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# SECURING AMERICAN SOVEREIGNTY: A REVIEW OF THE UNITED STATES' RELATIONSHIP WITH THE WTO

## HEARING

BEFORE THE

FEDERAL FINANCIAL MANAGEMENT, GOVERNMENT INFORMATION, AND INTERNATIONAL SECURITY SUBCOMMITTEE

OF THE

COMMITTEE ON HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS UNITED STATES SENATE

ONE HUNDRED NINTH CONGRESS

FIRST SESSION

JULY 15, 2005

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# SECURING AMERICAN SOVEREIGNTY: A REVIEW OF THE UNITED STATES' RELATIONSHIP WITH THE WTO

**FRIDAY, JULY 15, 2005**

U.S. SENATE,
SUBCOMMITTEE ON FEDERAL FINANCIAL MANAGEMENT,
GOVERNMENT INFORMATION, AND INTERNATIONAL SECURITY,
OF THE COMMITTEE ON HOMELAND SECURITY
AND GOVERNMENTAL AFFAIRS,
*Washington, DC.*

The Subcommittee met, pursuant to notice, at 9:31 a.m., in room SD–562, Dirksen Senate Office Building, Hon. Tom Coburn, Chairman of the Subcommittee, presiding.

Present: Senators Coburn and Levin.

## OPENING STATEMENT OF SENATOR COBURN

Senator COBURN. Good morning. Thank you all for being here today. Today's hearing will focus on the direction of the World Trade Organization and examine the relationship between WTO rulings and American sovereignty.

Unlike other international institutions in which the United States participates, the WTO links its adjudication process to an enforcement mechanism. Using this mechanism, international diplomats determine if U.S. laws and regulations are acceptable or unacceptable, according to the political trade standards of the international community. That is probably as it should be. If nations don't change laws that WTO rules against, WTO can and does impose punitive damages on that nation's taxpayers, and trade sanctions.

Since WTO inception 10 years ago, the United States has lost half the cases brought against it by other WTO members—25 out of at least 50 cases. Already, Congress has repealed two laws by WTO dictate. These include the foreign sales corporation provisions that were provided a tax benefit for U.S. exporters—the modification to that law is presently being challenged as well; and the Antidumping Act of 1916. Both laws were created to protect U.S. financial interests and were modified to accommodate the interests of foreign countries and their trade positions.

I would say that I believe in free trade. I believe in fair free trade. Americans run and work for the most innovative, efficient, and competitive businesses in the world. On balance, free and fair trade with every nation benefits every American. It is an onerous process to negotiate bilateral trade agreements with every other

Nation in the world. This process could result in confusing and conflicting standards or create burdensome consequences on American industry. That is why we are in the WTO, and that is why there is marked value to our participation.

When the United States has brought complaints against other countries through the WTO, the United States has, for the most part, prevailed. But when other countries have brought complaints against us, we do far less well. So we need to be careful. With adverse rulings from the WTO on the rise, Congress must exercise its appropriate oversight authority and make sure that the WTO does not cross the line into threatening U.S. national interests.

We need to ensure that the WTO does not misinterpret U.S. membership as a license to dictate to democratically elected Federal and State legislatures how to govern the affairs of the American people. Americans rely on our trade representatives, who serve as watchdogs of the WTO, to ensure that the WTO's adjudication process does not overstep its mission and impose unwelcome and un-voted-on changes in our national affairs.

Unfortunately, as with other international organizations, some of the WTO leadership seem to have higher ambitions for this trade body beyond its purpose as a forum for resolving trade disputes. WTO leaders pay a lot of lip service to the notion of consensus, but we have seen how elusive global consensus can be on fundamental matters of right and wrong. Let me give you an idea of what I mean. This is a portion of a statement given by a former WTO director general in his farewell speech entitled "Beyond the Multilateral Trading System." The former WTO director general stated:

"Not too long ago, the idea of a global system of governance would have seemed utopia, no less utopia than the fall of the Berlin Wall without a war, the creation of a single European currency. Cold War rivalries, ideologic conflicts, North-South differences all created an international system that was defined by its divisions, not by its shared interests.

