SUBSIDIES ENFORCEMENT
ANNUAL REPORT TO THE CONGRESS

Joint Report of the
Office of the United States Trade Representative
and the U.S. Department of Commerce
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EXECUTIVE SUMMARY

American workers and industries continue to face potential harm from foreign governments' use of market- and trade-distorting subsidies. The United States Government is committed to eliminating or neutralizing such practices when they adversely impact U.S. interests. Towards that end, in 2005, the Office of the U.S. Trade Representative (USTR) and the U.S. Department of Commerce (Commerce), working closely with other Executive Branch agencies, continued their close cooperation to monitor and challenge unfair foreign government subsidy practices by pursuing the United States' rights under the agreements of the World Trade Organization (WTO) and by ensuring that the United States' trading partners adhere to their obligations under those agreements. USTR and Commerce are responsible for submitting a joint report to the Congress describing the Administration's subsidy monitoring and enforcement activities throughout the previous year. This report, mandated by the section 281(f)(4) of the Uruguay Round Agreements Act, is the eleventh annual report submitted to the Congress.

The principal tool available to WTO Members to remedy harmful subsidy practices worldwide is the Agreement on Subsidies and Countervailing Measures (Subsidies Agreement, or Agreement), which establishes multilateral disciplines on subsidies. In the WTO, the Subsidies Committee serves as the primary forum regarding WTO Members' subsidy-related activities. The United States actively participates in the Subsidies Committee to ensure the continued effectiveness of the Subsidies Agreement. The United States seeks to deter or remedy harm caused to U.S. producers and workers from distortive subsidies through bilateral contacts, multilateral pressure and, where justified, WTO dispute settlement proceedings.

Another key and ongoing focus of the subsidies enforcement program is to address the root causes that give rise to unfair trade distortions. In this regard, the United States continued its efforts to strengthen and deepen existing multilateral disciplines on subsidies through the Doha Development Agenda negotiations. These efforts will help maintain and strengthen the open, competitive and market-oriented trading environment that provides benefits to American consumers, producers and workers alike.

Doha Development Agenda

In November 2001, a new round of global trade negotiations – known as the Doha Development Agenda (DDA) – was launched at the WTO's Fourth Ministerial Conference. In the Doha Ministerial Declaration, the United States secured a mandate to clarify and improve the disciplines under the Subsidies and Antidumping (AD) Agreements and address the trade-distorting practices that often give rise to the imposition of countervailing and antidumping duties. Importantly, the mandate recognizes that the negotiations must preserve the basic concepts, principles and effectiveness of the two Agreements and that Members' trade remedy laws are

legitimate tools for addressing unfair trade practices that cause injury.

In March of 2003, the United States submitted its principal subsidies paper to the Rules Negotiating Group (Rules Group) that outlined the basic parameters the United States will follow in seeking to strengthen the subsidy rules.[1] The United States called for enhanced subsidy disciplines and identified a broad array of issues with respect to the existing rules, as well as the need to develop new disciplines where none currently exist. The United States' negotiating position on subsidies addresses issues that relate to the negotiating objectives set forth in the Trade Act of 2002 (which encompasses Trade Promotion Authority), including the existing rules on the treatment of indirect taxes. In particular, the U.S. argued for the expansion of the prohibited ("red light") category of subsidies, and tougher rules on indirect subsidies, government investment in private sector companies, and government pricing of natural resources.

Beginning in 2004 and continuing into 2005, the United States made various submissions, specifically focusing on the further development of subsidy calculation methodologies so as to clarify the precise nature of Members' obligations under the Subsidies Agreement and to establish a firmer basis for strengthened rules (*e.g.,* quantitative limitations on subsidy benefit amounts). The U.S. submissions cover the related topics of when, and how, to allocate a subsidy benefit over time. The most recent submission proposed agreement on a single methodology or set of guidelines, to be employed by all Members and dispute settlement panels, for determining the appropriate allocation of subsidy benefits. The paper was subject to in-depth technical examination in the Rules Group and was well received by other WTO Members.

In January 2006, the United States submitted a follow-up proposal regarding prohibited subsidies. Noting that serious market and trade distortions can result from particular types of subsidies other than those currently prohibited by the Subsidies Agreement (*i.e.,* export subsidies and import-substitution subsidies), the United States called upon Members to consider expanding the current prohibition to encompass other subsidies that most typically and directly forestall or impede industry restructuring and rationalization. Among these, the United States suggested consideration of subsidies practices similar to those listed in the now-lapsed "dark amber" provisions of the Subsidies Agreement (*e.g.,* government debt forgiveness) and other forms of egregious government intervention. In addition to proposing the expansion of the prohibited category, the proposal also lays out a bold new approach to address the United States' increasing concerns with foreign state-owned and state-controlled enterprises. The paper asserts that private sector government investment decisions that run counter to the market's assessment should be made transparent, closely scrutinized and, as appropriate, curtailed. Accordingly, *inter alia*, the paper proposes that WTO Members

[1] See, TN/RL/W/78. (This document and other WTO public documents are available on the WTO website at http://docsonline.wto.org.)

be required to notify the WTO Subsidies Committee of any government equity investment.

The U.S. submission is one of the most far-reaching subsidy-related proposals tabled to date in the Rules negotiations, reinforcing the United States' leadership role in pursuing strong subsidies disciplines in the WTO. The strengthened disciplines proposed would greatly enhance the United States' ability to address, and potentially deter, subsidy-related unfair trade practices confronting U.S. industries. Australia, Canada, Brazil and the European Union also made important proposals to clarify and improve the Subsidies Agreement in 2005.

As to the fisheries subsidies negotiations within the Rules Group, the United States continued to play a major leadership role in advancing the discussion in 2005, working closely with a broad coalition of developed and developing countries.[2] The United States views these negotiations as a groundbreaking opportunity for the WTO to show that trade liberalization can benefit the environment and contribute to sustainable development as well as address traditional trade concerns. In the Rules Group, there continues to be a discussion of possible frameworks for improved disciplines. The United States and other proponents of stronger disciplines have been advocating a framework that would center on a broad-based prohibition, combined with appropriate exceptions (generally referred to as the "top down" approach). Negotiators also examined particular categories of fisheries programs and how they might be treated under new disciplines. In this context, the United States submitted a paper on programs for reducing fishing capacity (generally known as buyback programs), drawing upon recent U.S. experience with such programs. Significantly, Brazil introduced a comprehensive proposal essentially premised on a broad prohibition of fisheries subsidies, detailing, in particular, ideas for addressing developing country interests. At the Hong Kong Ministerial Conference in 2005, the United States participated in a high-level environmental event on fisheries subsidies organized by the United Nations Environmental Program and the World Wildlife Fund, which highlighted the importance of the issue and substantially raise its visibility.[3]

At Hong Kong, Ministers directed the Rules Group to intensify and accelerate the negotiating process in all areas of its mandate, on the basis of detailed textual proposals, and to complete the process of analyzing proposals as soon as possible.

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[2] The informal group of countries supporting stronger disciplines on fisheries subsidies, known as the "Friends of Fish," includes the United States, Argentina, Australia, Chile, Ecuador, Iceland, New Zealand and Peru.

[3] See USTR Press Release, December 14, 2005, *U.S. Welcomes Environmental NGO Support of Stronger WTO Rules on Fisheries Subsidies*; (http://www.ustr.gov/Document_Library/Press_Releases/2005/Section_Index.html).

Ministers also mandated the Rules Chairman to prepare consolidated texts of the Antidumping and Subsidies Agreements early enough to assure a timely outcome within the context of the 2006 end date for the Doha Agenda negotiations but also taking into account progress in other areas of the negotiations beyond WTO Rules. These consolidated texts will be the basis for final negotiations.

Steel

Although the global steel industry maintained relatively good health in 2005, the industry tends to be heavily influenced by the business cycle. A major contributor to this cycle, among others, continues to be the frequency and magnitude of inappropriate government intervention and the distorting impact that such intervention has on business planning and international trade. The Administration remains committed to the goals of the President's Initiative on Steel, implemented in 2001, to seek more lasting solutions to the industry's long-term, structural problems and to bring an end to the decades-long, cyclical proliferation of oversupply, unfair trade competition and trade remedy responses in the sector. Accordingly, since the last report, the United States has continued to spearhead efforts globally (*e.g.*, through the Organization for Economic Cooperation and Development) and regionally (*e.g.*, through the North American Steel Trade Committee) among the major steel-producing countries to bring about market-driven rationalization of the world's excess, inefficient steelmaking capacity, while also formulating better disciplines over practices that can distort markets and trade.

China

China's fourth year of membership in the WTO concluded in 2005 and with it the fourth examination of China's implementation of its accession commitments under the Transitional Review Mechanism (TRM). Reviews are conducted in a number of WTO Councils and Committees. The fourth annual review in the Subsidies Committee took place in November and focused heavily on China's continued failure to notify required information about its subsidies, which has stymied U.S. and other WTO Members' efforts to conduct a meaningful review of China's subsidy practices. The United States increased pressure on China for greater transparency in its subsidy regime, insisting that its government address U.S. concerns over a wide variety of specific subsidy programs. In both the United States' 2005 TRM submission and the United States' still outstanding submission made pursuant to Article 25.8 of the Subsidies Agreement, the United States requested detailed information concerning China's export subsidies; industrial policies that are targeted at specific industries and which rely on subsidies; ongoing reforms to China's heavily state-run banking sector and the role that these banks play in supporting unviable enterprises; the role of the central government in China's state-owned enterprises; and China's continued use of price controls. The United States also joined with the governments of Canada and Mexico to highlight concerns regarding China's steel development policy announced in July. As a result of

China's continued failure to provide information regarding its subsidy programs, and the rapidly growing public concern about the potential impact of China's subsidy practices, the United States has stepped up its surveillance of China's government practices in order to better identify and, as appropriate, respond to possible subsidy problems. This increased surveillance enhances the United States' ability to engage China regarding its subsidies practices and, potentially, confront those that are most egregious.

On a broader scale, the United States has been examining structural problems and distortions in China's economy in the Structural Issues Working Group (SIWG) established under the U.S.-China Joint Commission on Commerce and Trade (JCCT) in April of 2004. The United States made it a priority to directly address subsidies in the SIWG and obtained Chinese government agreement to do so during the July 2005 JCCT meeting. This is an area in which considerable time and resources will continue to be devoted in 2006.

Finally, in the past year, increasing attention has been given to the question of whether the countervailing duty (CVD) law would be applied to non-market economies (NMEs). In this regard, several pieces of legislation were introduced in the U.S. Congress, while the Government Accountability Office published a report discussing the legal, policy and methodological challenges that might arise in connection with the application of the CVD law to NME countries. At the same time, the Commerce Department has been reviewing and commenting on these developments, and has also begun an internal review of methodological and measurement issues regarding the potential application of the CVD law to NMEs.

Conclusion

The U.S. Government's subsidies enforcement program is committed to assisting American workers and companies that are threatened or harmed by distortive subsidy practices, both domestically and in foreign markets. Therefore, USTR and Commerce will continue to identify and challenge those unfair foreign government practices that adversely affect the interests of the United States, whether through advocacy, negotiation or legal action. During 2005, USTR and Commerce strengthened the subsidies enforcement program's monitoring, counseling and advocacy activities, and will work with other Executive Branch Agencies to further enhance them in 2006. These activities are primarily designed to help those U.S. parties that face particular problems from subsidized competition without imposing additional costs and obstacles to international commerce and investment. As such, the United States' preference is to resolve these issues through advocacy, negotiation or bilateral or multilateral contacts. However, the United States will not refrain from initiating WTO dispute settlement proceedings if its interests cannot be adequately addressed through advocacy and negotiation. The United States' fundamental aim in these activities remains to ensure that U.S. consumers benefit from the full range of choice, quality and affordable prices that can only be obtained through engagement in a

global economy that is competitive, market-oriented and free of distortions brought on by unfair practices such as subsidies.

INTRODUCTION

The Subsidies Agreement establishes multilateral disciplines on subsidies and provides mechanisms for challenging government programs that violate these disciplines. These disciplines are enforceable through binding dispute settlement, which specifies strict time lines for bringing an offending practice into conformity with the pertinent obligation. The remedies in such circumstances can include the withdrawal or modification of a subsidy program, or the elimination of the subsidy's adverse effects. In addition, the Subsidies Agreement sets forth rules and procedures to govern the application of countervailing duty (CVD) measures by WTO Members with respect to injurious, subsidized imports.

The Subsidies Agreement nominally divides subsidy practices among three classes: prohibited (red light) subsidies; permitted yet actionable (yellow light) subsidies; and permitted, non-actionable (green light) subsidies.[4] Export subsidies and import substitution subsidies are prohibited. All other subsidies are permitted, but are actionable (through CVD or dispute settlement action) if they are (I) "specific", *i.e.*, limited to a firm, industry or group thereof within the territory of a WTO Member and (ii) found to cause adverse trade effects, such as material injury to a domestic industry or serious prejudice to the trade interests of another WTO Member. With the expiration of the Agreement's provisions on green light subsidies, at present, the only non-actionable subsidies are those which are not specific, as defined above.

U.S. trade policy responses to the problems associated with foreign subsidized competition provide USTR and Commerce with both unique and complementary roles. In general, it is USTR's role to coordinate the development and implementation of overall U.S. trade policy with respect to subsidy matters, represent the United States in the World Trade Organization (WTO), including its Subsidies Committee, and chair the interagency process on matters of trade policy. The role of Commerce, through Import Administration (IA), is to enforce the CVD law, monitor the subsidy practices of other countries, and provide the technical expertise needed to analyze and understand the impact of foreign subsidies on U.S. commerce. IA will also provide assistance and

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[4] Prior to 2000, Article 8 of the Agreement provided that certain limited kinds of government assistance granted for industrial research and development (R&D), regional development, or environmental compliance purposes would be treated as non-actionable subsidies. In addition, Article 6.1 of the Agreement provided that certain other subsidies (*e.g.,* subsidies to cover a firm's operating losses), referred to as dark amber subsidies, could be presumed to cause serious prejudice. If such subsidies were challenged on the basis of these dark amber provisions in a WTO dispute settlement proceeding, the subsidizing government would have the burden of showing that serious prejudice had *not* resulted from the subsidy. However, as explained in the 1999 Annual Subsidies Report, these provisions expired on January 1, 2000, because a consensus could not be reached among WTO Members on whether to extend these provisions, or on the terms by which these provisions might be extended beyond their five-year period of provisional application.

advice to interested U.S. parties concerning the remedies available under the Subsidies Agreement and the procedures relating to these remedies and, where warranted, recommend action to USTR.

Within IA, subsidy monitoring and enforcement activities are carried out by the Subsidies Enforcement Office (SEO). These activities are also supported and complemented by the Trade Remedy Compliance Staff (TRCS), also located in IA. (See, Attachments 1 and 2, which contain full descriptions of the SEO and TRCS.) IA continues to build upon and improve coordination of these different efforts to pro-actively address foreign unfair trade practices. In 2004, IA created the Unfair Trade Practices Task Force, as called for by the Congress and in the U.S. Department of Commerce Report, "Manufacturing in America: A Comprehensive Strategy to Address the Challenge in U.S. Manufacturing" (January 2004). This task force, which became fully operational in 2005, has further enhanced Commerce's ability to aggressively track foreign unfair trade practices and develop strategies to address them. USTR and Commerce also work closely with, and receive valuable input and advice from, other federal agencies represented in the Trade Policy Staff Committee – such as the Departments of State, Treasury and Agriculture, and Council of Economic Advisors – concerning the full range of issues pertaining to the obligations of the United States' trading partners under the Subsidies Agreement.

