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A Weekly Report for Business Executives on U.S. Trade Policies, Negotiations, Legislation, Export Controls and Trade Laws

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U.S.-UK DEFENSE TREATY WILL ELIMINATE MANY USML LICENSES

The Defense Trade Cooperation Treaty that President Bush and British Prime Minister Blair signed June 21 could eliminate the need for a U.S. Munitions List (USML) license from the State Department for a large share of exports of defense items and services to the United Kingdom, according to the department. The Bush administration has tried to ease USML licensing requirements for the UK since it came into office but faced opposition from key Republicans in the House. Several of those House opponents have retired, and the new treaty will require only Senate ratification, so its chances of adoption seem good.

The treaty “would allow certain U.S. defense articles and services to be exported to Her Majesty’s Government and selected UK companies that meet specific requirements without U.S. licenses or other approvals,” a State official told WTTL. The products and projects to be covered and the requirements to be met by British buyers will be negotiated separately by the two governments.

Most U.S. defense articles and services will be eligible for export to these identified UK companies without prior approval as long as the items are being exported in support of combined U.S.-UK military and counterterrorism programs; joint U.S.-UK cooperative programs on security, research, development and support; and specific security and defense projects of the British government, the State official explained. U.S. defense exporters have obtained more than 13,000 USML license for sales to the UK in the last two years. The State official could not say how many of those licenses would be eliminated under the treaty’s provisions.

Exports under the treaty would still be subject to notification to Congress under statutory requirements. The treaty calls for Britain to continue its policy of not requiring export licenses for defense exports to the U.S. “Together, both governments will also aim to finalize implementing arrangements by the end of the year and to complete steps necessary under their respective domestic laws to implement the treaty,” Bush and Blair said in a joint statement.

DEEMED EXPORT PANEL STARTS HEARING RECOMMENDATIONS

The Bureau of Industry and Security’s (BIS) Deemed Export Advisory Committee (DEAC) has moved beyond merely hearing complaints about deemed export regulations and started to get specific recommendations on how to fix the system. The most recurring suggestion the committee heard at its June 19 meeting at MIT in Cambridge, Mass., called for limiting deemed export controls to a smaller list of technologies that are considered the most sensitive for national security. Speakers from the business and academic communities repeated the old

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mantra of “higher fences around fewer products,” and statements by DEAC members indicated that they may adopt that suggestion. “There is a growing sentiment that that probably is the sound approach,” said DEAC member Ruth David, who is president of Analytic Services, Inc. “Yet the trick becomes the details: what goes inside the high walls,” she added. David also said the goal of the committee is not just a temporary fix to the deemed export problem but to set the stage for a policy regime “for the next decade or two.”

Another DEAC member, retired Gen. John Gordon, who was a homeland security advisor to the president, said the committee has also discussed the need to look at the government’s organizational structure for dealing with deemed exports. He noted the problems exporters face having to deal with three different federal departments, Commerce, State and Defense, on deemed exports issues.

Claude Canizares, vice president for research at MIT, which does \$1.2 billion in contract research annually, recommended that items subject to deemed export controls should be narrowed to those where there is a specific national security threat and not just a hypothetical threat. He also suggested that the burden for identifying products that might be subject to “use” controls should be on the manufacturers of the products. John Barker of Arnold & Porter cautioned the committee about the mechanics of higher fences around fewer products. He noted that BIS has different levels of control for different countries and different products. As a result, universities might “end up with fences of different heights,” he said.

Geoffrey Grant, vice president of Partners Healthcare, called for the creation of permanent technical advisory committee to advise BIS on deemed export matters. Larry Disenhof, group director of export compliance at Cadence Design Systems, Inc., suggested creation of a provisional or transportable deemed export license that can be given to foreign nationals and provided to prospective employers before they are hired. He noted that most of the delay in getting a deemed export license approved is due to FBI background checks that can take up to four and a half months. Several speakers said the visa process should be the point of control for foreign nationals who might have access to controlled technology. This might require a special kind of visa that identifies the technology to which a foreign national could have access. Jon Goding, director of technology for Raytheon’s Florida operations, focused his remarks on deemed export controls on encryption products, saying current controls are out of date. He called for creating an industry-academic board to review current encryption rules.