"The trend in today's international system is very different. All around us and across many issues, we feel more and more the need for global cooperation, multilateral agreements, and the international rule of law. The WTO's emergence as a leading rulemaker in the global economy is a powerful example of this trend, but is not alone. From human rights to climate change to capital flows, our globalizing world demands global solutions, and these solutions must be increasingly by shared agreements and rules."

What he means here is that the idea of a perfect world consists of a WTO paving the way for an order that is involved in everything from human rights, climate change, to capital flows. This is the type of agenda that I see as a problem. It suggests that WTO sees itself more than just trade dispute-resolution body, but an ideologic instrument, where it swings an economic hammer to impose a U.N.-driven, consensus-based ideology.

Tying the economic well-being of the United States to its submission to international notions of right and wrong is the worst type of blackmail. We all remember when Libya was elected the chair of the U.N. Human Rights Commission only a couple of years after the United States had been kicked off the Human Rights Commission. Currently, Sudan, Zimbabwe, Cuba, and China—a literal

Who's Who in human rights violators—are on that same commission. Is that the kind of consensus we want? I think not.

WTO tentacles reach not only to Congress here in Washington, but to many State legislatures forced to change their laws in response to an adverse ruling. When an organization in Geneva requires a struggling entrepreneur in the middle of America to change how he does business or imposes new standards on entire industries, Congress cannot be derelict in exercising oversight. The balance between costs and benefits of U.S. participation in WTO must be constantly monitored. We need to tread carefully, because the WTO does carry a very big stick.

Let me thank each of our witnesses for being here. Senator Carper was unable to attend. He will offer a statement for the record.

We have before us today two panels. The first is James Mendenhall, Acting General Counsel for the Office of the United States Trade Representative. And we will have a second panel consisting of Claude Barfield, resident scholar, American Enterprise Institute; Dr. Robert Stumberg, professor of law, Harrison Institute for Public Law, Georgetown Law School; and Robert Vastine, president, Coalition of Service Industries.

Mr. Mendenhall, first of all, thank you for being here. I want to say something and I want you to take it in the proper perspective. It is very difficult for me to prepare for this hearing when I get your testimony at 8 o'clock last night. That is when it was delivered to my office. And I know that is not necessarily your fault. But at every hearing, I want the message to go back through the OMB that we have to have more timely availability of testimonies with which to be prepared to conduct the hearing. So if you would do that.

I thank you for your testimony. Your written testimony will be considered a part of the record, and I recognize you now. Thank you so much.

## TESTIMONY OF JAMES E. MENDENHALL,[1] ACTING GENERAL COUNSEL, OFFICE OF THE UNITED STATES TRADE REPRESENTATIVE

Mr. MENDENHALL. Thank you, Chairman Coburn.

I appreciate the opportunity to speak to you today about the relationship between the United States and the WTO. It is obviously a critical issue for all of the reasons that you highlighted in your own statement.

The specific title of today's hearing is "Securing American Sovereignty." I would suggest an equally appropriate topic would be "Securing American Economic Strength," for those two complementary objectives together form our guiding principles in negotiating and implementing the WTO agreements.

U.S. participation in the WTO and the world trading system is absolutely critical to our continued economic growth. At the same time, the safeguards that are built into the system, which I will describe in my testimony, fully preserve our sovereign right to regu-

[1] The prepared statement of Mr. Mendenhall with attachments appears in the Appendix on page 42.

late as we—the U.S. Government, State and local governments, and the people of America to whom we answer—see fit.

Since 1994, when the WTO agreements were completed, the United States has experienced an extraordinary period of economic growth. USTR's Annual Report, issued in May of this year, details those benefits at great length. Highlights also appear in my written testimony, and I won't go into the details of them here. But in summarize, they demonstrate dramatic increases over the past 10 years in production, productivity, incomes, and jobs throughout the United States.

In short, the benefits of U.S. participation in the WTO are large, tangible, and widespread, as recognized by the House of Representatives last month when it voted overwhelmingly—338 to 86—to defeat a resolution calling for U.S. withdrawal from the WTO.