The enactment of the Uruguay Round Agreements Act (URAA) in 1994 provided USTR and Commerce additional scope and focus in order to facilitate the exercise of U.S. multilateral rights with respect to subsidies that harm the interests of U.S. firms and workers. Among the joint responsibilities assigned to USTR and Commerce, as set forth in section 281(f)(4) of the URAA, is the submission of an annual report to the Congress describing the Administration's monitoring and enforcement activities throughout the previous year. This report constitutes the eleventh annual report to be transmitted to the Congress pursuant to this provision.

MULTILATERAL INITIATIVES

A. WTO NEGOTIATIONS

In November 2001, a new round of global trade negotiations – known as the Doha Development Agenda (DDA) – was launched at the WTO's Fourth Ministerial Conference. In the Doha Ministerial declaration, the United States secured a mandate to clarify and improve the disciplines under the Subsidies and Antidumping (AD) Agreements and to address the trade-distorting practices that often give rise to the imposition of countervailing and antidumping duties. Critically, the mandate recognizes that the negotiations must preserve the basic concepts, principles and effectiveness of the two Agreements and that Members' trade remedy laws are legitimate tools for addressing unfair trade practices that cause injury. Under this mandate, the United States has continued to pursue an aggressive, affirmative agenda, aimed at strengthening the rules and addressing the underlying causes of unfair trade practices.

The existing WTO disciplines on subsidies prohibit only two types of subsidies. However, other permitted subsidies also distort markets and international trade patterns. The specific language of the mandate agreed to at the Fourth Ministerial Conference is particularly important because it provides an avenue to address these other practices and to inform the discussions of trade remedies in a constructive manner. Moreover, it provides an avenue to take up the negotiating objectives of the Trade Act of 2002 and other subsidy concerns that affect key sectors of the U.S. economy.

The negotiating mandate has also permitted the United States to include, in its affirmative agenda, proposals that will protect the legitimate interests of U.S. exporters, who are often subject to trade remedy cases abroad. As discussed below, the United States has continued to submit increasingly detailed submissions in the Rules Group for clarifying, improving and strengthening the rules on trade remedy procedures to ensure that the practices of other countries are as transparent and fair as those of the United States. The United States' aim in this regard is to ensure that U.S. exporters can compete abroad with the assurance that they will not be denied fundamental procedural due process.

Another important component of the DDA is the discussion of disciplines on fisheries subsidies, which is included as part of the Rules negotiations. The United States has believed for some time that the depleted state of the world's fisheries stock is a major economic and environmental concern, and that subsidies that contribute to overcapacity and overfishing, or that have other trade-distorting effects, are a significant part of the problem. The inclusion of fisheries subsidies in the Rules negotiations represents a significant opportunity for all countries to advance simultaneously the goals of trade liberalization, environmental protection, and economic development.

1. Progress to Date

a. General

The Rules Group has based its work primarily on the written submissions from Members, with the work organized into the following categories: (1) antidumping (often including similar issues relating to countervailing duty remedies); (2) subsidies, including fisheries subsidies; and (3) regional trade agreements. Under the chairmanship of Ambassador Guillermo Valles Galmes of Uruguay, there were seven meetings in 2005 of the Rules Group to discuss the first two issues. Continuing the trend from the earlier year, during, 2005 the Group met only infrequently in "formal" sessions, preferring "informal" sessions that facilitate more detailed discussion in an effort to eventually winnow the considerable number of existing proposals to a more realistic list of topics for focused negotiation.

Towards this end, the Chair took several steps to facilitate the discussion. For example, in April, the Chairman began "plurilateral consultations" with a group of key WTO Members in order to conduct probing reviews of the technical feasibility of certain proposals previously discussed in the broader negotiating group. In September, in an effort to focus the examination further and make the plurilateral process "more concrete," the Chairman began to ask certain individuals to become "Friends of the Chair" to lead or facilitate the discussion of certain issues. Such "Friends" have generally been selected from among those Members that have been active users of trade remedies, including the United States (*e.g.*, a member of the U.S. delegation served as a "Friend" in a plurilateral discussion of various transparency proposals).

As to the negotiating agenda of the United States, consistent with the Doha mandate that the basic concepts and principles underlying the AD and Subsidies Agreements must be preserved, the United States outlined four principles in a 2002 submission that continued to guide U.S. proposals submitted in the past year.

- First, the negotiations must maintain the strength and effectiveness of the trade remedy laws and complement a fully effective dispute settlement system that enjoys the confidence of all Members;

- Second, trade remedy laws must operate in an open and transparent manner, which is fundamental to the rules-based trading system as a whole;

- Third, disciplines must be enhanced to address more effectively underlying trade-distorting practices; and

- Fourth, it is essential that dispute settlement panels and the Appellate Body, in interpreting obligations related to trade remedy laws, follow the appropriate standard of review and not impose on Members obligations that are not contained in the Agreements.

Consistent with these principles, the United States has remained active in the Rules Group discussions by identifying specific issues for consideration, following up with "elaborated proposals," and raising detailed questions concerning the issues raised by other Members. Pursuant to the first principle, the United States has continued to emphasize that the Doha mandate to preserve the effectiveness of the trade remedy rules must be strictly adhered to in evaluating proposals for changes to the AD or Subsidies Agreements, and has raised a number of questions to evaluate whether issues raised by other Members are consistent with that mandate. In 2005, the United States submitted elaborated proposals on: (1) the problem of the circumvention of antidumping and countervailing duty measures; (2) preventing abuse of provisions for "new shipper" reviews; and (3) the injury causation standard in antidumping and countervailing duty investigations. The United States has also highlighted the need for the unique characteristics of perishable and seasonal agricultural products to be reflected in the trade remedy rules.

As to the second principle, the United States has identified a number of areas in which investigatory procedures in antidumping and countervailing duty investigations could be improved, highlighting ones in which interested parties and the public could benefit from greater openness and transparency, as well as some where improved procedures could reduce costs. In this regard, in 2005, the United States submitted elaborated proposals advocating: (1) the disclosure by investigating authorities to the general public of non-confidential information from antidumping and countervailing duty proceedings; and (2) that investigating authorities take appropriate steps for the proper identification of parties in antidumping and countervailing duty proceedings. Implementation of these and earlier proposals will promote increased due process and transparency, thereby bringing others up to U.S. standards and ensuring that U.S. exporters subject to foreign trade remedy proceedings are treated fairly.

Regarding the third principle, the United States has stressed the need to address trade-distorting practices that are often the root causes of unfair trade, and has made a number of submissions to the Rules Group with respect to the strengthening of subsidies disciplines, including the expansion of the prohibited category of subsidies, as discussed further below.

With respect to the fourth principle, the United States has emphasized in its submissions the importance of ensuring that WTO panels and the Appellate Body adhere to the special standard of review in the AD Agreement, and the need to address several issues raised by certain past findings of the WTO Appellate Body in trade remedy cases.

In the weeks prior to the Hong Kong Ministerial Conference of December 13-18, 2005, Rules Group Chairman Valles initiated an open, consultative process among WTO Members with the goal of achieving a rough consensus on what further negotiating guidance to seek from Ministers. In the final Ministerial Declaration, Ministers directed the Rules Group to intensify and accelerate the negotiating process in all areas of its mandate, on the basis of detailed textual proposals presently before the Group, or yet to be submitted, and to complete the process of analyzing proposals as soon as possible. Ministers also mandated the Rules Chairman to prepare consolidated texts of the Antidumping and Subsidies Agreements early enough to assure a timely outcome within the context of the 2006 end date for the Doha Agenda negotiations and taking account of progress in other areas of the negotiations. These consolidated texts will be the basis for final negotiations.

b. U.S. Subsidies-Specific Submissions

In addition to the issues described in the previous section, the United States has been active in the subsidies-specific dimension of the work of the Rules Group, starting with a U.S. submission in December 2002 on special and differential treatment for

developing countries.[5] The purpose of the paper was to: (1) review the generally accepted view regarding the trade-distorting nature of subsidies; (2) outline the perspective of the United States on the issue of special and differential treatment; and (3) highlight the substantial and existing special and differential provisions of the Subsidies Agreement, as well as the significant practical implementation problems that had been addressed at the Fourth Ministerial Conference at Doha.

In March 2003, the United States submitted its second subsidies-specific paper on the general need for improved disciplines.[6] In this paper, the United States identified a broad array of subsidy issues with respect to the existing rules, and suggested areas for new disciplines where none currently exist. The U.S. position on subsidies is firmly grounded in the negotiating objectives of the Trade Act of 2002, including addressing certain aspects of the existing rules on the treatment of direct and indirect taxes. As noted above, the development of enhanced disciplines on trade-distorting practices, including subsidies, is particularly important because these practices are often the root cause of trade friction.[7]

In 2004 and 2005, the United States made four additional submissions, specifically focusing on the further development of subsidy calculation methodologies. While the Uruguay Round negotiations were successful in defining broad methodological concepts in the Subsidies Agreement regarding the measurement of various types of subsidies, the United States believes that greater detail is needed in certain areas so as to clarify the precise nature of Members' obligations under the Subsidies Agreement and to establish a firmer basis for strengthened rules (*e.g.,* quantitative limitations on subsidy benefit amounts). The issues covered in the submissions were: (1) when to allocate a subsidy over time; (2) how to allocate a subsidy over time; and (3) when allocating a subsidy over time, how to determine the length of time over which the allocation should occur.

The first topic addresses the question of which subsidies should be allocated over time (*i.e.,* over more than one year) and which should be "expensed" (*i.e.*, allocated in their entirety to a single year). In its submission on this issue the United States describes its approach in countervailing duty investigations for distinguishing

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[5] See, TN/RL/W/33. (This document and other WTO public documents are available on the WTO website at http://docsonline.wto.org.)

[6] See, TN/RL/W/78.

[7] Specifically, the U.S. March 2003 paper covered ten general topics: (1) expansion of the prohibited category of subsidies; (2) the "serious prejudice" provisions of the Subsidies Agreement; (3) indirect subsidies; (4) natural resource and energy pricing; (5) the provision of equity capital; (6) taxation; (7) royalty-based financing; (8) codification of analytical and calculation methodologies; (9) procedural issues; and (10) subsidy notifications.

between subsidies that should be allocated over time versus subsidies that should be expensed.

Once it is determined that a subsidy benefit should be allocated over time, the next question is how to do so. While it is recognized in the Subsidies Agreement that certain subsidy benefits should be allocated over time, the Subsidy Agreement provides no rules as to how the allocation should be done. The U.S. paper examines the technical questions that need to be addressed when allocating a subsidy benefit over time, and, most importantly, argues that any methodology must recognize the "time value of money" (*e.g.,* allocated subsidy benefits must reflect constant, rather than nominal values).

A subsidiary question is the appropriate length of time over which to allocate the benefit. The Subsidies Agreement is silent as to the appropriate length of the period. The U.S. paper generally advocates relying on the average useful life of assets in the industry of the subsidy recipient when allocating a subsidy benefit over time.

In its fourth and last paper to date on subsidy allocation, the United States reiterated and further elaborated upon the points in the previous three submissions.[8] The paper then suggested that the goal of the Rules Group with regard to this issue should be to reach a consensus on a single methodology or set of guidelines, to be employed by all Members and dispute settlement panels, for determining when and how subsidy benefits should be expensed or allocated. The proposal calls for new rules that would recognize the following general principles:

- "Recurring" subsidies (*e.g.*, those that are not exceptional, or linked to the capital assets or capital structure of the recipient firm) only provide a benefit in the year of receipt. "Non-recurring" subsidies provide a benefit throughout the allocation period.

- The allocation period for non-recurring subsidies should normally be based on the average useful life of depreciable, physical assets for the relevant industry or firm.

- Any method for allocating subsidy benefits over time must reflect the time value of money.

- Members should be required to notify the particular subsidy allocation methodology they follow in countervailing duty proceedings and explain the rationale for any deviation from that methodology in individual cases.

Finally, an additional, practical question is how (and where) any such new rules or guidelines would be incorporated into the Subsidies Agreement. Although one logical place in which to add such rules is Article 14 (which provides guidelines for

[8] See, TN/RL/Gen/45, June 3, 2005.

calculating the subsidy benefit to the recipient), that Article only pertains to countervailing duty remedies. Recalling that several WTO dispute settlement reports have applied the principles of Article 14 to dispute settlement proceedings under Parts II and III of the Subsidies Agreement,[9] the U.S. paper opines that much, if not all, of Article 14 is also relevant to Parts II and III of the Subsidies Agreement (while recognizing that this is an issue worthy of further deliberation and discussion).

This last subsidy allocation paper was discussed in a Rules plurilateral session in July 2005, where it was generally well received. Most interested Members appear to appreciate that the U.S. papers on these topics raise the next set of questions that must be answered to continue the historical development of a general set of subsidy benefit calculation rules. Such rules are commonly viewed as critical to strengthening and increasing the predictability of the subsidy disciplines of the Subsidies Agreement.

In January 2006, the United States submitted a more detailed paper on prohibited subsidies. Noting that serious market and trade distortions can result from subsidies other than those currently prohibited by the Subsidies Agreement (*i.e.,* export subsidies and import-substitution subsidies), the United States called upon Members to consider expanding the current prohibition to encompass other subsidies that most typically and directly forestall or impede industry restructuring and rationalization, and which often result in inefficient excess capacity. Among these, the United States suggested considering practices similar to those listed in the now-lapsed "dark amber" provisions of Article 6.1 of the Subsidies Agreement as the "first candidates" for inclusion in an expanded prohibited category of subsidies. Other possible additional candidates named in the U.S. proposal include government funding of companies in very poor financial health unable to obtain commercial financing.

In addition to proposing the expansion of the prohibited category, the paper also lays out a bold new proposal to address increasing concerns with foreign state-owned and state-controlled enterprises. Questioning the justification for any government investment in the private sector in countries with well-developed capital markets, the paper states that government investment decisions that run counter to the private sector's assessment that a company is not likely to generate a market return should be made in a transparent fashion, closely scrutinized and, as appropriate, curtailed. Accordingly, the paper proposes that there be a requirement that Members notify the WTO Subsidies Committee of government equity investment, including debt-to-equity conversions. Such notifications should describe: (1) the terms of the transaction; (2) how such an investment is consistent with the usual practice of private investors; and (3) potential adverse trade effects. Moreover, additional transparency measures should be considered for all government-controlled companies as well, such that Members can be assured of a consistently commercial, arm's-length relationship between the government-owner and the state-owned enterprise.

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[9] *See*, *e.g.*, Appellate Body Report, *Canada - Measures Affecting the Export of Civilian Aircraft*, WT/DS70/AB/R; Panel Report, *Korea - Measures Affecting Trade in Commercial Vessels*, WT/DS273/R, para. 7.420.

The potential importance of this recent paper is considerable. It is one of the most far-reaching subsidy-related proposals tabled to date in the Rules negotiations, reinforcing the United States' leadership role in pursuing strong subsidies disciplines under the WTO. The proposed strengthened disciplines would greatly enhance the United States' ability to address, and potentially deter, subsidy-related unfair trade practices confronting U.S. industries.

In 2006, the United States will continue to pursue an aggressive negotiating strategy on subsidy issues in the Rules Group. In keeping with this strategy, the United States looks forward to introducing additional submissions – increasingly focusing on text-based proposals – to strengthen the disciplines set forth in the Subsidies Agreement.

c. Subsidies-Specific Submissions of Other Members

Australia, Canada, Brazil and the European Union (EU) also made important proposals concerning subsidy-related issues last year listed in the chart below.