U.S., EU BLAME INDIA, BRAZIL FOR COLLAPSE OF TRADE TALKS

The U.S. and European Union (EU) are scrambling to come up with a Plan B for saving the Doha Round after a meeting of U.S., EU, Brazilian and Indian trade ministers, the so-called G-4, in Potsdam, Germany, collapsed June 21. If a new approach can’t be devised quickly, the breakdown of the Potsdam meeting could mark the Bush administration’s last chance to get a multilateral deal before leaving office. Realistically, negotiators have until the end of July to resuscitate the talks, which always remains a possibility. Another suspension of negotiations, however, might see a repeat of history, and, as in the Uruguay Round, require two or three years to pass and a new president in the White House before a final deal can be reached.

U.S. Trade Representative (USTR) Susan Schwab and Agriculture Secretary Mike Johanns went to Geneva after the Potsdam meeting to talk with trade officials there to see if a return to the multilateral negotiating forum could produce a route that would circumvent the hard line drawn by Brazil and India. The success of that approach would depend on some other developing countries being willing to step into a leadership role to replace Brazil and India and also on the chairmen of the agriculture and non-agriculture market access (NAMA) negotiating committees being able to draft negotiating texts that might become the basis for a new deal.

“The G-4 may not ever be able to reach closure, but that certainly does not mean the end of the round,” Schwab told reporters after the meeting. She said she looked forward to going to

Geneva for talks with World Trade Organization (WTO) Director General Pascal Lamy and other officials “that want to see a successful, ambitious end to this round.” But EU Agriculture Commissioner Mariann Fischer Boel didn’t hold out much hope for the success of this approach. “We, of course, hope that the Geneva process can do better, but frankly I am not optimistic,” she told reporters. “So, historic opportunities have been lost today,” she declared. A Brazilian diplomat, speaking on background, also doubted that the multilateral approach would achieve a better a result than the G-4. “It’s worse. With a small group, you know everyone’s position; with a big group you never know what the positions are,” he said.

Schwab, Johanns, Boel and EU Trade Commissioner Peter Mandelson put the blame for the failure of the meeting in Germany squarely on Brazil and India. One source, however, said it was Indian Commerce Minister Kamal Nath who walked out without telling anyone in advance. One source said Brazil doesn’t share India’s strong resistance to cutting industrial tariffs, and Brazilian Foreign Minister Celso Amorim may have walked out with Nath to maintain solidarity.

The U.S. and EU officials said they had come to the meeting with flexibility on agriculture issues, but Brazil and India adamantly refused to offer any concessions on NAMA or services. Schwab and Johanns said technical-level talks among the staffs of the G-4 had made significant progress on all three pillars in the agriculture negotiations and had even reached agreement on the issue of food aid.

“When talks broke down, it was clear that while the U.S. and the EU were prepared to make significant concessions, significant contributions to this round, that there was a lack of flexibility, indeed a rigidity, when it came to the advanced developing countries who were present,” Schwab said. Johanns said talks by senior officials had not reached agreement on all agriculture issues but had shown “very positive signs, very hopeful signs” in all areas.

“We made substantial progress relative to the tariff cuts. We made substantial progress relative to the tiers and the distance between tiers...We made substantial progress on definition of sensitive products,” Johanns said. Despite this progress “we had two ministers who literally hadn’t moved an iota from a point that started nearly two years ago, showed no sign of flexibility,” he stated. “We stretched, and it just seemed to me that they grabbed,” Johanns declared.

Brazilian sources put the blame on the U.S. for not offering deeper cuts in domestic subsidies. The U.S. reportedly has offered to cap its subsidies at \$17 billion, while Brazil has asked for a cap of \$15 billion. The Brazilians say the U.S. uses only about \$11-12 billion of its currently permitted support level, so it is not “cutting the water” from its real subsidies. They say they are making the same case Americans are making in demanding industrial tariff cuts based on actual applied rates instead of higher bound rates.