During the WTO negotiations—the Uruguay Round negotiations—and in the current round, U.S. trade negotiators have been ever mindful of the need to protect U.S. sovereignty. It is absolutely critical that at the same time we work to integrate the global economy and maximize opportunities for U.S. workers, farmers, and businesses, we fully preserve our sovereign prerogatives.

To better explain how we have sought to achieve those objectives, I will break my testimony into three parts: First, a discussion of the substantive rules; second, a discussion of the administrative structure of the WTO; and third, a discussion of the landmark dispute settlement mechanism negotiated during the Uruguay Round, including a summary of how we have fared under that system.

The predecessor to the WTO, the GATT, or General Agreement on Tariffs and Trade, lasted for about 50 years and covered only trade in goods. Since the negotiation of that agreement, though, the global economy has evolved and it now looks much different than it did 50 or 60 years ago. The services sector now accounts for 60 to 80 percent of the U.S. economy. It is the one area where the United States actually has a trade surplus. Protection of intellectual property has come to play a central role in U.S. economic growth. The value of innovation, creativity, and branding, covering everything from movies and music to software to pharmaceuticals to basic trademarks, is a key driver of U.S. competitiveness.

As a result, we negotiated new rules in the Uruguay Round to cover services and intellectual property and break down trade barriers. We also modernized and elaborated on the old GATT disciplines, so that they now cover in greater detail issues such as standards, sanitary and phytosanitary measures, and trade remedies. Yet, all these rules share the same hallmarks as the previous GATT system. They set general parameters to eliminate protectionist measures and liberalize trade, while at the same time they allow ample flexibility to regulate in the public interest.

Outside general guidelines prohibiting discrimination on the basis of nationality, promoting transparency and the like, the GATT and the GATS—the services agreement—impose few constraints on a country's ability to regulate as it sees fit. In the context of the GATS, a country may agree to open, for example, its markets to foreign firms seeking to provide legal and architectural services, but governments will retain their right to regulate admission, licensing, and disciplinary standards and the like.

As another example, WTO rules require that governments base their food safety standards on science. At the same time, though, governments are free to adopt as high a standard of protection as they want, provided those standards are in fact science-based. The GATT and GATS also contain explicit exceptions for measures taken to protect health and safety, national security, and the like.

When it comes to intellectual property, the rules we negotiated in the Uruguay Round codified, elaborated on, and made consistent 100 years of international practice and rulemaking, and at the end of the day, the agreement that we negotiated, the TRIPS agreement, effectively obligated other countries to meet standards that the United States by and large already met.

But perhaps the most important safeguard with respect to the substantive rules is the way the United States, in accordance with our constitutional procedures, has chosen to implement them. The rules negotiated in the WTO, in and of themselves, have absolutely no domestic legal effect. Instead, the United States implemented the WTO agreements by statute, through the Uruguay Round Agreements Act. Any and all changes to U.S. law necessary to implement the WTO agreements are contained in that act and in subsequent amendments to U.S. law that the Congress may choose to adopt. If the Congress chooses not to amend a law that conflicts with a WTO rule, the domestic law prevails.

Other protections are built into the statute as well. For example, there is no private cause of action that may be brought in U.S. Federal courts on the basis that a particular measure—State, local, Federal—is inconsistent with the WTO agreements. And State laws are given similar protection. The WTO agreements don't automatically preempt State laws, and the statute contains provisions establishing procedures for consultation between the Federal and State governments regarding implementation of the WTO rules, including when it comes to dispute settlement.

Turning to the administration of the WTO, it is important to recognize that the WTO is a member-driven organization. There is a secretariat that administers the organization, which is based in Geneva, but it has virtually no independent decisionmaking ability. Decisions are generally taken by consensus, that is, by unanimous consent, which means that any member may, in theory, exercise a veto, including, of course, the United States. Now, countries with stronger economic and political clout—which of course includes the United States—can effectively use this threat to motivate other members to reach compromises that are acceptable to all.

Special rules are spelled out in the WTO Agreement for taking particularly important decisions, such as amendments or binding interpretations. For example, core provisions on most favored nation treatment, the amendment process, the decisionmaking process—those rules may only be amended by consensus. No substantive amendment to the WTO agreements can apply to any member that doesn't agree to its application.