Australia	• Prohibited Export Subsidies (TN/RL/GEN/34) • Withdrawal of a Subsidy (TN/RL/GEN/35) • Prohibited Export Subsidies (TN/RL/GEN/80)
Brazil	• Treatment of Government Support for Export Credits and Guarantees under the Agreement on Subsidies and Countervailing Measures (TN/RL/GEN/66) • Serious Prejudice (TN/RL/GEN/81) • De Facto Export Contingency (TN/RL/GEN/88)
Canada	• Benefit Pass-Through (TN/RL/GEN/86)
European Union	• Countervailing Measures (TN/RL/GEN/93)

Australia's two proposals sought to clarify the definition of a *de facto* export subsidy. As a WTO Member with a small domestic economy, but with a considerable export presence, Australia is concerned that subsidies it provides to its export-oriented industries will be more likely to be found to be contingent in fact on export performance and, therefore, prohibited rather than merely actionable. The Subsidies Agreement currently says relatively little about what constitutes export contingency, other than noting that "the mere fact that a subsidy is granted to enterprises which export shall not for that reason alone be considered to be an export subsidy". However, there have been a handful of WTO disputes involving export subsidies (including one concerning Australian subsidies to its automotive leather industry)[10] in which panels and the Appellate Body have generally upheld the principle that the export orientation of a

[10] See Panel Report, *Australia - Subsidies Provided to Producers and Exporters of Automotive Leather,* WT/DS126/R, May 25, 1999.

subsidy recipient can be one (but not the only) consideration in determining whether a subsidy is contingent on export performance. Australia believes that existing WTO jurisprudence does not provide sufficient clarity or predictability on this matter and is, therefore, proposing an explicit rule that export propensity cannot be the sole factor or be given greater weight in evaluating the evidence of export contingency.

Australia also submitted a revised version of its proposal on subsidy withdrawal. Australia believes that the Subsidies Agreement must be clarified to provide Members better guidance with regard to the meaning and scope of the "withdrawal of subsidy" remedy for prohibited subsidies. Specifically, Australia proposes that the text of Article 4 of the Subsidies Agreement be elaborated to clarify what is required in order to satisfy the test for "withdrawing" a subsidy. Australia's concerns stem directly from the WTO dispute settlement proceedings in the *Australian Leather* case in which the Panel considered whether the phrase "withdraw the subsidy" could be understood to encompass repayment. The Panel noted that where a one-time subsidy has been granted, the mere termination of a subsidy program would have no deterrent effect and, under the particular circumstances presented, found repayment in full to be the only way in which withdrawal of the subsidy could be achieved.

Canada submitted another paper on benefit pass-through, containing a modified and scaled-back version of an earlier proposal (June 2004) on the same topic, and largely reflecting Canada's position in the ongoing dispute with the United States over softwood lumber. Currently under the Subsidies Agreement, a subsidy is defined as a financial contribution (*e.g.,* a grant or tax break) that provides a benefit. Canada's position is that where the recipient of a financial contribution and the alleged recipient of the resulting benefit are different entities, the investigating authority cannot presume that the benefit "passes through" from one to entity to the other. More specifically, an investigating authority cannot presume that a financial contribution and benefit provided to one entity – an input supplier, for example – is automatically passed through to an unrelated entity – a downstream purchaser, for example – following an arm's-length transaction. To address this concern, Canada proposes that the Subsidies Agreement be amended to require that a pass-through analysis be conducted in any instance where the recipients of the financial contribution and of the benefit are different entities.

Brazil submitted several subsidy-specific papers for consideration during 2005, including written comments on other Members' proposals. In one such set of comments on Canada's proposed requirement of a pass-through analysis, Brazil made clear that it believes any such requirement should pertain only to countervailing duties and not to parts II and III of the Subsidies Agreement, which contain the multilateral remedies for prohibited and actionable subsidies.

In a second paper, Brazil commented on a proposal regarding serious prejudice that Canada submitted in 2004. Notably, Brazil supports Canada's earlier proposal to reinstate Article 6.1 (the dark amber category) with certain additions and clarifications. First, Brazil proposes that footnotes 15 and 16, which relate to civil aircraft, be deleted from Article 6.1. In addition, Brazil proposes adding language to clarify that subsidies to

cover operating losses associated with *a particular product line* should also be deemed to cause serious prejudice. Brazil agrees with Canada that paragraph 4 of Annex IV, particularly with regard to company start-up situations, is in need of clarification and proposes language to help define that concept. Canada's earlier paper also proposed to (a) replace the cost-to-government approach with a benefit-to-recipient approach in the calculation of *ad valorem* subsidization under subparagraph 6.1(a) of the Subsidies Agreement; (b) extend the market share analysis in Article 6.4 of the Subsidies Agreement to the causation assessment under 6.3(a) and; (c) confirm that the threshold percentage in paragraph 4 of Annex IV to the Subsidies Agreement applies not only to subsidies expensed in the start-up period but also to subsidies allocated over a multi-year period. Brazil provisionally supported these aspects of Canada's proposal.

Reflecting what is likely one of the most important subsidies-related issue for Brazil in the Rules Group negotiations, Brazil submitted an informal paper on export credits, proposing fundamental changes to items (j) and (k) of Annex I of the Subsidies Agreement. The proposed amendments seek to further "level the playing field" for government-supported export credits so that developing countries – from Brazil's perspective – are not disadvantaged as compared to developed countries when offering such credits.

Brazil's paper also raises the legal relationship between the OECD Arrangement on Officially Supported Export Credits (the Arrangement) and the Subsidies Agreement. Currently, the second paragraph of item (k) provides a "safe harbor" for official export credits provided in accordance with the interest rate provisions of the Arrangement, which is incorporated by reference into the Subsidies Agreement. The WTO panel in the Brazil/Canada dispute on regional aircraft held that, under the provisions of the Subsidies Agreement, applicable aspects of any subsequently amended versions of the Arrangement are also incorporated into the Subsidies Agreement. Brazil argues that this effectively allows OECD Participants to change aspects of the export credit rules under the Subsidies Agreement without the concurrence of all WTO Members.

Brazil proposes amending the first paragraph of item (k) by deleting the prohibition against a government providing export credit financing below its cost of funds. Brazil argues that this provision disadvantages developing countries with higher costs of funds. Instead, Brazil proposes that governments be prohibited from providing export credits "at rates below those available on international capital markets." Brazil also proposes amending the second paragraph of item (k) by adding a clause to the incorporation provision that freezes the safe harbor rules to those applicable at end of the Uruguay Round. Under this proposal, the relevant provisions of any revision or amendment of the Arrangement would not automatically be incorporated into the Subsidies Agreement.

On item (j), Brazil proposes adding a second test to the existing programmatic "long-term break even" test. Specifically, this second test would require that the "all-in cost" (*i.e.,* the total financing cost paid by the buyer which includes the cost of the guarantee/insurance and interest on the guaranteed/insured financing) of a government

guaranteed or insured export credit not be less than what the recipient would pay on a comparable commercial loan.

In an additional submission, Brazil proposed clarifying the Subsidies Agreement's rules with regard to the definition of a *de facto* export subsidy. In particular, Brazil argues that recent WTO panels and the Appellate Body have interpreted the definition of a *de facto* export subsidy too narrowly. In the same vein, Brazil maintains that a subsidy specifically granted to enable the fulfillment of an export contract should be considered as a *de facto* export subsidy.

In its first subsidies-related paper in some time, the EU raised the following issues in the countervailing duty context that have also already been discussed in the Rules Group to some extent with respect to the AD Agreement: facts available, sunset reviews, sampling, new shippers ("newcomers"), and "constructive remedies" (*e.g.,* price undertakings). Specifically with regard to facts available, the EU proposes that the more specific rules in the AD Agreement regarding use of facts available be imported into the Subsidies Agreement, making due allowance for relevant considerations unique to CVD. On CVD sunset reviews, the EU argues that the concepts of "continuation" and "recurrence" (*e.g.*, of a subsidy) need to be more clearly defined in the context of CVD to take into account unique aspects of CVD, such as the expiration of allocation periods for subsidies. The EU also proposes eliminating self-initiations of sunset reviews.

With regard to sampling, the EU proposes similar rules on sampling to those that are in the AD Agreement in light of the fact that in certain instances, such as those involving highly fragmented industries, calculating individual rates for every producer/exporter is not practical. That said, the EU notes that there are some differences between AD and CVD with regard to sampling, such as the fact that subsidies are often available for all exporters on an equal basis but that different exporters may avail themselves of different types and amounts of subsidies. The EU's paper, therefore, suggests that consideration be given to applying the average of the sample to all producers, including those sampled.

As to new shipper reviews, the EU proposes a re-examination of the existing rules in the Subsidies Agreement to take better account of the fact that subsidy programs are widely available to all exporters, including newcomers. Therefore, from the EU's perspective, there is insufficient reason to give new shippers who claim not to have received any subsidy benefits a zero rate, at least until they have established that they have not benefitted from these widely available subsidies. One alternative would be to assign new shippers upon request a weighted average countervailing duty rate of all the investigated exporters.

On the issue of "constructive remedies for developing countries," the EU notes that the Subsidies Agreement – unlike the Antidumping Agreement – contains no requirement that "the special situation of developing country members be taken into account" prior to the imposition of countervailing duties. The EU proposes adding such

a rule to Article 27, in addition to that article's existing special and differential treatment provisions. The EU further suggests that, although undertakings are the usual remedies that have been considered in the AD context, the Group should also consider other remedy forms.

c. *Fisheries Subsidies*

Members have committed to negotiations that "aim to clarify and improve WTO disciplines on fisheries subsidies, taking into account the importance of this sector to developing countries." The United States views these negotiations as a groundbreaking opportunity for the WTO to show that trade liberalization can benefit the environment and contribute to sustainable development as well as address traditional trade concerns. The United States continued to play a major role in advancing the discussion of fisheries subsidies reform in the Rules Group in 2005, working closely with a broad coalition of developed and developing countries, including Argentina, Australia, Chile, Ecuador, Iceland, New Zealand and Peru (collectively known as the "Friends of Fish").

Although a broad consensus has finally emerged in favor of stronger disciplines, including a prohibition of the most harmful subsidies (*i.e.*, those that contribute to overfishing and overcapacity), there remains considerable disagreement over the structure of such disciplines, as well as their extent and coverage. The United States and the other Members of the Friends of Fish advocate a framework that would center on a broad-based prohibition, with appropriate, well-defined exceptions (referred to as the "top-down" approach). Specifically, the United States supports a prohibition focused on subsidies that contribute to overcapacity and overfishing and consideration of carefully targeted exceptions to allow appropriate flexibility. The United States has also stressed that, to be effective as well as to increase the transparency of existing subsidies, the negotiation of exceptions should be focused on the actual, particular subsidy programs and concerns of Members rather than on broad, open-ended categories of support programs. The United States believes that, grounded in a general prohibition, the top-down approach offers a simple, administrable, enforceable, and realistic structure for strengthened disciplines.

In contrast, Japan and Korea, supported by Chinese Taipei, advocate a "bottom-up" approach premised on a potentially large number of permitted subsidies and a small number of prohibited subsidies (*i.e.*, those that cause demonstrable adverse resource and trade effects). In response, the United States and the other Friends of Fish have noted that such an approach appears to put too much emphasis on resource effects and that it introduces concepts (*e.g.*, "properly managed fisheries") that lie outside the competence and objectives of the WTO. In light of its inherent practical and other difficulties, the United States has suggested that the bottom-up approach could actually lead to a set of disciplines weaker than the current rules.

During 2005, putting aside – temporarily – the contentious issue of the appropriate framework, Members turned their attention to examining the technical

parameters of different areas of government involvement in the fisheries sector that might be considered for exemption from any subsidy prohibition. Detailed papers were submitted on the following topics: management services, vessel decommissioning and license retirement (a U.S. paper – see discussion below), fisheries infrastructure, aquaculture, small scale and artisanal fishing, IUU (illegal, unregulated and unreported) fishing, and special and differential treatment. The EU also submitted a proposal on the question of enforcement and transparency.

The United States' May 2005 submission on vessel decommissioning and license retirement discusses the issue of government-funded programs for decommissioning vessels, retiring fishing licenses and other possible "capacity-reducing" subsidies (*i.e.,* buyback programs).[11] Specifically, the paper identifies a number of problems that need to be addressed for a buy-back program to be successful. The paper then provides examples of U.S. buyback programs, in which United States has attempted to address these problems. In the view of the United States and other Members (*e.g.*, Argentina, Chile, Ecuador, New Zealand, Philippines and Peru), appropriately-designed buyback are strong candidates for an exception to an expanded prohibition of fisheries subsidies.

In November, Brazil submitted a comprehensive textual proposal for an overall framework for new fisheries subsidies disciplines. Brazil's stated primary purpose for tabling the proposal was to focus on possible special and differential treatment for developing countries in the context of strengthened disciplines on fisheries subsidies. Despite reservations regarding the appropriateness and practicality of many of the details of Brazil's proposal, the United States and other Friends of Fish were supportive in that the paper provided a further impetus to moving the negotiations forward.

In November 2005, with a view towards the Hong Kong Ministerial, the United States co-sponsored a paper with Brazil, Chile, Colombia, Ecuador, Iceland, New Zealand, Pakistan and Peru summarizing the progress to date, and laying down certain principles that they believe should characterize any new disciplines on fisheries subsidies.[12] Specifically, the submission called for any new rules: (1) to be simple and enforceable; (2) to provide for a far greater level of transparency than under current rules; (3) to be both flexible and responsive, not just in the structure of the disciplines but in accommodating and reflecting the dynamic nature of the fishing industry and the evolving nature and extent of fisheries subsidies policy and practice; (4) to be consistent with the Doha mandate; (5) to must recognize the importance of this sector for developing countries through appropriate special and differential treatment. At the Hong Kong Ministerial Conference in 2005, the United States participated in a high-level environmental event on fisheries subsidies organized by the United Nations Environmental Program and the World Wildlife Fund, which highlighted the importance

[11] See, TN/RL/GEN/41.

[12] See, TN/RL/W/196.

of the issue and substantially raise its visibility.[13] The United States and the Friends of Fish intend to continue to build on the momentum that the fisheries discussions have gathered during 2005.

d. Agriculture Subsidies

At the Fourth WTO Ministerial Conference in Doha, Members agreed to an ambitious mandate for agriculture, including "substantial improvements in market access; reductions of, with a view to phasing out, all forms of export subsidies; and substantial reductions in trade-distorting domestic support." This mandate was augmented with specific provisions for agriculture in the framework agreed by the General Council on August 1, 2004 and at the Hong Kong Ministerial Conference in December 2005.

Following agreement in July 2004 on an agricultural framework, discussions in the WTO focused on developing specific approaches to reduce tariffs and trade-distorting domestic support and eliminate export subsidies. The United States has long advocated fundamental reform of all trade-distorting measures by all WTO Members and in 2002 made specific proposals to phase-out all tariffs, trade-distorting domestic support, and export subsidies in the Doha negotiations. While the July 2004 framework made progress by establishing a basic structure for the negotiations, the critical element of the actual formulas detailing how far and fast to cut tariffs and subsidies remained to be agreed.

U.S. negotiators met bilaterally with interested Members, with small groups of like-minded Members, in informal groups of Members with varied interests in the negotiations, and in large informal and formal meetings organized by the Chairman of the WTO agriculture negotiations. Negotiations were stalled through the spring of 2005 on the technical issue of establishing *ad valorem* equivalents (AVEs) for specific tariffs. Due to the leadership of the United States, Members reached an agreement on an AVE methodology in May. As discussions continued into the summer some additional marginal progress was made, but the negotiations lacked the critical spark to tackle the issue of the level of ambition.