POTSDAM DEBACLE LEAVES QUESTION: WHITHER DOHA NOW?

The collapse of G-4 negotiations in Potsdam June 21 may have marked a negotiating end-game but not the end of the Doha Round, sources in Geneva said. “The G-4 process is dead,” one official in Geneva declared. A hastily called meeting of the Doha Round Trade Negotiating Committee (TNC) June 22 heard members rallying around the multilateral talks in Geneva. “With the G-4 failure, developing country members and groupings now need to assert their power and influence in the multilateral process and lay claim to the development promise of Doha,” Philippine Ambassador Manuel A.J. Teehankee told the TNC meeting.

Whether the multilateral process can successfully replace the G-4 is still uncertain. The deadlock reached by trade officials from the U.S., EU, Brazil and India represented a feeling out of the outer limits of their demands in agriculture, industrial tariffs and services, one diplomat told WTTL. If talks continue through the end of July, these issues will be addressed again at the Eleventh Hour in the so-called “Green Room” among 30 or so countries and by the G-4, he predicted. Although USTR Susan Schwab would like to find new negotiating partners to

replace Brazil and India, it seems doubtful there are any advanced developing countries that would be able or willing to step in and replace those two nations as leaders for the developing countries in the Doha talks. While China has been the near silent partner in the talks, Schwab acknowledged that the broad resistance of developing countries to lowering industrial tariffs isn't due to concerns about U.S. or EU goods but rather fear of Chinese exports.

Schwab said China needs to play a greater role in the talks to provide developing countries assurance their markets won't be flooded by Chinese goods. "One of the reasons, quite frankly, that many of the other developing countries give for not wanting to open their markets for manufactured goods is because of China's exports of manufactured goods," she said. "So China really needs to make its contribution commensurate with its capacity as an export superpower," she said.

The next stage in the multilateral process is the expected release of new negotiating texts by Crawford Falconer, the chairman of the agriculture negotiating committee, and Don Stephenson, chairman of the non-agriculture market access (NAMA) negotiating committee. These papers are due within the next two weeks, sources in Geneva say. In the meantime, the two chairs have cancelled planned meetings of their committees the week of June 25.

Sources in Geneva see the Potsdam breakdown as a numbers game. "While the G-4 didn't converge, the numbers are not as far apart as they were one year ago," one diplomat told WTTL. Last year the U.S. offered to cap domestic support at \$22 billion while the G-20 group of advanced developing countries demanded a cut to \$12 billion. Falconer has suggested a range of \$13 to \$19 billion. "So at least they're now speaking in the 17 range, which is what Lamy is saying: 17 to 13," the diplomat noted. But \$17 billion, the new U.S. offer "is now out," he added. "So it's 13 to 16. Now the only choices are 13, 14, 15 and 16, post-Potsdam."

In the NAMA talks, the disagreement over the co-efficient or discount that will be taken in tariff cuts is also narrowing, the official suggested. A year ago the spread was 15 to 35 for developing countries and 6 to 10 for developed nations. "Stephenson has not said it in so many words, but that's too big a gap," he said. "At least now you know that 30-35 is not even in the picture anymore, because the U.S. and EU will walk out on that," the diplomat opined. "15 is also out of the picture. At least we're down to – if you're the U.S. or EU – it's 18 to 29. If you're the U.S., it will say they rejected even 25, so they will say it's 18 to 24," he explained.

Speaking to reporters in Geneva, Brazilian Foreign Affairs Minister Celso Amorim claimed other negotiators were confused about the meaning of the co-efficients and "were never properly briefed by their negotiators [about] the difference between co-efficients and tariffs." In the NAMA talks, "I can tell you very directly, the difference of a co-efficient 30 and a co-efficient 20, for instance, for a product of the automobile industry in Brazil means the following: given the flexibilities, in one case it [the tariff] will fall from 35 to 25; in another case, it will come down from 35 to 23...Can you imagine that the round will break because it's falling to 25 and not to 23; not true; not credible," Amorim said.