Turning to dispute settlement: The dispute settlement system that existed under the GATT was overhauled during the Uruguay Round, and the new rules for dispute settlement are set forth in the Dispute Settlement Understanding, or DSU. The DSU is in

turn administered by something called the Dispute Settlement Body, which is a subsidiary body to the WTO General Counsel.

The Dispute Settlement Understanding, and the process that is set forth therein, provides a forum for resolving disputes over a member's compliance with the rules. But dispute settlement is only available to governments, not to private parties. Private parties can't go to the WTO and bring a claim against any other member, including the United States.

The dispute settlement process begins with consultations, and if that fails to produce a resolution, the complaining member may submit the dispute to a formal panel for resolution. The panel is composed of three members chosen by the disputing parties, so there is party control over the process. And if no agreement is reached, the WTO director general will choose the members of the panel. The panel will then issue findings as to whether the responding member has acted inconsistently with its obligations. If such a finding is rendered, the panel may recommend that the member bring its measure into compliance.

Either member may appeal the panel's decision to the appellate body, which is a standing body of seven members, one of which is from the United States. The appellate body will then issue its findings and correct errors in the report.

The DSB will then automatically adopt the panel or appellate body report, unless it agrees by consensus not to do so—which effectively means that all reports are adopted. It is important, in fact critical, to recognize, however, that regardless of any decision that may be rendered by a panel or the appellate body, the WTO has absolutely no authority to require any member to change a law, regulation, or practice.

If a member fails to bring its measure into compliance, there are other options available. It can offer compensation to the complaining member, which may mean, for example, that it lowers tariffs on imports from the complaining member. It doesn't have to do that. If it chooses not to offer compensation, or if no agreement on compensation is reached, the complaining member can retaliate, which means it can impose higher tariffs, for example, on imports from the member found to be acting inconsistently with the rules.

But again, the WTO cannot force any member to change a law or regulation or practice. And if a country refuses to comply with a finding, it can't be forced to do so.

In a sense, this is no different than what would happen if the WTO never existed in the first place. In such a world, any country could impose sanctions for whatever reason it deemed appropriate. There are, of course, significant differences, which are important. The complaining member, if it goes through the process and sanctions are its only alternative at the end of the day, it receives a stamp of approval from the WTO, and that is important from the perspective of the international community. And the international community may bring pressure to bear on the country that was found to be acting inconsistently with the WTO rules and try to persuade, on that basis, the member to bring its measures into compliance. But diplomatic pressure is vastly different from a system that could compel a government to comply. And again, the

WTO cannot compel the United States or any other member to comply with a ruling.

The United States has fared fairly well under this system. Since the start of the WTO, we have initiated 75 cases, of which we have settled 24, we have won 24, we lost four, and the remainder are in litigation or being monitored for progress or otherwise inactive. We have been challenged 84 times. As you noted, 52 of those cases have been completed, and of those we have settled 15 and won 12.

The number of cases filed by the United States and all WTO members combined has declined over time, as countries in the beginning of the system, back when the WTO first began, essentially picked the low-hanging fruit and there was a pent-up demand that was exhausted during the first few years of the WTO. That, combined with the fact that the WTO dispute settlement system works to deter new breaches, has resulted in a gradual decline in cases over time, but there still is a steady stream of them, as there has been over the past few years.

The system isn't perfect, and we recognize that, and part of the negotiations that are going on now are to improve the system. The United States has played a critical role, central role in that process. We have advocated, for example, increased transparency in the dispute settlement process by opening proceedings to the public, opening up the hearings, facilitating public access to documents, and urging members to consider establishing guidelines for accepting, for example, amicus curiae submissions so that members of civil society and others who wish to voice an opinion on the interpretation of the agreements may do so.

We have also suggested that WTO members provide additional guidance to panels and the appellate body to help ensure that the process better serves its primary function of facilitating settlement of disputes rather than merely rendering legal decisions. And we have recommended the development of new mechanisms to improve flexibility and member control over the process.