The United States took the lead in breaking the negotiating deadlock by submitting a comprehensive proposal on October 10, 2005 in all three areas of the agriculture negotiations: export subsidies, market access, and domestic support. The U.S. proposal, consistent with the 2002 U.S. proposal and the 2004 WTO framework, called for substantial reductions in tariffs and trade-distorting domestic support, with higher tariffs and countries with higher subsidy levels subject to deeper cuts. These reductions would be phased-in over a five-year period for developed countries, with developing countries taking slightly lesser cuts and given more time to implement. In the second five-year phase (immediately following the first), all tariffs and trade-

[13] See USTR Press Release, December 14, 2005, *U.S. Welcomes Environmental NGO Support of Stronger WTO Rules on Fisheries Subsidies*; (www.ustr.gov/Document_Library/Press_Releases/2005/December).

distorting domestic support would be eliminated. Under the U.S. proposal, export subsidies would be eliminated within the first phase of reform, with parallel commitments undertaken on export state trading enterprises, export credits, and food aid programs.

The U.S. proposal sparked counter-proposals by other Members, including the G-20 group of developing countries led by Brazil and the EU. Despite the bold U.S. proposal, negotiations bogged down in the fall over failure of other key countries to provide proposals that delivered meaningful reforms in their own programs particularly in the area of market access. While numbers and formulas for making the cuts are now on the table, the differences between Members were too large to be resolved at the Hong Kong Ministerial Conference and substantive discussions on agriculture there focused on setting an end date for export subsidies.

In Hong Kong, Members further narrowed some of their key differences. Perhaps most importantly, Members agreed to an end date for export subsidies – 2013 – with the further commitment that the substantial part of the elimination would be completed by 2010. Going forward Members also agreed to some further refinements of the 2004 framework, including on cotton where they agreed to: eliminate export subsidies for cotton in 2006; ensure trade-distorting domestic support for cotton would be cut deeper and more quickly than for other commodities (with the actual numbers subject to negotiation); and developed country Members would eliminate tariffs on cotton exports from the least-developed country Members as of the commencement of the implementation period.

In 2006, negotiations will focus on reaching agreement on the basic formulas and rules for cutting tariffs and trade-distorting support by the April 30, 2006 deadline established at Hong Kong. These formulas will set the stage for the final bargaining through the end of the year over specific commitments, product-by-product and country-by-country. Initial lists of these product commitments are due by WTO members by the end of July, another deadline set at Hong Kong. In addition, bilateral discussions and sectoral negotiations for reductions beyond those called for in the basic modalities will occur when progress is achieved on the core modalities. As talks move forward, the United States will work to achieve the high level of ambition in all three pillars. U.S. objectives for agriculture reform will continue to focus on the principles of greater harmonization across countries, substantial overall reforms, and specific commitments of interest in key developed and developing country markets.

B. STEEL: MULTILATERAL EFFORTS TO ADDRESS MARKET-DISTORTING PRACTICES

1. Organization for Economic Cooperation and Development

In 2001, the United States and other major steel-producing countries launched talks in the Organization for Economic Cooperation and Development (OECD), via the creation of a High-Level Group (HLG), to address the inter-related problems of global

uneconomic steel capacity and the market distorting practices which help to sustain such capacity. Prior reports have detailed the scope and progress through 2004 of the work of the HLG's two subsidiary bodies: the Capacity Working Group and the Disciplines Study Group (DSG). While the Capacity Working Group and the DSG remained largely inactive in 2005, HLG participants expressed ongoing interest in the issues raised during this process and seemed prepared to re-engage on these issues should market developments and the policy environment warrant such action

Meanwhile, the OECD Steel Committee reconvened in January 2005 for a short organizational meeting for the first time since the High-Level Steel Process began. In October, the Committee then held a full meeting with strong participation from both OECD and non-OECD member countries and their respective industry representatives. The United States has long supported the Steel Committee, and nearly all participants agree that the Committee can serve as an important forum to discuss policy issues, such as subsidies, that had been at issue within the High-Level Process. Indeed, participants are eager to maintain an international dialogue on the industry's unresolved structural problems and to further develop contacts with emerging producers in such countries as China, India and Brazil.

In addition, in January 2005, U.S. Government and industry officials attended the "Outlook for Steel" Conference in Paris, organized by the OECD in conjunction with the International Iron and Steel Institute. Participation included more than 30 countries as well as a large contingent of industry representatives and private sector analysts. The conference provided an opportunity to take stock of current strong steel market conditions, discuss public policy issues and consider the current and likely future impact of new capacity growth, particularly in China and developing countries. The OECD will hold another such conference on May 16-17, 2006, in New Delhi, India.

In a January 2006 *Aide Memoire*, the OECD Secretariat outlined a proposed framework for continuing discussion of some of the key issues explored in the High-Level Process, as well as the statistical work of the Steel Committee. This will be the subject of further consultations. The United States intends to continue working with other key steel participants in the OECD context, particularly within the Steel Committee, and in other multilateral fora (*e.g.*, the WTO) to identify a feasible and effective means to strengthen multilateral subsidy disciplines in the steel sector.

2. North American Steel Trade Committee

The North American Steel Trade Committee (NASTC) was established by the Governments of the United States, Canada and Mexico in the context of the work done together in the OECD's HLG work on steel. Since its inception three years ago, the NASTC has been a successful forum for collaborating with industry and promoting continued cooperation on policy matters affecting the North American steel market and industry. While the work of the Committee is wide ranging, its efforts have focused primarily on the frequency and magnitude of government intervention in the global steel sector and the resulting distortions to international trade.

With the March 2005 launching of the North American governments' Security and Prosperity Partnership (SPP), cooperation on steel policy matters was identified as an SPP signature initiative and the NASTC was tasked with drafting and pursuing a detailed program of work for a North American Steel Strategy by 2006. Consistent with the ongoing cooperative efforts of Canada, Mexico and the United States in the OECD, the North American Steel Strategy will focus on several areas of work, including continued joint efforts focusing on distortions in the global steel market and cooperation in other multilateral negotiations of importance to steel, particularly the WTO Rules Negotiations.

During 2005, the NASTC increased its profile as a cooperative bloc on steel policy matters in the multilateral arena. The NAFTA governments submitted joint comments to the OECD on the Secretariat's Blueprint for a Steel Subsidies Agreement which highlighted their continued support for increased subsidy disciplines in the global steel sector. In addition, in October 2005, the three governments submitted an unprecedented joint set of questions to China regarding its Iron and Steel Industry Development Policy in connection with the annual review of China's WTO implementation efforts before the WTO Subsidies Committee (See, also, *WTO Subsidies Committee* section below). This joint set of questions emphasized the NAFTA governments' concerns with the large degree of Chinese government involvement in the steel sector and was supported by delegations of other major steel-producing countries during the TRM discussion that occurred within the WTO Subsidies Committee.

The NASTC meets at least twice a year, with the possibility left open for *ad hoc* meetings to address particular issues should the need arise. The United States will host the next regular meeting of the committee in Washington, D.C. during the spring of 2006.

MONITORING AND ENFORCEMENT

A. ADVOCACY EFFORTS

1. Counseling U.S. Industry

USTR and IA staff within Commerce regularly respond to inquiries from, and meet with representatives of, U.S. industries concerned with the subsidization of foreign competitors. The goal is to resolve problems arising from unfair foreign government subsidization through a combination of informal and formal contacts. However, where appropriate, the United States will also advise U.S. companies of other options for action, such as a CVD investigation, WTO dispute settlement or an action taken under Section 301 of the Trade Act of 1974.

In 2005, a number of U.S. industries sought assistance in this regard. USTR and IA are currently counseling and advocating on their behalf. The nature of the inquiries and information provided by U.S. companies to USTR and IA varies greatly.

Some companies have basic questions concerning the Subsidies Agreement and U.S. rights to address unfair and harmful foreign subsidies under that Agreement. Other inquiries relate to complaints about particular subsidies and allegations that these practices have adversely affected a U.S. industry or company in either the U.S. or overseas markets. In these cases, USTR and IA work closely with the industry or company to collect information concerning the potential subsidies and to determine how its commercial interests may have been harmed.

The firm or industry in question is usually the best source of information concerning the damage resulting from the subsidization. This information is critical to support a claim of adverse trade effects in a WTO subsidy enforcement proceeding.[14] In most instances, USTR and IA also conduct significant additional research to determine the legal framework under which the foreign government is offering the assistance and whether other U.S. exporters have been facing similar problems.

USTR and IA staff also draw upon additional internal and external sources to develop information concerning potentially harmful foreign subsidies. These include Commerce offices with country and industry specialists that routinely collect information on regional or sector specific subsidies. If appropriate, U.S. embassies in the relevant foreign countries are contacted for additional "on the ground" information they may be able to provide. On occasion it has also been useful to contact other governments to learn whether similar complaints about the same third-country subsidy have been identified by their exporters. Where appropriate, USTR and IA may also seek public comment and/or consult with representatives of U.S. state and local governments.

Working with an interagency team, USTR and IA staff then evaluate the information and determine the most effective way to proceed. As noted above, it is often advantageous to pursue resolution of these problems through a combination of informal and formal contacts. For example, raising the matter with the foreign government authorities through informal contacts, formal bilateral meetings or through discussions in the WTO Subsidies Committee may produce more expeditious and practical solutions to the problem than resorting to WTO dispute settlement or the filing of a CVD petition. These contacts may also lead to additional information about the practice which, in turn, can affect the decision concerning the appropriate measures to take. However, if these efforts fail to resolve the issue, bringing a formal dispute settlement action in the WTO always remains a viable option.

[14] In order for subsidies, other than prohibited subsidies, to be actionable they must be specific (*e.g.*, provided to a specific firm or industry or a group thereof) and cause adverse effects to the interests of another WTO Member. Adverse trade effects can include (1) material injury to a domestic industry, or the threat thereof, as in CVD proceedings, (2) the nullification or impairment of benefits accruing directly or indirectly to another WTO Member under the GATT 1994, and (3) "serious prejudice," which includes the displacement or impeding of sales or significant price undercutting, price suppression or price depression in so-called "serious prejudice" disputes brought to the WTO.

During 2005, USTR and Commerce continued to advocate on behalf of a broad array of U.S. industries and companies that complained about unfair foreign government subsidy practices in a wide range of countries. These activities included ongoing work on behalf of the U.S. textile, steel, aerospace, paper, automobile, orchid and biotechnology industries, among others. The subsidy practices examined included those maintained by the governments of China, Korea, Canada, the European Union and its Member States, Malaysia, Brazil, Chinese Taipei, India, Russia, Ukraine and Japan, among others.

2. Outreach Efforts

USTR and IA staff work with government personnel who have daily contact with the U.S. exporting community, both in the United States and abroad, to make them aware of the resources and services available regarding subsidy enforcement efforts. Senior Import Administration officers also have been stationed in Beijing, China and Seoul, Korea, as mandated by Congress. Working closely with their colleagues in U.S. Embassies and with IA personnel in Washington, these officers have proved invaluable in undertaking primary source research of potential unfair trade problems in their host countries and in other countries in the region. Overseas personnel have also been an important part of the outreach of the U.S. Government, as they have participated in numerous trade-related seminars in their host countries, which normally cover a country's subsidy-related obligations under the WTO. Additionally, a senior Import Administration officer stationed in Geneva, Switzerland has been a key participant in the Rules negotiations, dispute settlement activities and the WTO Antidumping and Subsidies Committees.

IA staff also maintain close contacts with other units within Commerce's International Trade Administration (ITA) through the Compliance Coordinators Group (CCG). The CCG is comprised of all of ITA's units (Market Access and Compliance, Manufacturing and Services, Import Administration, and the United States Commercial Service (USCS)), as well as the Patent and Trademark Office. The CCG serves as the central coordinating point for ITA's market access and agreement compliance activities. The group meets regularly to share information on issues that may be common across regions or industrial sectors, and works to resolve these issues by drawing upon the full range of expertise available within ITA. The USCS, which is charged with counseling U.S. companies through its network of domestic and foreign posts, draws upon SEO resources to inform other USCS officers and the U.S. business community of the work done, and services offered by the SEO. IA staff also benefit from information provided by USCS officers about the types of subsidy problems U.S. companies are facing in their host countries.

USTR and IA staff also work closely with the other U.S. Government agencies, including the Department of State and the U.S. Department of Agriculture, to involve foreign service economic and agriculture officers in subsidies enforcement activities.[15]

[15] Section 281(g) of the URAA requires that Commerce secure the cooperation of other federal agencies in these activities.

To this end, USTR and IA personnel train foreign service officers on how to identify and evaluate foreign subsidy practices that may be inconsistent with the Subsidies Agreement and that may harm the interests of U.S. companies. Cooperation of this type occurs not only when initiated by IA or USTR, but on an ongoing basis whereby foreign service officers develop and share information with Commerce, USTR and the interagency team concerning foreign government subsidy practices and the administration of foreign governments' unfair trade laws.[16] This type of collaboration among government agencies is critically important to help exercise effectively U.S. rights under the Subsidies Agreement.

IA also arranges and participates in training sessions for foreign government officials. A major focus of these programs is a detailed discussion of the Subsidies Agreement. In 2005, IA staff worked with officials from several countries, stressing procedural issues, calculation methodologies, and the importance of transparency. The training activities form part of a comprehensive program to strengthen ties between foreign officials and their U.S. counterparts, and to help ensure that the administration of trade remedy laws by other WTO Members is consistent with their international obligations.

3. Monitoring Subsidy Practices Worldwide

In 2005, USTR and IA staff expanded their efforts to monitor market- and trade-distorting practices by governments worldwide, including the provision by governments of harmful subsidies. These monitoring activities are ongoing and, as outlined above, are conducted in response to concerns raised directly by U.S. industries and individual companies. The research, which is conducted by experienced analysts in IA, involves daily searches of worldwide business journals, periodicals, news publications, as well as online resources maintained by governments, industries and international organizations. Analysts fluent in a variety of foreign languages also conduct research in their language of expertise. Information is obtained from U.S. embassies overseas through cable reports and direct inquiries by USTR and IA staff for in-depth country-related research. IA research activities are also aided by ongoing relationships with U.S. industry contacts, both in the United States and overseas.

The 'Electronic Subsidies Enforcement Library' (ESEL) website is a key tool used by IA to organize subsidy-related material and convey it to the public. The website, available at http://ia.ita.doc.gov/esel/, is used by USTR, IA, and other Commerce staff to review foreign governments' subsidies notifications made to the WTO, present an overview of the SEO, provide a link to the Subsidies Agreement, and furnish an easily navigable tool which provides information about each subsidy program investigated by Commerce in CVD cases since 1980. (See, Attachment 3.) Another

[16] As described above, an important factor in a U.S. company's ability to do business in any given market is the manner in which the foreign government administers its unfair trade laws and, in particular, its CVD and AD laws. IA monitors these foreign AD and CVD actions involving U.S. companies to ensure that the foreign governments are conducting these investigations in accordance with their international obligations.

useful aspect of the ESEL are the links it provides to other U.S. and foreign government websites such as USTR, the U.S. Export-Import Bank, the International Monetary Fund, the WTO (which maintains databases of Members' CVD actions, and their subsidy notifications to the WTO), the Canadian and Mexican government trade agencies and the NAFTA secretariat. The website is updated frequently to provide the most recently available information to the public in a timely manner.

