGOA, including its GSP provisions, were valued at $32 million, down 21 percent from the same period in 2001.

Ghana and the United States enjoy a long standing commercial relationship despite occasional disputes involving U.S. companies. A number of commercial issues have been resolved or addressed within the U.S.-Ghana TIFA. The July 2002 U.S.-Ghana TIFA Council meeting included discussions on outstanding commercial disputes, WTO issues, AGOA implementation, and trade capacity building.

d. Other Countries and Regions

The Administration plans to continue ongoing efforts to strengthen bilateral trade and investment ties throughout sub-Saharan Africa and to promote regional economic integration through work with the African Union, the Economic Community of West African States, the Economic and Monetary Community of Central Africa, WAEMU, COMESA and SADC.

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

AGOA has also helped to promote sub-Saharan Africa's integration into the multilateral trading system and to encourage support for the new round of global trade negotiations in a region that accounts for more than a quarter of WTO membership. U.S. consultation and collaboration with African Members of the WTO played an important part in the successful launch of the Doha Development Agenda in November 2001. This close working relationship between the United States and African Members continued in 2002 as the negotiations under the Doha Development Agenda began in earnest. In particular, the United States consulted with African countries on topics related to WTO negotiations on agriculture, trade in services, and TRIPS. Many African countries took a special interest in the U.S. proposal on agriculture, particularly the elements calling for the phase-out and eventual elimination of export subsidies and trade-distorting domestic support. African countries are also playing a more active role in the request and offer process in the trade in services negotiations. Finally, African countries played a leading role in the TRIPS Council negotiations on a mechanism to allow Member countries, especially in the developing world, to use compulsory licensing of pharmaceuticals to respond to serious health crises related to HIV/AIDS, malaria, tuberculosis and other epidemics. At the U.S.-Sub-Saharan Africa Trade and Economic Cooperation Forum in January 2003, U.S. Trade Representative Zoellick co-chaired a Roundtable with African trade ministers on WTO issues.