BIS ISSUES FINAL AMENDED CHINA CATCH-ALL RULE

BIS is getting praised for the improvements it made in the final China catch-all rule published in the June 19 Federal Register, but many exporters still say the rule should never have been issued. "It's a vast improvement on the earlier rule, but it's still really a bad rule," said Ben Flowe, an attorney with the law firm of Berliner, Corcoran & Rowe. National Foreign Trade Council President Bill Reinsch, who is a former BIS under secretary, said the final order was a significant improvement over the proposal but "it is still defective because it is unilateral and because it will impose a significant liability and compliance burden on companies – far larger than BIS estimates – without an equivalent improvement in our security."

BIS officials, including Under Secretary Mario Mancuso, rolled out an orchestrated defense of the final rule in speeches, video conferences and webinars with industry following release of

the regulation over the June 16-17 weekend. Mancuso stressed the value of the new Validated End-User (VEU) mechanism, calling it the “most significant trade facilitation” rule ever issued by the agency (see **WTTL**, May 21, page 1).

The final rule reduced the number of Export Control Classification Numbers (ECCNs) that are subject to new military end uses controls for exports to China to 31 from 47. Dropped from the regulation are such key export categories as ECCN 3B991 for equipment used in manufacturing electronic equipment; ECCN 4E992 for technology associated with development and production of computers; ECCN 5B991 for telecommunications test equipment; ECCN 5A992 and ECCN 5D992 for information security equipment and software; and ECCN 9E990 for technology for the production and development of diesel engines.

BIS raised the control threshold for computers in ECCN 4A994 to 0.5 weighted teraFLOPS (WT) from the 0.1WT level in the proposal. It also raised the threshold for requiring an end-user statement from the Chinese government to \$50,000 from \$5,000 per each export. BIS also made it clear that employees of VEU-designated entities in China will be able to have access to the same technology covered by the VEU if they come to the U.S. without the need for a separate deemed export license. The final rule clarifies the meaning of “military end use” and adds new definitions for terms such as operation, installation and maintenance.

In an exclusive interview with **WTTL**, Mancuso said he expects the certification of the initial group of VEU entities to eliminate the need for 100 licenses annually. This would be about a 7% reduction from the 1500-plus China licenses BIS handled in fiscal 2006. These 100 or so licenses would reduce the value of exports subject to licenses by one-third, he claimed. By BIS calculations that would free more than \$100 million in exports from license requirements.

BIS officials also tried to draw a distinction between on-site visits that the agency will conduct of VEUs and post-shipment verifications or compliance visits. The on-site visit by BIS engineers and compliance officers are intended to check on recordkeeping and other requirements imposed by the VEU. But one BIS official conceded that those visits might uncover export violations unrelated to the VEU. “I don’t think they’ll go in with blinkers on,” one BISer told **WTTL**. “If they find violations, we’ll take that into account,” he said.

ITC HEARING ON KOREAN FTA SHOWS WEAK POINTS OF SUPPORTERS

The International Trade Commission’s (ITC) June 20 hearing on the economic impact of the proposed U.S.-Korea free trade agreement revealed one of the main problems supporters of the deal will face trying to win congressional approval of the accord. Witnesses in support of the agreement seemed to be wrapped up in the regulatory and bureaucratic changes the FTA will require Korea to make, primarily in the services sector, but found it hard to explain clearly the economic benefits those changes will make for the U.S. economy and workers.

Getting the right to comment on Korean insurance regulation doesn’t sound like a strong argument to make to auto workers in Detroit, steelworkers in Cleveland, semiconductor workers in Idaho or textile workers in North Carolina. The main witnesses supporting the deal were from the banking, finance, express delivery, insurance, services, pharmaceuticals, motions picture and information technology sectors, as well as pork producers. Witnesses against it included officials from Ford Motor Company, textile manufacturers, the United Auto Workers and Rep. Sander Levin (D-Mich.), chairman of the Ways and Means trade subcommittee.