B. CHINA

1. Transitional Review Mechanism

Paragraph 18 of the Protocol of Accession of the People's Republic of China to the WTO provides that all subsidiary bodies, including the Subsidies Committee, "which have a mandate covering China's commitments under the WTO Agreement or [the] Protocol shall, within one year after accession . . . review, as appropriate to their mandate, the implementation by China of the WTO Agreement and of the related provisions of [the] Protocol." Paragraph 18 states further that such reviews shall be conducted on an annual basis for eight years, with a final review occurring by the tenth year after accession. In November 2005, the United States took part in the fourth annual transitional review with respect to China's implementation of its WTO obligations. The United States, along with other Members, once again presented China with questions related to potentially prohibited and actionable subsidies maintained by China, including tax incentives, preferential bank financing and regional benefits provided to producers of agricultural and industrial products, as well as banking and financial sector reform. Canada and Mexico joined the United States in raising a series of questions and highlighting concerns regarding China's new Iron and Steel Industry Development Policy, released in July 2005. (See, also, *North American Steel Trade Committee*, section above.)

During the TRM, the United States particularly focused on the lack of a subsidies notification from China, which has stymied WTO Members' efforts to conduct a meaningful review of China's subsidy practices. Although China became a WTO Member in 2001, it has yet to provide a subsidy notification as required under Article 25.1 of the Agreement and China's Protocol of Accession. The obligation to notify subsidies is a key element of the Subsidies Agreement, because it provides WTO Members with the ability to evaluate a Member's compliance with the disciplines contained in the Agreement. Full compliance with the Article 25.1 reporting requirement is critical in the case of China because of the general lack of detailed, specific, publicly available data on Chinese government subsidy policies and practices, at both the central and sub-central level. For this reason, the United States has repeatedly urged China to submit a full subsidy notification.

At a meeting of the WTO Council for Trade in Goods in late 2004, China committed to provide a subsidies notification by the end of 2005. China reaffirmed its intention to do so at the July 2005 meeting of the U.S.-China Joint Commission on Commerce and Trade. However, at the November 2005 WTO Subsidies Committee

meeting, China cited continuing difficulties in assembling and submitting the appropriate information. While recognizing the problems inherent in compiling a comprehensive subsidy notification for a large country, the United States remained emphatic concerning China's subsidy notification obligation under the Subsidies Agreement. The intervention by the United States for a full and complete notification was strongly supported by several other Members. China reiterated its position that it would submit a full and complete notification by the end of 2005. As of the date of writing of this report, no notification has yet been received from China.

In the course of the TRM this year, the United States also raised China's failure to submit written answers to the United States' Article 25.8 questions posed to it a year ago (October 2004). Article 25.8 of the Subsidies Agreement permits any WTO Member to request information on the nature and extent of any subsidy granted or maintained by another Member. The U.S. request submitted to China in October 2004 identified programs and practices providing benefits to agricultural products, forest and paper products, textiles and various high technology products, among others, as well as programs and practices that appeared to constitute prohibited export and import substitution subsidies within the meaning of Article 3 of the Subsidies Agreement. Under Article 25.9 of the Agreement, China is obligated to provide a written, comprehensive response to the U.S. questions. However, the October 2004 request made by the United States remains outstanding, and China provided no new information at the November 2005 Subsidies Committee meeting.

Once China submits its full and complete subsidies notification and its response to the questions the United States posed under Article 25.8, the United States will analyze the documents for accuracy and completeness and will prepare to engage China actively on the programs and practices it notifies, both bilaterally and at the WTO. In addition, U.S. subsidies experts will continue to examine China's subsidy practices in 2006, including through the expansion of information gathering techniques.[17]

Regardless of when China provides information regarding its subsidy programs, the United States intends to step up its dialogue with China about its subsidies policies and programs. In the July 2005 U.S.-China Joint Commission on Commerce and Trade meeting, the Chinese government agreed to an "intensified" process of discussions in the U.S.-China Structural Issues Working Group (SIWG) meetings, including a direct discussion of Chinese subsidies. The United States plans to open such discussions beginning with the first meeting of the SIWG in 2006 and will continue to raise China's obligation to provide a subsidies notification in the WTO.

[17] See, also, 2005 Report to Congress on China's WTO Compliance, United States Trade Representative, December 11, 2005, pp. 38-39.

2. JCCT - Structural Issues Working Group

Established in 1983, the U.S.-China Joint Commission on Commerce and Trade (JCCT) is a government-to-government consultative mechanism that provides a forum to resolve trade concerns and promote bilateral commercial opportunities. Previously led by the U.S. Secretary of Commerce and the Chinese Commerce Minister, the status of the JCCT was elevated following the December 2003 meeting of President Bush and Chinese Premier Wen to focus higher-level attention on outstanding trade disputes. It is now chaired by Secretary Gutierrez and Ambassador Portman on the U.S. side and by Vice Premier Wu Yi on the Chinese side.

In the case of China, one avenue to help ensure that the playing field is made more level is to encourage China's ongoing structural reforms, which are intended to create a market economy. On the other hand, China's treatment as a non-market economy under U.S. law is of substantial concern and importance to the Chinese government. In order to better understand China's reforms to date and various structural and operational aspects of China's economy, as well as discuss issues that relate to China's desire for market economy status under the U.S. antidumping law, China and the United States agreed during the April 2004 JCCT meetings to the establishment of a new working group, the SIWG, to be jointly chaired by Commerce's Assistant Secretary for Import Administration and the Assistant U.S. Trade Representative for China on the U.S. side and the Director General of the Bureau of Fair Trade from MOFCOM on the Chinese side.

The Administration attaches great importance to the SIWG, which provides a forum for the U.S. and Chinese governments to explore and discuss China's economy and its ongoing economic reform program, pragmatically address concerns about trade- and market-distorting practices that might otherwise lead to bilateral trade frictions, and consider the Government of China's concerns about China's non-market economy status under U.S. law.[18] The working group has met three times since its launch in July 2004, with both sides including in their delegations experts from a variety of agencies responsible for the broad range of structural issues and economic reforms under discussion. During the July 2005 meeting of the JCCT, China and the United States agreed to intensify the SIWG process, which will provide greater opportunity to explore with China its economic policies and reforms at a more technical level. In addition, the United States made it a priority to directly address subsidies in the SIWG and obtained Chinese government agreement to do so. The Department of Commerce and USTR are currently working with the Chinese government to finalize a schedule and agenda for meetings of the working group in 2006.

3. Application of Countervailing Duty Law

[18] Some concern has been raised that the SIWG is to be used as a platform to grant China market economy status under the antidumping law. This is not the case. Under U.S. law, any review of China's non-market economy status must take place in a formal proceeding before the Commerce Department, open to all interested parties. The Chinese government has yet to formally request such a review.

Twenty years have passed since the landmark decision in *Georgetown Steel Corp. v. United States*, 801 F.2d 1308 (Fed. Cir. 1986) ("*Georgetown Steel*"), which affirmed Commerce's policy at the time of not applying the CVD law to countries classified as non-market economies ("NMEs") for antidumping purposes. Much of the NME world has changed dramatically since then, and many now question whether or to what extent the logic of *Georgetown Steel* still applies to the non-market and transition economy countries of today. For example, the Government Accountability Office published a report in June 2005 that discusses the legal, policy and methodological challenges that might arise in connection with any application of the U.S. countervailing duty law to NME countries. Members of Congress also introduced last year several bills that would explicitly make the CVD law applicable to NMEs. Some in the U.S. industry point with increasing alarm at what they believe is growing evidence of the broad scope and pervasive nature of NME government subsidy practices and their impact on trade and market access. Various non-governmental organizations have also noted that NME government subsidies continue to frustrate much-needed industrial restructuring and efficient resource allocation, and many WTO Members are becoming increasingly aware of NME government subsidy practices as a result of bilateral and multilateral discussions in the WTO, OECD and other fora. As a result, WTO Members have expressed concern and reiterated their requests that NME governments make their subsidy regimes more transparent and consistent with their international obligations, so that the nature and scope of NME government subsidy practices can be understood and their trade effects meaningfully assessed.

Commerce and USTR are closely following these developments and the ongoing debate. At the same time, keenly aware of the growing concerns about NME government subsidy practices and their significance, Import Administration (IA) is also actively engaged in a systematic review of all relevant trade remedy policies and methodologies. IA is organizing staff to take maximum advantage of all available resources and NME-subsidy-CVD expertise, and, with effective enforcement of U.S. trade remedy laws in mind, IA and USTR are considering all possible legal and policy options to determine how best to address the complex issue of NME subsidies.

C. WTO DISPUTE SETTLEMENT AND CVD CASES OF SIGNIFICANCE TO SUBSIDIES DISCIPLINES

1. European Union Support for Airbus

For many years, the United States has had serious concerns about the continued EU subsidization of Airbus, a company with more than a 50 percent share of the world market for large civil aircraft ("LCA"). The subsidies have taken many forms, including "launch aid," which Airbus uses to launch new models of aircraft; grants for Airbus infrastructure; forgiveness of debt; and subsidies to underwrite Airbus' research and development costs.

U.S. concerns about Airbus subsidies intensified in 2004, when it became apparent that Airbus intended to launch a new aircraft, the A350, with another round of EU launch aid. In October 2004, following unsuccessful, U.S.-initiated efforts to

negotiate a new U.S.-EU agreement that would preclude new subsidies, the United States filed a WTO consultation request with respect to the A350 subsidies and other subsidies that Airbus has received. Concurrent with the U.S. WTO consultation request, the United States also exercised its right to terminate the 1992 U.S.-EU bilateral agreement on large civil aircraft.

The WTO consultations failed to resolve the U.S. concerns, and a renewed effort to negotiate a solution ended without success in April, 2005. Therefore, on May 31, 2005, the United States filed a WTO panel request. The EU filed a WTO panel request on the same day with respect to alleged U.S. federal, state and local government subsidies to Boeing. The WTO established the panel on July 20, 2005, and panel proceedings are currently ongoing.

U.S. officials have consistently noted their willingness to negotiate a new bilateral agreement on large civil aircraft, even while the WTO litigation proceeds, but have insisted that any such agreement must end launch aid and other direct subsidies for the development and production of such aircraft.

2. United States Support for Upland Cotton

On September 27, 2002, Brazil requested WTO consultations pursuant to Articles 4.1, 7.1 and 30 of the Agreement on Subsidies and Countervailing Measures, Article 19 of the Agreement on Agriculture, Article XXII of the General Agreement on Tariffs and Trade 1994, and Article 4 of the Understanding on Rules and Procedures Governing the Settlement of Disputes. The Brazilian consultation request on U.S. support measures that benefit upland cotton claims that these alleged subsidies and measures are inconsistent with U.S. commitments and obligations under the Subsidies Agreement, the Agreement on Agriculture, and the General Agreement on Tariffs and Trade 1994. Consultations were held on December 3, 4 and 19 of 2002, and January 17, 2003.

On February 6, 2003, Brazil requested the establishment of a panel. Brazil's panel request pertains to "prohibited and actionable subsidies provided to US producers, users and/or exporters of upland cotton, as well as legislation, regulations and statutory instruments and amendments thereto providing such subsidies (including export credit guarantees), grants, and any other assistance to the US producers, users and exporters of upland cotton". Brazil's principal claims were that:

(1) U.S. domestic support for cotton causes "serious prejudice" to Brazilian interests by depressing or suppressing world cotton prices and unfairly expanding or maintaining U.S. world market share,

(2) U.S. export credit guarantees for all commodities confer export subsidies,

(3) Step 2 payments for cotton are both prohibited export subsidies and prohibited import substitution subsidies; and

(4) FSC/ETI tax benefits are prohibited export subsidies.

The Dispute Settlement Body established the panel on March 18, 2003.

Following briefing by both parties, on June 20, 2003, the panel decided to bifurcate the proceeding and first consider whether the Peace Clause (Article 13 of the Agreement on Agriculture) exempted the challenged U.S. measures from Brazil's action. After additional briefing on September 5, the panel declined to make findings on the Peace Clause issue.

On September 8, 2004, the panel circulated its final report. The panel made findings that side with Brazil on certain of its claims in this dispute and other findings that side with the United States:

- The panel found that the "Peace Clause" in the WTO Agreement on Agriculture did not apply to a number of U.S. measures, including (1) domestic support measures and (2) export credit guarantees for "unscheduled commodities"[19] and rice (a "scheduled commodity"[20]). Therefore, Brazil could proceed with certain of its challenges.

- The panel found that export credit guarantees for "unscheduled commodities" (such as cotton and soybeans) and for rice are prohibited export subsidies. However, the panel also found that Brazil had not demonstrated that the guarantees for other "scheduled commodities" exceeded U.S. WTO reduction commitments and therefore breached the Peace Clause. Further, Brazil had not demonstrated that the programs threaten to lead to circumvention of U.S. WTO reduction commitments for other "scheduled commodities" and for "unscheduled commodities" not currently receiving guarantees.

- Some U.S. domestic support programs (marketing loan, counter-cyclical, market loss assistance, and Step 2 payments) were found to cause significant suppression of cotton prices in the world market in marketing years 1999-2002 causing serious prejudice to Brazil's interests.

- However, the panel found that other U.S. domestic support programs (production flexibility contract payments, direct payments, and crop insurance payments) did not cause serious prejudice to Brazil's interests because Brazil failed to show that these programs caused significant price suppression.

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[19] "Unscheduled commodities" are agricultural products for which the United States is not permitted to provide export subsidies because they are not set out in the export subsidy part of the U.S. WTO schedule.

[20] "Scheduled commodities" are agricultural products set out in the U.S. WTO schedule, and the United States is permitted to provide export subsidies up to the scheduled level. Besides rice, U.S. "scheduled commodities" are wheat, skim milk powder, coarse grains, butter, bovine meat, other milk products, poultry meat, vegetable oils, live dairy cattle, cheese, eggs, and pigmeat.

- The panel also found that Brazil failed to show that any U.S. program caused an increase in U.S. world market share for upland cotton constituting serious prejudice.

- The panel did not reach Brazil's claim that U.S. domestic support programs threatened to cause serious prejudice to Brazil's interests in marketing years 2003-2007. The panel also did not reach Brazil's claim that U.S. domestic support programs *per se* cause serious prejudice in those years.

- The panel also found that Brazil had failed to establish that FSC/ETI tax benefits for cotton exporters were prohibited export subsidies.

- Finally, the panel found that Step 2 payments to exporters of cotton are prohibited export subsidies, not protected by the Peace Clause, and Step 2 payments to domestic users are prohibited import substitution subsidies because they were only made for U.S. cotton.

On October 18, 2004, the United States filed a notice of appeal with the Appellate Body; Brazil then cross-appealed. The Appellate Body circulated its report on March 3, 2005. The Appellate Body upheld the panel's findings appealed by the United States. The Appellate Body also rejected or declined to rule on most of Brazil's appeal issues. On March 21, 2005, the DSB adopted the panel and Appellate Body reports and, on April 20, 2005, the United States advised the DSB that it intends to bring its measures into compliance.

On June 30, 2005, the United States announced certain administrative changes relating to its export credit guarantee programs. Further, on July 5, the United States proposed legislation relating to the export credit guarantee and Step 2 programs. On July 5, 2005, Brazil requested authorization to impose countermeasures and suspend concessions in the amount of $3 billion in connection with the "prohibited subsidy" findings. On July 14, 2005, the United States objected to the request, thereby referring the matter to arbitration. On August 17, 2005, the United States and Brazil agreed to suspend the arbitration. On October 6, 2005, Brazil made a separate request for authorization to impose countermeasures and suspend concessions in the amount of $1.04 billion per year in connection with the "serious prejudice" findings. The United States objected to Brazil's request on October 17, 2005, and that matter was also referred to arbitration. Thereafter, on November 21, 2005, the United States and Brazil jointly requested suspension of this second arbitration.

