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REPORT SHOWS THERMAL IMAGING INDUSTRY'S RELIANCE ON DEFENSE SALES

A draft Bureau of Industry and Security (BIS) report on the economic health of the U.S. thermal imaging and sensor industry reveals a sector that has developed major reliance on U.S. defense spending while its share of the global market for commercial equipment is shrinking due to U.S. export controls. A major shortcoming in the report was the lack of independent statistical data on domestic sales in foreign markets and the size of the global market. The report relies heavily on a survey of U.S. manufacturers conducted by the BIS Office of Strategic Industries and Economic Security (SIES) and thus includes much anecdotal evidence.

> The defense share of sales fluctuated around 70% from 2001 to 2005, settling at 70.2% in 2005. "The future of the financial performance for the imaging and sensors industry will depend primarily on U.S. Department of Defense appropriations and the needs of U.S. forces in Iraq and Afghanistan," the report declares.

Because of the strong defense orientation of the U.S. industry, export licensing through State's Directorate of Defense Trade Controls (DDTC) far exceeds licensing by BIS. In 2005, for example, the value of night vision products approved by DDTC was $560 million compared to $107 million for BIS. The largest markets for products subject to International Traffic in Arms Regulations (ITAR) licenses were Sweden, South Korea, Japan and Israel.

Although the value of U.S exports – based on industry figures -- increased 65.1% from 2001 to 2005, the report shows it was nearly flat from 2003 to 2005. The U.S. share of the global export market rose slightly to 10.8% from 10.4% from 2001 to 2005, but faster growth rates for other countries led to larger market shares for several nations, including Germany, the world's largest producer of thermal imaging products, whose share grew to 34.3% from 28.4%. The French market share grew to 6.2% from 4.0%, while China's share rose to 2.1% from 1.3%.

While defense sales dominate the industry, U.S. producers are losing their lead in the rapidly growing commercial market for uncooled focal plane arrays (FPAs) and amorphous silicon FPAs, the report reveals. "Before 1999, the United States was the only producer and exporter of uncooled FPAs," BIS reports. "Within the last four years, foreign producers of uncooled FPAs had taken approximately 22 percent of the market from U.S. producers," it reveals.

CANADIAN INDUSTRY AGREES TO ACCEPT SOFTWOOD LUMBER DEAL

In the end, it was all about money. Canadian lumber producers, facing serious economic troubles and not willing to wait another year to resolve the U.S.-Canada softwood lumber

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dispute, have decided to take some $4 billion in duty refunds and accept the bilateral deal signed by Washington and Ottawa July 1. Canadian Prime Minister Stephen Harper announced on Aug. 22 that he had "received a clear majority of support from companies in all regions" for the agreement, setting the stage for his government to take it the Canadian Parliament for approval in the fall (see **WTTL**, Aug. 21, page 2).

> Although the agreement won't be changed, Canadian sources say there may be an exchange of side letters to clarify or resolve some of the concerns raised by the Canadian industry. One change may require six months' advance notice before the termination of the agreement and a one-year standstill instead of the one month notice and one year standstill in the current deal. Other issues will be given to a binational technical working group to consider.

Although Canada recently won several key rulings from the Court of International Trade (CIT) and a World Trade Organization (WTO) panel, Canadian producers realized that it would take another year to resolve the dispute through litigation. But the main reason most of the industry decided to accept the deal was "financial pressure," one Canadian source said. "Many of these companies are in real trouble," he said. In some cases, creditors are waiting for the refunds. In others, the settlement will open the way for additional consolidation of the industry.

Another major factor, however, was the decision of the Canadian government to reach a deal with the U.S. and put pressure on its industry to accept its terms. "The Canadian government abandoned its industry," one critic of the deal said. "They wanted the deal," he added, noting that there was little the industry could do without the government's support. "No one gave his support with a light heart, but no one was in a financial position to oppose it," he said.

ITA AGAIN REJECTS REQUEST TO GIVE CHINA MARKET ECONOMY STATUS

China is making significant progress toward becoming a market-oriented economy, but it isn't there yet, the International Trade Administration (ITA) concluded in a formal rejection of another request from Beijing to have its status as a nonmarket economy (NME) ended. Along with a final dumping ruling issued Aug. 31 on <u>certain lined paper from China</u>, ITA released an 82-page memorandum explaining why China doesn't meet the six criteria set in U.S. law for determining when a communist country has shifted to market-oriented status.