Citigroup Senior VP Laura Lane, speaking for the U.S.-Korea FTA Business Coalition, noted that U.S. exports to Singapore grew 25% in the two years following its FTA with the U.S. and exports to Chile jumped 33%, 43% and 38%, respectively, in the three years after that pact was implemented. “We expect to see the similar growth and expansion of U.S. trade volume with Korea,” she said. Similar business growth was seen among express delivery services with new

FTA partners, testified T. James Min II, senior attorney with FedEx. Pork producers have already seen a sharp jump in exports to Korea due concessions won during the Uruguay Round. Pork exports to Korea have surged 2,217% since implementation of the Uruguay Round, testified Brian Buhr, an economist from the University of Minnesota who testified on behalf of the National Pork Producers Council. He cited a study suggesting the FTA would give the U.S. an advantage over its main competitors from Chile, Canada and Australia.

Criticism of the accord was voiced by Levin, who complained about tax and insurance barriers that will remain in place even after the deals goes into effect for U.S. autos. He was particularly critical of the auto “snapback” provision which would allow the U.S. to reimpose the 2.5% tariff on Korean cars if Seoul fails to open its auto market under the terms of the deal. “Incredulously [it] does not include the meaningful 25% pick-up truck tariff,” he said.

While General Motors has remained neutral in the debate over the Korean FTA because of its interest in Korean carmaker, Daewoo, Ford has come out strongly against it. Ford VP Stephen Biegun cited the failure of previous bilateral agreements with Seoul to open the Korean auto market to U.S. imports. “We are convinced that a traditional negotiating approach – that is to negotiate around the edges of current NTBs [nontariff barriers] – as was the case in 1995 and 1998 – will not have meaningful results for our industry,” he testified.

* * * BRIEFS * * * *

JUSTICE: Justice June 20 appointed Steven W. Pelak, 18-year veteran federal prosecutor, to serve as department’s first-ever National Export Control Coordinator. He will be detailed to counter-espionage section of Justice’s national security division. “Going forward, Mr. Pelak will also be responsible for ensuring full coordination between the Justice Department and the many other U.S. law enforcement, licensing and intelligence agencies that play a role in export enforcement,” Justice statement explained. “He will also solicit and receive regular progress reports from U.S. Attorneys’ offices on the development of export control cases,” it added.

ITAR: DDTC in June 7 Federal Register amended note in ITAR category VIII (e) to add “primary” to reference to commercial standby instrument systems to make it clear that category does not include commercial quartz rate sensors (QRS) used as primary controls on commercial aircraft. Control of these sensors apparently will be in limbo until BIS issues amendment to EAR to add them to CCL.

CUBA: Bipartisan group of lawmakers in Senate and House June 21 introduced legislation (S. 1673) to overturn 2005 Treasury policy requiring agriculture shipments to Cuba to be paid for before leaving U.S. ports. It also would lift travel restrictions and allow Cuban buyers to make payments directly to U.S. exporters without having to go through foreign banks.

CELLPHONES: ITC June 20 issued final Section 337 remedy order and limited exclusion order against Qualcomm for its infringement of Broadcom patents for chips for cellphones (see WTTL, June 11, page 1). On June 21 it denied Qualcomm motion for stay of order.

OFF-ROAD TIRES: Titan Tire Corp. and United Steel Workers, June 18 filed antidumping and countervailing duty complaints at ITC and ITA against off-the-road tires from China.

TIFAs: U.S. and Georgia June 20 signed Trade and Investment Framework Agreement (TIFA), which is often seen as precursor to FTA. U.S. and Vietnam June 21 also signed TIFA.

REWANDA: U.S. and Rwanda June 14 launched negotiations on Bilateral Investment Treaty

EXPORT ENFORCEMENT: BIS has imposed 10-year denial orders on Winter Aircraft Products, SA of Madrid, Spain, which is also known as Ruf S. Lopez, SA, plus its president, Jose Alberto Diaz, and principal, Rufina Sanchez Lopez, for alleged obtaining aircraft parts subject to ECCN 9A991 from U.S. and exporting them to Iran without approved export license.