3. Canada's Challenge of the CVD Investigation of Canadian Lumber

On May 3, 2002, Canada requested WTO consultations with the United States regarding the U.S. Department of Commerce's final countervailing duty determination concerning certain softwood lumber from Canada. Among other things, Canada challenged the evidence upon which the investigation was initiated, claimed that the Commerce Department imposed countervailing duties against programs and policies that are not subsides and are not "specific" within the meaning of the Subsidies

Agreement, and that the Commerce Department failed to conduct its investigation properly. Consultations were held on June 18, 2002, and a panel was established at Canada's request on October 1, 2002.

In its report, circulated on August 29, 2003, the panel found that the United States acted consistently with the Subsidies Agreement and GATT 1994 in determining that the programs at issue provided a financial contribution and that those programs were "specific" within the meaning of the Subsidies Agreement. It also found, however, that the United States had acted inconsistently with the Subsidies Agreement when it rejected private timber prices in Canada as the benchmark to determine whether – and to what extent – Canada was subsidizing lumber companies by providing low-cost timber. (The Commerce Department had used U.S. prices as the basis for the benchmark, rejecting Canadian private prices because they were distorted by the government's dominance in the timber market.) The panel also found that the United States had improperly failed to conduct a "pass-through" analysis to determine whether subsidies granted to one producer were passed through to other producers. The United States appealed these issues to the WTO Appellate Body on October 21, 2003, and Canada appealed the "financial contribution" issue on November 5.

On January 19, 2004, the WTO Appellate Body issued a report in which it reversed the panel's unfavorable finding with respect to the rejection of Canadian prices as a benchmark; upheld the panel's favorable finding that the provincial governments' provision of low-cost timber to lumber producers constituted a "financial contribution" under the Subsidies Agreement; and reversed the panel's unfavorable finding that the Commerce Department should have conducted a "pass-through" analysis to determine whether subsidies granted to one lumber company were passed through to other lumber companies through the sale of subsidized lumber. The Appellate Body's only finding against the United States was that the Commerce Department should have conducted such a pass-through analysis with respect to the sale of *logs* from harvester/sawmills to unrelated sawmills.

On March 5, 2004, the United States notified the DSB of its intention to implement the findings of the Appellate Body. The Government of Canada and the United States agreed that 10 months was a reasonable period of time for implementation. On November 9, 2004, pursuant to section 129 of the Uruguay Round Agreements Act, the USTR requested that the Department issue by December 17, 2004, a revised determination not inconsistent with the findings of the Appellate Body. On December 6, 2004, Commerce issued its section 129 determination reflecting its analysis of Canada's claims for an adjustment to the subsidy rate to account for "arm's-length" sales of logs (from provincial government land) in which some or all of the stumpage subsidy benefit did not "pass through" to the purchasing sawmills. On December 10, 2004, the USTR, after consultations with the Department and congressional committees, directed the Department to implement the revised determination. The notice of implementation was published in the Federal Register on December 16, 2004.

On December 30, 2004, Canada requested formation of an Article 21.5 "compliance" panel to consider the consistency of the Department's "pass-through" implementation decision. Canada also sought authority to suspend WTO concessions pursuant to Article 22.2 of the DSU; however, that action was stayed to permit the Article 21.5 challenge to proceed. In April 2005, the Article 21.5 panel held a hearing on Canada's claim. Thereafter, on August 1, 2005, the panel issued its decision finding that the Department's implementation was inconsistent with its WTO obligations. In making its decision, the Article 21.5 panel extended its jurisdiction to encompass the results of a subsequent review. The Department appealed that aspect of the Article 21.5 panel decision to the Appellate Body. On December 5, 2005, the Appellate Body upheld the Panel's exercise of jurisdiction over the subsequent review. On December 20, 2005, the DSB adopted the reports. Canada has been silent so far with respect to re-activating its Article 22.2 request for concessions.

4. Korea's Challenge to the CVD Investigation of DRAMs from Korea

Following final affirmative determinations by both Commerce and the ITC, on August 11, 2003, Commerce published a CVD order on dynamic random access memory semiconductors ("DRAMS") from Korea. The order imposed cash deposits of 44.29 percent on imports of DRAMS produced by Hynix. This deposit rate was based largely on Commerce's finding that the Korean Government had provided, or had "entrusted or directed" private bodies to provide, massive subsidies to Hynix in order to save it from going out of business. Commerce excluded the other major Korean producer, Samsung, from the order because Commerce found that the subsidies Samsung received were *de minimis*.

On June 30, 2003, Korea instituted dispute settlement proceedings in the WTO. On January 23, 2004, a panel was established to review Commerce's subsidy determination and the ITC's injury determination. On February 21, 2005, the panel circulated its report in which it decided that Commerce's countervailing duty order, and most specifically its finding of entrustment or direction, was not consistent with WTO rules. With respect to Korea's challenge to the ITC determination of injury, with one exception the panel agreed with the United States on all of the issues. The exception involved one minor aspect of the injury determination where the panel found that the ITC had not adequately explained its analysis. The United States did not appeal this panel finding.

The United States appealed the panel's findings with respect to Commerce's subsidy determination to the WTO Appellate Body. The Appellate Body issued its report on June 27, 2005. The Appellate Body agreed with the United States that the panel committed the following key errors: (1) the panel failed to consider the evidence of entrustment or direction in its totality, as Commerce had done, requiring instead that individual pieces of evidence in themselves establish entrustment or direction; (2) the panel declined to consider evidence on the Commerce administrative record but not cited by Commerce in its published determination; (3) the panel failed to make an objective assessment of the matter within the meaning of Article 11 of the DSU by finding, notwithstanding the absence of supporting evidence in Commerce's record, that

certain Hynix creditors had invoked mediation provisions of Korean law; and (4) the panel essentially applied a *de novo* review, thereby failing to comply with Article 11 of the DSU. As a result, the Appellate Body reversed the panel's finding that Commerce's determination of Korean Government entrustment or direction was inconsistent with the SCM Agreement. The Appellate Body also reversed other panel findings that were based on the panel's finding concerning entrustment or direction. The Appellate Body also modified the panel's interpretation of the phrase "entrusts or directs" as used in Article 1 of the SCM Agreement.

In addition, having reversed the panel's findings, the Appellate Body declined to "complete the analysis" of the panel that had been based upon an improper interpretation and application of the provisions of the Subsidies Agreement. As a result, the original Commerce determination was upheld. The DSB adopted the panel and Appellate Body reports on July 20, 2005. The United States and Korea subsequently agreed that the reasonable period of time for the United States to implement the adverse panel ruling with respect to the ITC's injury determination will expire on March 8, 2006.

5. European Union Challenge to Commerce's "Privatization" Methodology - Spain and United Kingdom

In 2001, the European Communities (EC) challenged Commerce's findings in the 2000 sunset reviews of the CVD orders on certain steel products from Spain and the United Kingdom, as well as the findings in ten other CVD cases involving imports of European steel products. Specifically, the EC argued that Commerce's methodology for analyzing the impact of the privatization of formerly state-owned companies on any pre-privatization subsidies they received was inconsistent with U.S. obligations under the WTO Subsidies Agreement. A WTO Panel and the Appellate Body agreed and overturned Commerce's privatization methodology.

In June 2003, in response to a request from USTR that Commerce correct its methodology to conform with the WTO dispute settlement findings, Commerce adopted and applied a new privatization methodology to the facts of the 12 disputed cases. Commerce's new methodology focused essentially on whether a privatization was conducted at arm's length and for fair market value. In the Spanish and UK cases, Commerce found that, even assuming that the Spanish and UK steel privatizations occurred at arm's length and at fair market value, countervailable subsidization would likely continue or recur in light of certain other subsidies unaffected by privatization, and thus the CVD orders should remain in place.

Commerce's Section 129 findings in the UK and Spanish cases, as well as in a third sunset review on corrosion resistant steel from France, were again challenged by the European Communities. In an August 17, 2005 opinion, a WTO Article 21.5 panel upheld Commerce's finding in the French case, but found that Commerce failed to comply with the express language of the original panel and Appellate Body reports in that it did not examine the privatizations in the UK and Spanish cases. Moreover, regarding the UK case, the compliance panel faulted Commerce's decision not to

consider evidence, submitted for the first time during the implementation proceeding, regarding another, private UK company.

Noting that the United States had been upheld on the more important, substantive findings at issue in the French case, the United States subsequently agreed to the adoption of the compliance panel's findings regarding the UK and Spanish cases. USTR then requested that Commerce bring these measures into conformity with the compliance panel's findings. Accordingly, in the context of an ongoing Section 129 proceeding, Commerce is currently examining the UK and Spanish steel privatizations, as well as a sale of a private UK steel producer, to determine what impact, if any, those transactions had on the likelihood of continued or recurring countervailable subsidization under those orders. Determinations in these Section 129 proceedings are due in late May 2006.

6. Canadian Countervailing Duty Investigation of Grain Corn from the United States

On August 12, 2005, the Ontario Corn Producers' Association, the Manitoba Corn Growers Association, Inc. and the Fédération des producteurs de cultures commerciales du Québec, collectively referred to as the Canadian Corn Producers, filed a complaint with the Canada Border Services Agency (CBSA) alleging the injurious dumping and subsidizing of grain corn originating in or exported from the United States. The complaint covers three federal programs alleged to provide support to grain corn producers in the United States: Direct and Countercyclical Payment Program; Nonrecourse Marketing Assistance Loans and Loan Deficiency Payments; and Federal Crop Insurance Programs. After consultations with the U.S. Government, the CBSA initiated a CVD investigation on September 16, 2005. Included in the scope of the investigation were grain corn in all forms excluding seed corn, sweet corn, popping corn, and certain processed corn products (such as corn flour, meal, and grits) originating in or exported from the United States.

As part of its investigation, the CBSA issued questionnaires to the U.S. Government requesting information regarding the alleged assistance programs. Working with USTR, IA provided extensive technical assistance to the United States Department of Agriculture and other federal entities involved in responding to the Canadian questionnaires. On November 15, 2005, the Canadian International Trade Tribunal (CITT) announced a preliminary affirmative injury determination, while terminating the investigation on processed corn products. On December 15, 2005, the CBSA preliminarily determined that the three U.S. Government programs provided countervailable subsidies to U.S. corn growers and imposed a countervailing duty of US$1.07 per bushel of corn imported into Canada.

Throughout the CVD investigation, USTR, Commerce and the Department of Agriculture will continue to defend forcefully the interests of the U.S. corn industry. These efforts will include providing factual information to the Canadian authorities, making any appropriate procedural objections, and providing substantive arguments both in writing and in the course of meetings held with the Canadian authorities.

On March 15, 2006, the CBSA is scheduled to issue its final determination in the countervailing duty investigation. On April 18, 2006, the CITT is scheduled to issue its final injury determination. If these findings are affirmative, and countervailing duties are imposed, the U.S. Government will consider pursuing an appeal in appropriate fora.

D. WTO SUBSIDIES COMMITTEE

The Subsidies Committee's agenda in 2005 included its routine activities concerned with reviewing and clarifying the consistency of WTO Members' domestic laws, regulations and actions with Agreement requirements. During the fall meeting, the Committee undertook its fourth annual transitional review with respect to China's implementation of the Agreement (see, *Transitional Review Mechanism* section above). The Committee, and the United States, continued to accord special attention to the general matter of subsidy notifications made to and considered by the Subsidies Committee. Other issues addressed in the course of the year included: the examination of the export subsidy program extension requests of certain developing countries, the review of Member's semi-annual reports, the calculation update of the per capita GNP threshold in Annex VII of the Agreement, and consideration of an appointment to the Permanent Group of Experts.

1. Subsidy Notifications

Subsidy notification and surveillance is one means by which the Subsidies Committee and its Members seek to ensure adherence to the disciplines of the Subsidies Agreement. In keeping with the objectives and directives expressed in the URAA, and as demonstrated by the extensive use of the SEO's Electronic Subsidies Enforcement Library, WTO subsidy notifications also play an important role in the United States' monitoring and enforcement activities to protect U.S. rights and benefits under the Subsidies Agreement.

Under Article 25.2 of the Subsidies Agreement, Members are required to report certain information on all measures, practices and activities that, as set forth in Articles 1 and 2 of the Agreement, meet the definition of a subsidy and are specific within the territory of a Member. Last year, 27 subsidy notifications covering 2004 were reviewed. The Committee also continued its examination of new and full notifications and updating notifications for earlier time periods. Unfortunately, numerous Members have never made a subsidy notification to the WTO, although many are lesser developed countries.[21] (For further information regarding the lack of a subsidy notification by China, see *Transitional Review Mechanism* section above).

2. Review of CVD Legislation, Regulations and Measures

Throughout the year, WTO Members continued to submit notifications of new or amended CVD legislation and regulations and of CVD investigations initiated and

[21] For further information, see the Report (2005) of the WTO Committee on Subsidies and Countervailing Measures (G/L/754; October 31, 2005).

decisions taken. These notifications were reviewed and discussed by the Committee at both of its regular meetings. In reviewing notified CVD legislation and regulations, the Committee procedures provide for the exchange in advance of written questions and answers in order to clarify the operation of the notified laws and regulations and their relationship to the obligations of the Agreement. The United States continued to play an important role in the Committee's examination of the operation of other Members' CVD laws and their consistency with the obligations of the Agreement.

To date, 88 Members of the WTO (counting the 25 Members of the European Union as one) have notified that they currently have CVD legislation in place, while 35 Members have not, as yet, made a notification. Among the notifications of CVD laws and regulations reviewed in 2005 were those of: China, the European Union, Jordan, Mexico, and South Africa.

As for CVD measures, 14 WTO Members notified CVD actions taken during the latter half of 2004, and 13 Members notified actions taken in the first half of 2005. Specifically, the Committee reviewed actions taken by Argentina, Australia, Brazil, Canada, Chinese Taipei, Costa Rica, the European Union, Japan, Mexico, New Zealand, the United States and Venezuela.

3. Article 27.4 Update

Under the Agreement, most developing countries were obligated to eliminate their export subsidies by December 31, 2002. Article 27.4 of the Agreement allows for an extension of this deadline provided consultations were entered into with the Committee by the end of 2001. If the Committee grants an extension, annual consultations with the Committee must be held to determine the necessity of maintaining the subsidies.[22] If the Committee does not affirmatively sanction a continuation, the export subsidies must be phased out within two years.

To address the concerns of certain small developing countries, a special procedure within the context of Article 27.4 of the Agreement was adopted at the Fourth WTO Ministerial Conference in 2001. Under this procedure, countries whose share of world exports was not more than 0.10 percent and whose Gross National Income was not greater than $20 billion could be granted a limited extension for particular types of export subsidy programs subject to rigorous transparency and standstill provisions. Members meeting all the qualifications for the agreed upon special procedures were eligible for a five-year extension of the transition period, in addition to the two years referred to under Article 27.4.[23]

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[22] Any extension granted by the Committee would only preclude a WTO dispute settlement case from being brought against the export subsidies at issue. A Member's ability to bring a countervailing duty action under its national laws would not be affected.

[23] In addition to agreement on the specific length of the extension, it was also agreed at the Fourth Ministerial Conference, in essence, that the Committee should look favorably upon the extension requests of Members which do not meet all the specific eligibility criteria for the special small exporter procedures but which are similarly situated to those that do meet all the

At the end of 2001, Antigua and Barbuda, Barbados, Belize, Bolivia, Costa Rica, Dominica, Dominican Republic, El Salvador, Fiji, Grenada, Guatemala, Honduras, Jamaica, Jordan, Kenya, Mauritius, Panama, Papua New Guinea, St. Kitts and Nevis, St. Lucia, St. Vincent and Grenadines and Sri Lanka made requests under the special procedures adopted at the Fourth Ministerial Conference for small exporter developing countries.[24] Uruguay requested an extension for one program under both the normal and special procedures. Additionally, Colombia sought an extension for two of its export subsidy programs under a procedure agreed to at the Fourth Ministerial Conference analogous to that provided for small exporter developing countries (See, footnote 19). These requests were approved by the Committee in 2002, 2003 and 2004.