> While China has made "significant and sustained economic reforms," ITA said it has concluded that "market forces in China are not yet sufficiently developed to permit the use of prices and costs in that country for purposes of the Department's dumping analysis." Beijing still maintains restrictions on interbank foreign exchange, favors certain export-oriented industries, has poorly defined property rights, allocates some resources in the financial sector, and bolsters state control in certain core or "pillar" industries, ITA concluded.

BIS ISSUES RULES ENDING LIBYA'S STATUS AS TERRORIST STATE

BIS in the Aug. 31 Federal Register finally amended the Export Administration Regulations (EAR) to drop all anti-terrorism (AT) restrictions on exports to Libya and to change its Country Group status to D:1 from E:1. Although President Bush formally notified Congress on May 15 of his decision to take Tripoli off the list of terrorist supporting countries, export licensing requirements remained unchanged awaiting BIS publication of this interim final revision of the EAR. The new rules became effective Aug. 31. State has still not revised the Libya provisions of the International Traffic in Arms Regulations (ITAR) (see **WTTL**, July 21, page 4).

As a D:1 designated country, Libya will face similar licensing requirements for National Security (NS) items as nations such as China, Russia and Vietnam. Libya remains designated under Country Group headings D:2, D:3 and D:4. "This action is the latest in a series of steps taken by the U.S. government to reflect the improvement in the bilateral relationship since Libya's announcement in December 2003 that it was renouncing terrorism and giving up its weapons of mass destruction programs," BIS said. Libya remains subject to licensing requirements imposed under various multilateral export control regimes, and all exports, even those EAR99 items not requiring licenses, may need a license if the exporter knows it is going to an end-user or end-use subject to restrictions.

> BIS has also eliminated License Exception USPL which was created to allow AT exports to U.S. persons in Libya while Washington was deciding on Tripoli's final fate. "With the lifting of AT controls on Libya, this License Exception has been rendered irrelevant," BIS said.

The agency reminded exporters that previously issued disclosure rules regarding the discovery of items that might have been exported to Libya while the country was subject to the U.S. embargo are still in force. "The installed based provisions, as set forth in section 764.7, continue in effect," it said. In the section-by-section revisions to the EAR, BIS has placed Libya in Tier 3 for computer controls. It has also made it eligible for most license exceptions and comprehensive special licenses. The new rules revise the *de minimis* restrictions on Libya, raising the *de minimis* level to 25% from 10%.

REVISIONS TO EAR SHIFT EXPORT RESTRICTIONS ON IRAQ

In the same Federal Register notice revising EAR controls on Libya, BIS also changed the regulations to reflect the fact that Iraq was taken off the list of state sponsors of terrorism in 2004. The new rules lift anti-terrorism (AT) controls on Iraq for eight Export Control Classification Numbers (ECCNs) for which the agency had required licenses for exports or retransfers in Iraq. These items, however, will remain subject to licensing requirements for Regional Stability (RS) reasons, BIS stated. The eight ECCN subject to this game of musical chairs are: 0B999, 0D999, 1B999, 1C992, 1C995, 1C997, 1C999 and 6A992.

> "BIS has retained a licensing requirement for these items for RS reasons to reflect the U.S. government's position that they could contribute to military capabilities within Iraq and in the region in a manner destabilizing to the region and contrary to the foreign policy interests of the United States," the agency said.

BRAZIL UPS ANTE ON COTTON DISPUTE TO PRESSURE U.S. IN DOHA ROUND

The U.S. isn't the only WTO member looking for pressure points on other countries to encourage the restarting of Doha Round talks. While the U.S. has raised the specter of ending or limiting the benefits of the Generalized System of Preferences (GSP) for some advanced developing countries, Brazil has reacted with a renewed challenge of U.S. cotton subsidies. The U.S. Sept. 1 temporarily blocked a Brazilian request to the WTO Dispute Settlement Body (DSB) to form a new panel to review whether the U.S. has come into compliance with a March 2005 WTO ruling that Washington's support programs for U.S. cotton growers constituted an illegal export subsidy. The case, however, will be back on the DSB agenda in the fall.