In 2005, requests were made by all the countries which had received extensions under the special procedures adopted at the Fourth Ministerial Conference for small exporter developing countries.[25] All these requests required, *inter alia*, a detailed examination of whether the applicable standstill and transparency requirements had been met. In total, the Committee conducted a detailed review of more than 40 export subsidy programs. At the end of the process, all of the requests under the special procedures were granted. (A chart showing how each of the requests was addressed, as well as the current status of other programs which were not granted extensions, is found in Attachment 4.) Throughout the review and approval process, the United States actively participated and submitted questions on certain Members' export subsidy programs, ensuring close adherence to all of the preconditions necessary for continuation of the extensions, and the faithful implementation of the decisions taken at the Fourth Ministerial Conference.

4. Update of Annex VII Calculations

Annex VII of the Agreement identifies certain lesser developed countries that are eligible for particular special and differential treatment. Specifically, the export subsidies of these countries are not prohibited and, therefore, are not actionable as

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criteria. This provision was added at the request of Colombia.

[24] Bolivia, Honduras, Kenya and Sri Lanka are all listed in Annex VII of the Subsidies Agreement and, thus, may continue to provide export subsidies until their "graduation" from Annex VII status (see *Update of Annex VII Calculations* section, which follows). Therefore, these countries have only reserved their rights under the special procedures in the event they graduate during the five-year extension period contemplated by the special procedures. Because these countries are only reserving their rights at this time, the Committee did not need to make any decisions as to whether their particular programs qualify under the special procedures.

[25] Colombia did not request an extension in 2004 for two of its export subsidies programs for which extensions were granted under the procedure agreed to at the Fourth Ministerial Conference. Consequently, the two export subsidy programs of Colombia which had been granted extensions under a procedure agreed to at the Fourth Ministerial Conference analogous to that provided for small exporter developing countries, must be phased out within two years (*i.e.,* the end of 2006). For more information, see Attachment 4.

prohibited subsidies under the dispute settlement process. The countries identified in Annex VII include those WTO Members designated by the United Nations as "least developed countries" (Annex VII(a)) as well as countries that had, at the time of the negotiation of the Agreement, a per capita GNP under $1,000 per annum and were specifically listed in Annex VII(b).[26] A country automatically "graduates" from Annex VII(b) status when its per capita GNP rises above the $1,000 threshold. When a Member crosses this threshold it becomes subject to the subsidy disciplines applicable to other developing country Members.

Since the adoption of the Agreement in 1995, the *de facto* interpretation by the Committee of the $1,000 threshold was that it reflected current (*i.e.*, nominal or inflated) dollars. The concern with this interpretation, however, was that a Member could graduate from Annex VII on the basis of inflation alone, rather than on the basis of real economic growth.

In 2001, the Chairman of the Committee, in conjunction with the WTO Secretariat, developed an alternative approach to calculate the $1,000 threshold in constant 1990 dollars. At the Fourth Ministerial Conference, decisions were made which led to the adoption of this methodology. The WTO Secretariat updated these calculations in 2005.[27]

5. Permanent Group of Experts

Article 24 of the Agreement directs the Committee to establish a Permanent Group of Experts (PGE), "composed of five independent persons, highly qualified in the fields of subsidies and trade relations." The Agreement articulates three possible roles for the PGE: (I) to provide, at the request of a dispute settlement panel, a binding ruling on whether a particular practice brought before that panel constitutes a prohibited subsidy, within the meaning of Article 3 of the Agreement; (ii) to provide, at the request of the Committee, an advisory opinion on the existence and nature of any subsidy; and (iii) to provide, at the request of a WTO Member, a "confidential" advisory opinion on the nature of any subsidy proposed to be introduced or currently maintained by that Member. To date, the PGE has not yet been called upon to perform any of the aforementioned duties. Article 24 further provides for the Committee to elect the experts to the PGE, with one of the five experts being replaced every year.

As of the beginning of 2005, the members of the Permanent Group of Experts were: Professor Okan Aktan (Turkey); Dr. Marco Bronckers (Netherlands); Mr. Yuji Iwasawa (Japan); Mr. Hyung-Jin Kim (Korea); and Mr. Terence P. Stewart (United

[26] Members identified in Annex VII(b) are Bolivia, Cameroon, Congo, Cote d'Ivoire, Dominican Republic, Egypt, Ghana, Guatemala, Guyana, India, Indonesia, Kenya, Morocco, Nicaragua, Nigeria, Pakistan, Philippines, Senegal, Sri Lanka, and Zimbabwe. In recognition of the technical error made in the final compilation of this list and pursuant to a General Council decision, Honduras was formally added to Annex VII(b) on January 20, 2001.

[27] See, G/SCM/110/Add.2 , May 11, 2005.

States). Mr. Hyung-Jin Kim's term expired in the spring of 2005. The Committee has been unable to reach a consensus as to his replacement.

6. Areas of Focus in 2006

In 2006, the United States will continue to work with others to encourage Members' to meet their subsidy notification obligations, and to provide technical assistance to help them prepare their notifications when available and where appropriate. Second, the United States will focus particularly on China's subsidy practices, both through the regular meetings of the WTO's Subsidy Committee and the Transition Review Mechanism, continuing the effort to ensure that China meets its obligations under its Protocol of Accession and the Agreement. Thirdly, the United States will continue to ensure the close adherence to the provisions of the agreed upon export subsidy extension procedures for small exporter developing countries. Finally, the United States is prepared to contribute significantly in addressing any technical questions or developing country issues that the Subsidies Committee may be asked to consider in the context of issues that may arise within the Rules Negotiating Group.

E. U.S. MONITORING OF SUBSIDY-RELATED COMMITMENTS

1. Accessions

Countries and separate customs territories seeking to join the WTO must negotiate the terms of their accession with current Members. It is widely recognized that the accession process, with its emphasis on implementation of WTO provisions and the establishment of stable and predictable market access for goods and services, provides a proven framework for adoption of policies and practices that encourage trade and investment and promote growth and development. The accession process strengthens the international trading system by ensuring that new Members understand and implement WTO rules from the outset. The process also offers current Members the opportunity to secure expanded market access opportunities and to address outstanding trade issues in a multilateral context.

In a typical accession negotiation, the applicant submits an application to the WTO General Council, which establishes a Working Party to review information on the applicant's trade regime and to conduct the negotiations. Accession negotiations involve a detailed review of the applicant's entire trade regime by the Working Party and bilateral negotiations for import market access. Applicants are expected to make necessary legislative changes to implement WTO institutional and regulatory requirements, to eliminate existing WTO-inconsistent measures, and to make trade liberalizing specific commitments on market access for goods, services, and agriculture. Most accession applicants take these actions prior to accession.

The economic and trade information reviewed by the Working Party includes the acceding candidate's subsidies regime. USTR and Commerce, along with an interagency team, review the compatibility of acceding countries' subsidy regimes with WTO subsidy rules. Specifically, information on the nature and extent of the

candidate's subsidies is examined, with particular emphasis on subsidies that are prohibited under the Subsidies Agreement. Additionally, an accession candidate's trade remedy laws are examined to determine their compatibility with the relevant WTO obligations.

Subsidy-related information is summarized in a memorandum submitted by an applicant country detailing its foreign trade regime, which is supplemented and corroborated by independent research throughout the accession negotiation. The United States seeks commitments from accession candidates that they eliminate all prohibited subsidies upon joining the WTO, and that they will not introduce any such subsidies in the future. Additional commitments may be sought regarding any subsidies that are of particular concern to U.S. industries.

In 2005, intensive negotiations continued, in particular, with Saudi Arabia, Tonga, Russia, Ukraine, and Vietnam. Saudi Arabia has completed its working party negotiation and its protocol was approved by the General Council in early November. On December 11, 2005, Saudi Arabia became the 149th Member of the WTO. Tonga's final working party report was adopted in mid-November and its protocol was approved by Ministers on December 15, 2005, putting it in line to become the 150th Member of the WTO. In addition, the General Council established working parties to examine the membership applications of Iran, Saotome and Principe and the now separate applications of Serbia and Montenegro. With the addition of these countries, the number of applicants with established working parties in the WTO rose to 30.[28]

Russia

Subsidies continued to be a significant topic of concern for the United States during 2005 in the accession negotiations with the Russian Federation. The 29th meeting of the Working Party took place in October 2005 and bilateral negotiations occurred frequently throughout the year. The United States and other Working Party Members continue to seek commitments from Russia with regard to a number of subsidies, including some potentially prohibited subsidies such as those provided through production sharing agreements, as well as incentives to the automotive and aircraft industries.

Russia's current natural gas pricing policies remain one of the most contentious subsidies-related issues in the negotiations. The United States and several other Members have raised concerns in this area. In particular, the potentially distortive effect that low-priced gas has on Russian industrial production and internationally-traded energy-intensive products has been a key issue because of the possible resulting adverse impact on U.S. industries. The United States will continue to pursue

[28] Accession applicants with working parties established are Afghanistan, Algeria, Andorra, Azerbaijan, Bahamas, Belarus, Bhutan, Bosnia and Herzegovina, Cape Verde, Ethiopia, Iran, Iraq, Kazakhstan, Laos, Lebanon, Libya, Montenegro, Russia, Samoa, Sao Tome and Principe, Serbia, Seychelles, Sudan, Tajikistan, Tonga, Ukraine, Uzbekistan, Vanuatu, Vietnam and Yemen.

this issue in the negotiations and remains committed to Russia's accession to the WTO.

Ukraine

Ukraine's Working Party was established on December 17, 1993. Throughout the negotiations, the issue of subsidies has been a major topic of discussion. The United States has been seeking a commitment from Ukraine with regard to a number of subsidies, including some potentially prohibited subsidies. Ukraine is still in the process of developing its trade remedies legislation. Ukraine has amended it antidumping legislation twice but currently does not have countervailing duty legislation. Ukraine has made substantial efforts in moving forward. The United States remains committed to its accession to the WTO.

Vietnam

Vietnam's Working Party was established on December 17, 1993. Vietnam is in the process of updating its investment laws to bring them into conformity with its obligations with respect to prohibited subsidies. Vietnam has provided two subsidy notifications consistent with the requirements under Article 25 of the Subsidies Agreement, which describe several possible prohibited subsidy programs. The United States has sought clarification of these programs. An updated subsidy notification is to be provided in the near term. The United States and Vietnam are working closely together as Vietnam develops its trade remedy legislation. The United States is prepared to move forward, as appropriate, and remains committed to Vietnam's accession to the WTO.

2. WTO Trade Policy Reviews

The WTO's Trade Policy Review Mechanism provides USTR and Commerce with another opportunity to review the subsidy practices of WTO Members. These reviews were agreed to as part of the Uruguay Round Agreements with the aim of (1) increasing transparency and promoting understanding of other countries' trade policies and practices; (2) improving the quality of public and intergovernmental debate on important issues; and (3) enabling a multilateral assessment of the effects of trade policy on the world trading system. These "peer reviews" encourage WTO Members to follow WTO rules and disciplines more closely and to fulfill their multilateral commitments.

Trade Policy Reviews (TPRs) focus on the trade policies and practices of a particular country while also taking into account overall economic and developmental needs, policies and objectives, as well as the external economic environment that a country faces. The four largest traders in the WTO (the European Union, the United States, Japan and China) are examined once every two years. The next 16 largest countries, based on their share of world trade, are reviewed every four years. The remaining countries are reviewed every six years, with the possibility of a longer interim period for the least-developed countries. For each review, two documents are

prepared: a policy statement by the government under review, and a detailed report written independently by the WTO Secretariat.

These reviews play an important role in ensuring that WTO Members meet transparency requirements concerning their subsidy practices. TPRs also provide a broader context than the Subsidies Committee notification reviews in which to assess a Member's subsidy policies and their role in that Member's economy. In reviewing these trade policy reports, USTR and Commerce focus on the information concerning the subsidy practices detailed in the report, but also conduct additional research on potential omissions regarding known subsidy practices that have not been reported. In 2005, USTR and Commerce reviewed 15 Members' trade policy reports, including those of Japan, Egypt and the Phillippines.[29]

CONCLUSION

In 2005, the United States vigorously enforced U.S. rights under the WTO Subsidies Agreement in order to address some of the root causes that give rise to unfair trade distortions, which can cause harm to American workers and industries. In particular, USTR and Commerce continued their work in a number of key areas. These included efforts to seek deeper multilateral subsidies disciplines through the Doha Development Agenda; press China to bring its subsidies practices in line with its international obligations; formulate better disciplines over practices that can distort markets and trade in the steel sector; strengthen ongoing efforts to monitor and challenge subsidies practices that harm U.S. industries and workers; and end unfair subsidies to Airbus.

In the Doha Development Agenda subsidy negotiations, the United States has firmly asserted its leadership in support of the need for improved subsidy disciplines, identifying a broad array of subsidy issues that need to be addressed and proposing new disciplines where none currently exist. Identification of enhanced disciplines on trade distorting practices, including subsidies, is particularly important because it is these practices that are the root causes of trade friction. In 2005, the United States continued the technical work of furthering the development of subsidy benefit calculation methodologies that will promote greater predictability in the application of the rules and permit a firmer basis for strengthened disciplines based on quantitative limitations on subsidy benefit amounts. In early 2006, the United States elaborated on its earlier proposal to expand the category of subsidies prohibited under the Subsidies Agreement. This proposal is perhaps the most far-reaching subsidy-related proposals tabled to date in the Rules negotiations. The proposed strengthened disciplines would greatly enhance the United States' ability to address, and potentially deter, subsidy-related unfair trade practices confronting U.S. industries.

[29] Fifteen Members were reviewed in 2005 Jamaica, Japan, Sierra Leone, Qatar, Mongolia, Paraguay, Nigeria, Ecuador, the Philippines, Egypt, Trinidad and Tobago, Tunisia, Republic of Guinea, Bolivia and Romania.

China's fourth year of membership in the WTO concluded in 2005 and with it the fourth examination of China's accession under the TRM. In the Subsidies Committee, the United States continued to vigorously press China to bring its subsidy practices into compliance with WTO subsidy-related rules and disciplines. Unfortunately, China's failure to notify required information about its subsidy programs continues to frustrate a fully meaningful review of China's WTO compliance record. The United States will continue to press China at the WTO regarding its subsidy practices and expand the United States' unilateral surveillance of China's government practices in order to better identify and, as appropriate, respond to possible subsidy problems. To achieve this, the United States will devote significant resources to China subsidy issues in 2006 and work to ensure that China follows through with its commitment to come into compliance with its Subsidy Agreement obligations. On a broader scale, the United States will continue to examine structural problems and distortions in China's economy and pragmatically address concerns about trade- and market-distorting practices in the Structural Issues Working Group.

In 2006, USTR and Commerce will continue to promote the goal of strengthening the international subsidy discipline regime and to pursue proactively an agenda to safeguard the interests of U.S. industries and workers facing unfairly subsidized foreign competition.

ATTACHMENT 1

SUBSIDIES ENFORCEMENT:
ASSISTING U.S. EXPORTERS TO COMPETE EFFECTIVELY

Subsidies Enforcement Office: The Department of Commerce's Import Administration is responsible for coordinating multilateral subsidies enforcement efforts. The primary mission is to assist the private sector by monitoring foreign subsidies and identifying government assistance programs that can be remedied under the Subsidies Agreement of the World Trade Organization, of which the United States is a member. To fulfill this mission, Import Administration has created the Subsidies Enforcement Office (SEO). As part of its monitoring efforts, the SEO has created a Subsidies Library, which is available to the public via the Internet (http://ia.ita.doc.gov/esel). The goal is to create an easily accessible one-stop shop that provides user-friendly information on foreign government subsidy practices.