> In an Aug. 21 request to the DSB, Brazil asked for the formation of an Article 21.5 panel to review U.S. compliance with the WTO ruling. Congress has repealed one of the illegal measures, the Step 2 export subsidy program, and the Agriculture Department has stopped taking applications for export credit guarantees (ECG) under three General Sales Manager (GSM) programs.

Nonetheless, Brazil contends that past benefits of those programs continue to suppress world prices for upland cotton and increase the U.S. world market share. In addition, it says the U.S. hasn't eliminated other support programs found illegal by the WTO ruling, including those aiding exports of rice, pig meat and poultry. "Brazil believes that measures taken by the

United States to comply with the recommendations and rulings of the DSB in some respects do not exist, and, to the extent they do exist, are not consistent with the Agreement on Agriculture and the SCM [subsidies and countervailing measures] Agreement," Brazil said in its request.

SCHWAB URGES CHINA TO HELP GET DOHA TALKS RESTARTED

U.S. Trade Representative (USTR) Susan Schwab, during talks with Chinese officials in Beijing Aug. 28, urged China to help get the WTO Doha Round restarted and successfully concluded, but she also warned that China could become the target of more trade litigation and restrictive legislation if the talks fail. "It is my strong hope that China will carry out a clear-eyed assessment of the costs and benefits of a successful Doha Round and conclude that it is in China's long-term self-interest to play an active role in ensuring the round's ultimate success," she said in her prepared remarks to the American Chamber of Commerce the next day.

> "If the Doha Round is unsuccessful, it will be tempting for countries to rely on litigation rather than negotiations to achieve new market opportunities," she said. "In such a scenario, China's commerce could be particularly vulnerable to legal challenge over its compliance with global trade rules," Schwab not so subtly threatened. "There are dozens of bills in the U.S. Congress proposed by members who want us to 'get tough' or 'stand up to China'," she also warned.

The Chinese didn't seem to accept her invitation or warning. After her meeting with Chinese Minister of Commerce Bo Xilai, his office issued a statement saying Bo had said China "was willing to cooperate with all members to keep a constructive attitude to participate in negotiations, and actively push forward the resumption of Doha negotiations." The statement, however, added: "On the other hand, he hoped developed members take the lead and make an essential contribution to the negotiation resumption as soon as possible."

U.S. TAKES STEP TOWARD TRADE PACT WITH SOUTHEAST ASIAN NATIONS

If the U.S. decides to seek another regional free trade agreement, it may choose the 10-member Association of Southeast Asian Nations (ASEAN). On her swing through Asia, USTR Susan Schwab Aug. 25 signed a Trade and Investment Framework Agreement (TIFA) with ASEAN. A TIFA is often seen as the precursor to the opening of FTA talks with a country. The U.S. already has an FTA with one ASEAN member, Singapore, and is negotiating pacts with Malaysia and Thailand. "The U.S.-ASEAN TIFA signed today reflects our commitment to establishing the architecture that will facilitate an even more vigorous U.S. economic engagement in the ASEAN region," Schwab said (see **WTTL**, Aug. 21, page 4).

> In addition to the TIFA, the U.S. and ASEAN agreed to begin work on a plan to create a common system throughout ASEAN for entry of goods, establish a framework agreement on sanitary and phytosanitary issues, and support the development of harmonized standards for pharmaceutical registration and approval.

* * * BRIEFS * * *

PHILIPPINES: USTR Susan Schwab and Philippines Secretary of Trade and Industry Peter Favila Aug. 23 signed Memorandum of Understanding (MOU) to cooperate on stopping illegal transshipments of textiles and apparel through the Philippines to U.S. MOU provides for customs cooperation, identification of actual textiles and apparel manufacturers, and joint verification visits.

NEW SHIPPERS: Customs issued notice to port directors Aug. 18 to implement provisions of Pension Protection Act, which requires cash deposits from new shippers under review for antidumping or CVD duties in lieu of bond or security (see **WTTL**, Aug. 7, page 4).

COLOMBIA: President Bush Aug. 24 notified Congress of his intent to sign U.S.-Colombia FTA after 90 days. USTR's office Aug. 28 asked ITC to conduct economic impact study of pact.