Types of Subsidies: A subsidy can be almost anything a government does, if the following conditions are met: (1) a financial contribution is made by a government or public body and (2) a benefit is received by the company. Trade rules permit remedies in circumstances when subsidies are "specific" (*i.e.*, provided to a limited number of companies, such as all exporters) and have caused adverse trade effects. Subsidies can take a variety of forms. Following are some of the types of foreign subsidies that could place a U.S. exporter at a competitive disadvantage vis-a-vis a foreign competitor.

- ***Export financing*** at preferential rates.
- ***Grants or Tax exemptions*** for favored companies or industries.
- ***Loans that are conditioned on meeting local content requirements***, or are contingent upon the use of domestic goods over U.S. exports (commonly referred to as "import substitution subsidies").

As an illustration:
A U.S. exporter is bidding on a project in Country A and is competing against an exporter from Country B. The company from Country B offers a bid that is extremely low, possibly even below what one would assume to be the cost of production. The U.S. exporter may have knowledge that the reason the company from Country B is able to bid so low is that it is being assisted by its government with low cost loans and payment of various export related expenses. In such a situation, we would encourage the U.S. exporter to collect as much information as possible concerning the potential subsidies and then contact us with all of the relevant information. We would then check further into the types of subsidies being received and determine whether any action should be taken.

Types of Remedies: Remedies for violations of the Subsidies Agreement could involve requiring the foreign government to eliminate the subsidy program or its adverse effect, or, as a last resort, to authorize offsetting compensation.

Working Together to Assist U.S. Exporters: The SEO welcomes any information about foreign subsidy practices that may adversely affect U.S. companies' export efforts. The SEO can evaluate the subsidy in relation to U.S. and multilateral trade rules to determine what action may be possible to take to counteract such adverse effects. By working together to monitor foreign subsidies and enforce the WTO Subsidies Agreement, we can ensure that U.S. companies are competing in a fair international trading system.

***Questions and information can be referred to*:**
Carole Showers tel.: (202) 482-3217
fax : (202) 501-7952
e-mail: Carole_Showers@ita.doc.gov

ATTACHMENT 2

TRADE REMEDY COMPLIANCE STAFF:
PRO-ACTIVELY ADDRESSING UNFAIR TRADE PROBLEMS

THE TRADE REMEDY COMPLIANCE STAFF

In recent years, Congress has called for more pro-active steps to address unfair practices hindering U.S. trade. To this end, it has provided both resources and a mandate for increased monitoring of other countries' trade policies and practices, as well as the strengthening of U.S. trade law enforcement. Import Administration (IA) has taken up that charge, in part through the creation of the Trade Remedy Compliance Staff (TRCS). The TRCS is a team of trade analysts working in tandem with new IA officers stationed overseas in such locations as China and Korea. Their mission is to support administration of the U.S. unfair trade laws, including by monitoring foreign policies and trade trends in order to better detect and address developing unfair trade problems.

THE TRCS ROLE AND SERVICE

IA's central role remains the enforcement of the U.S. antidumping (AD) and countervailing duty (CVD) laws. However, IA has built upon its law enforcement duties by instituting a variety of import monitoring and subsidies enforcement activities designed to help American industry deal more effectively with a broader range of unfair trade problems. The TRCS is the latest extension of this commitment to provide assistance to U.S. businesses which feel that their trade problems may stem from unfair practices or the improper application of foreign unfair trade laws. Focused initially on our major trading partners in east Asia, the TRCS has in place an ongoing monitoring program which tracks import trends as well as certain government policies, business conditions and company practices in the countries concerned. The goal is to help pinpoint and analyze problematic policies and trade trends so that governments have an opportunity to avert unfair trade frictions and prevent harm to U.S. interests. The placement of IA officers overseas gives the TRCS better access to various sources of information with which to more effectively identify and understand these potential unfair trade problems, as well as the ability to immediately address such problems, through discussion with government counterparts and technical assistance.

TRCS INITIATIVES UNDER WAY

For its key focus countries, TRCS personnel in Washington and abroad continually develop key information sources and databases to study imports into the United States and evaluate the status and evolution of foreign government policies and market developments that might contribute to unfair trade. On a wider front, TRCS keeps watch on all our trading partners' AD and CVD activity to identify potential difficulties for U.S. exporters and/or conflicts with WTO obligations or basic precepts of transparency and due process. One example of the TRCS's contributions thus far is its monitoring of China's WTO-related subsidies and unfair trade law obligations as part of the U.S. Government's broader efforts to verify Chinese compliance with WTO accession commitments.

TRCS Activities

Washington, D.C.

•For key countries, monitor data on imports into the United States, as well as foreign government policies and economic/business trends that may contribute to unfair trade problems.

•Monitor other countries' development and use of their AD, CVD and other trade remedy statutes.

•Provide information related to the enforcement of U.S. AD/CVD laws to foreign and domestic parties.

Overseas

•Support Washington-based case analysts in matters directly related to the administration of U.S. AD/CVD laws.

•Collect, assess, and confirm information about certain foreign market conditions, trade practices, and governmental policies that would facilitate administration of U.S. unfair trade laws or U.S. monitoring of unfair trade commitments.

•Report on developments in use of foreign unfair trade laws, particularly as they affect U.S. interests.

•Actively assist countries to meet WTO obligations, through discussion and

Need further information?

Please contact:

Trade Remedy Compliance Staff
Tel: 202-482-3415/Fax: 202-482-6190/email: trcs@ita.doc.gov

ATTACHMENT 3

THE SUBSIDIES ENFORCEMENT LIBRARY

[http://ia.ita.doc.gov/esel/]

First Screen

ELECTRONIC SUBSIDIES ENFORCEMENT LIBRARY

- **WTO Agreement on Subsidies and Countervailing Measures**
- **Overview of the Subsidies Enforcement Office**
- **Subsidy Programs Investigated by DOC**
- **WTO Subsidies Notifications**

Annual Reports to Congress on Subsidies Enforcement

- **1998 Annual Report on Subsidies Enforcement - February 1998**
- **1999 Annual Report on Subsidies Enforcement - February 1999**
- **2000 Annual Report on Subsidies Enforcement - February 2000**
- **2001 Annual Report on Subsidies Enforcement - February 2001**
- **2002 Annual Report on Subsidies Enforcement - February 2002**
- **2003 Annual Report on Subsidies Enforcement - February 2003**
- **2004 Annual Report on Subsidies Enforcement - February 2004**
- **2005 Annual Report on Subsidies Enforcement - February 2005**

- **Review and Operation of the WTO Subsidies Agreement - June 1999**

Description of Choices

WTO Agreement on Subsidies and Countervailing Measures

This links the visitor to the World Trade Organization Agreement on Subsidies and Countervailing Measures as found in the Multilateral Agreement on Trade in Goods. Information in this Agreement includes the definition of a subsidy and provides general guidelines under which remedies may be put in place.

Overview of the Subsidies Enforcement Office

This links the visitor to the informational page found in Attachment 1 of this Report, which includes a general overview of the SEO as well as contact information.

Subsidy Programs Investigated by DOC

This links the visitor to information regarding subsidy programs which have been analyzed by Import Administration staff during countervailing duty (CVD) proceedings since 1980. The information is provided by country and then subdivided into various categories, based on the DOC's finding in the proceeding. More detailed information about a program in a specific case can be easily found by clicking on the hyperlinked cite to the Federal Register notice, in which a complete description of the program and Commerce's analysis is provided. As of December 2004, the number of countries which have had programs investigated in U.S. CVD proceedings was 52.

WTO Subsidies Notifications

This will link the visitor to all unrestricted WTO subsidy notifications, listed either by date or by country. Beside each country's name is a description of the document, the document number and document symbol as well as the date the document was submitted to the WTO. Clicking on the name of a country will lead the visitor to that country's subsidy notification. The notification will provide a list of notified subsidies, in addition to specific information concerning each subsidy program, such as the type of incentive provided, the duration and purpose of the program, and the governing law or provision of the incentive. Although the Subsidies Agreement stipulates that the notification of a subsidy practice does not prejudge its legal status under the Agreement, these notifications do provide detailed information concerning a number of countries' subsidy measures. In the event that less than full information about the program is provided, the Subsidies Enforcement Office, working with other Agencies, seeks more detailed information.

Annual Reports to Congress on Subsidies

Links are provided for the visitor to review the most recent SEO Annual Report to Congress as well as past Annual Reports.

Reports to Congress

- **Review and Operation of the WTO Subsidies Agreement - June 1999**

This links the visitor to the June 1999 Report to Congress that reviews the operation of the WTO Subsidies Agreement.

ATTACHMENT 4

Extension of the Transition Period Pursuant to Article 27.4 of the Agreement on Subsidies and Countervailing Measures		
WTO MEMBER	**NAME OF PROGRAM**	**SUBSIDIES COMMITTEE ACTION****
ANTIGUA & BARBUDA	Fiscal Incentives Act*	Fourth one-year extension granted
	Free Trade/Processing Zones*	Fourth one-year extension granted.
BARBADOS	Fiscal Incentive Program*	Fourth one-year extension granted.
	Export Allowance*	Fourth one-year extension granted.
	Research & Development Allowance*	Fourth one-year extension granted.
	International Business Incentives*	Fourth one-year extension granted.
	Societies with Restricted Liability*	Fourth one-year extension granted.
	Export Re-discount Facility	**No extension requested.**
	Export Credit Insurance Scheme	**No extension requested.**
	Export Finance Guarantee Scheme	**No extension requested.**
	Export Grant & Incentive Scheme	**No extension requested.**
BELIZE	Fiscal Incentives Program*	Fourth one-year extension granted.
	Export Processing Zone Act*	Fourth one-year extension granted.
	Commercial Free Zone Act*	Fourth one-year extension granted.
	Conditional Duty Exemption Facility*	Fourth one-year extension granted
BOLIVIA (Annex VII Country)	Free Zone	Reservation of rights. No action taken.
	Temporary Admission Regime for Inward Processing	Reservation of rights. No action taken.
COSTA RICA	Duty Free Zone Regime*	Fourth one-year extension granted.
	Inward Processing Regime*	Fourth one-year extension granted.
COLOMBIA	**Free Zone Regime**	**No extension requested.**
	Special Import-Export System for Capital Goods & Spare Parts (SIEX)	**No extension requested.**
	Transport Compensation Mechanism	**No extension requested.**
DOMINICA	Fiscal Incentives Program*	Fourth one-year extension granted.
DOMINICAN REPUBLIC	Law No. 8-90, to "Promote the Establishment of Free Trade Zones*	Fourth one-year extension granted.
EL SALVADOR	Export Processing Zones & Marketing Act*	Fourth one-year extension granted.
	Export Reactivation Law	**No extension requested.**
FIJI	Short-Terms Export Profit Deduction	Fourth one-year extension granted.
	Export Processing Factories/Zones Scheme	Fourth one-year extension granted.
	The Income Tax Act (Film Making & Audio Visual Incentive Amendment Degree 2000)	Fourth one-year extension granted.

WTO MEMBER	NAME OF PROGRAM	SUBSIDIES COMMITTEE ACTION**
GRENADA	Fiscal Incentives Act No. 41 of 1974*	Fourth one-year extension granted.
	Qualified Enterprise Act No. 18 of 1978*	Fourth one-year extension granted.
	Statutory Rules and Orders No. 37 of 1999*	Fourth one-year extension granted.
GUATEMALA	Special Customs Regimes*	Fourth one-year extension granted.
	Free Zones*	Fourth one-year extension granted.
	Industrial and Free Trade Zones (ZOLIC)*	Fourth one-year extension granted.
HONDURAS (ANNEX VII COUNTRY)	Free Trade Zone of Puerto Cortes (ZOLI)	Reservation of rights. No action taken.
	Export Processing Zones (ZIP)	Reservation of rights. No action taken.
	Temporary Import Regime (RIT)	Reservation of rights. No action taken.
JAMAICA	Export Industry Encouragement Act*	Fourth one-year extension granted.
	Jamaica Export Free Zone Act*	Fourth one-year extension granted.
	Foreign Sales Corporation Act*	Fourth one-year extension granted.
	Industrial Incentives (Factory Construction) Act*	Fourth one-year extension granted.
JORDAN	Income Tax Law No. 57 of 1985, as amended*	Fourth one-year extension granted.
KENYA (ANNEX VII COUNTRY)	Export Processing Zones	Reservation of rights. No action taken.
	Export Promotion Program Customs & Excise Regulation	Reservation of rights. No action taken.
	Manufacture Under Bond	Reservation of rights. No action taken.
MAURITIUS	Export Enterprise Scheme*	Fourth one-year extension granted.
	Pioneer Status Enterprise Scheme*	Fourth one-year extension granted.
	Export Promotion*	Fourth one-year extension granted.
	Freeport Scheme*	Fourth one-year extension granted.
PANAMA	Export Processing Zones*	Fourth one-year extension granted.
	Official Industry Register*	Fourth one-year extension granted.
	Tax Credit Certificates (CAT)	**No extension requested.**
PAPUA NEW GUINEA	Section 45 of the Income Tax Act*	Fourth one-year extension granted.
SRI LANKA (ANNEX VII COUNTRY)	Income Tax Concessions	Reservation of rights. No action taken.
	Tax Holidays & Profits Generated	Reservation of rights. No action taken.
	Concessionary Tax on Dividends	Reservation of rights. No action taken.
	Indirect Tax Concessions - Internal Tax Exemptions	Reservation of rights. No action taken.
	Export Development Investment Support Scheme	Reservation of rights. No action taken.
	Import Duty Exemption	Reservation of rights. No action taken.

WTO MEMBER	NAME OF PROGRAM	SUBSIDIES COMMITTEE ACTION**
	Exemption from Exchange Control	Reservation of rights. No action taken.
ST. KITTS & NEVIS	Fiscal Incentives Act*	Fourth one-year extension granted.
ST. LUCIA	Fiscal Incentives Act*	Fourth one-year extension granted.
	Micro & Small Scale Business Enterprise Act*	Fourth one-year extension granted.
	Free Zone Act*	Fourth one-year extension granted.
ST. VINCENT AND THE GRENADINES	Fiscal Incentives Act*	Fourth one-year extension granted.
THAILAND	**Investment Promotion Incentives**	**No extension requested.**
	Industrial Estate Authority of Thailand	**No extension requested.**
	Export Market Diversification Program	**No extension requested.**
URUGUAY	Automotive Industry Export Promotion Regime*	Fourth one-year extension granted.

* Program qualifies under special procedures adopted at the Fourth Ministerial Conference.

** All programs for which an extension was requested are permitted a two-year phase-out period after the extension period sanctioned by the Subsidies Committee. If no extension period was approved, Members must phase-out the program in two years.

Programs in bold are programs for which no further extension has been requested. Therefore, these programs are subject to the two-year phase-out period. The following programs were granted extensions in 2002, however no extension was requested during the 2003 review: Barbados' Export Re-discount Facility, Export Credit Insurance Scheme, Export Finance Guarantee Scheme and Export Grant & Incentive Scheme; Colombia's Transport Compensation Mechanism; Panama's Tax Credit Certificates (CAT) program; and Thailand's Investment Promotion Incentives, Industrial Estate Authority of Thailand and Export Market Diversification Programs. The following programs were granted extensions in 2003, however no extension was requested during the 2004 review: Colombia's Free Zone Regime and Special Import-Export System for Capital Goods & Spare Parts (SIEX) program; and El Salvador's Export Reactivation Law.