In conclusion, I return to where I began, that participation in the WTO has benefitted the United States tremendously. We recognize, however, that efforts to strengthen integration and open foreign markets for U.S. farmers, workers, and businesses must at all times be balanced with appropriate safeguards to protect our sovereignty. As in the past, we will continue to ensure that we preserve this balance as we continue with the current round of negotiations. Thank you.

Senator COBURN. Thank you very much for your testimony. Let me ask a few questions of you, if I might.

The people who actually make the decisions is from a list of what I understand is experts in the area. Is that right?

Mr. MENDENHALL. You are talking about dispute settlement panels?

Senator COBURN. Yes.

Mr. MENDENHALL. That is right.

Senator COBURN. Who are they? Where is the list? Who makes the list?

Mr. MENDENHALL. Right.

Senator COBURN. Where do they come from? Where is the transparency to know who is making the decisions? Do we know who

is—when the dispute settlement body is undergoing a decision, and there is this list of experts that they choose from, who makes the choice of who the experts are that see that; and does the general public, are they aware of who made the decisions?

Mr. MENDENHALL. Right. The particular panelists in a given case are chosen by agreement of the disputing parties—so the complaining member and the responding party. If they can't agree, then the WTO director general chooses the panelists in close consultation with the parties and others that have——

Senator COBURN. Does that happen, in fact, often that they can't agree?

Mr. MENDENHALL. It does happen quite frequently that——

Senator COBURN. Let's go behind that. Why is that? Because certain experts will rule one way and certain experts will be deemed to—thought to rule another way? Or we don't believe that they are experts?

Mr. MENDENHALL. Well, there may be concerns about a particular member having conflicts. There may be concerns about a particular panelist, or proposed panelist, who has rendered decisions that one of the disputing parties may not approve of; it doesn't agree with the approach that has been taken, and so on. So they have the ability to take that into account in deciding whether or not they would agree to a particular panelist.

Senator COBURN. Is this all transparent? In other words, anybody anywhere in the world could find out who the list of experts are and who is the experts on each panel?

Mr. MENDENHALL. There is a roster that is maintained, which is included in our annual report. And that is available. It is available on our Web site—we publish it in hard copy as well.

So, yes, the roster itself is publicly available. The particular panelists in a given case are, of course, known, as the ones who are presiding over the dispute are of course known as well.

Senator COBURN. You say that WTO rules have no domestic legal effect. That is your testimony. Isn't it true to say that if the United States chose not to comply with these rulings, there will be serious implications about our trade relations?

Mr. MENDENHALL. I think it is fair to say that if any country doesn't comply, they will face pressure to comply. I think that is true. Now, at the same time, though, that doesn't mean that every country complies in every case. If there is a particular issue that is particularly sensitive for a member, that member may not comply. That has happened. The United States has not complied with several rulings that——

Senator COBURN. Can you give me some examples of those?

Mr. MENDENHALL. We haven't complied yet with the Byrd Amendment, the finding against the Byrd Amendment. We haven't complied with the ruling against us on a particular intellectual property matter dealing with Irish music. By and large, we have complied, and we have sought to do so. But it is recognized that the Congress, if a law needs to be changed, has the final say on whether or not that law is changed, at the end of the day.

Senator COBURN. I am sorry, I didn't hear the last thing you said.

Mr. MENDENHALL. There are times when the United States, as with other countries, has not complied with a given ruling. And it is recognized in the United States, as with all members, that the final say, if legislation needs to be changed, the final say on whether to do that lies with the legislature. So it lies with the Senate and the House of Representatives whether to implement or not, if a law needs to be changed.

Senator COBURN. So the WTO allows countries to impose punitive damages and sanctions if a country does not come into compliance with a WTO ruling.

Mr. MENDENHALL. Right. They are not punitive. They are capped at the level of economic harm that the inconsistent measure has caused to the complaining member.

Senator COBURN. Well, let's talk about France and beef, then. How did we get to the dollar amount that we got on hormone beef going into France?

Mr. MENDENHALL. We calculated—I don't know if we did France specifically, but we calculated the value of what our trade would have been absent the EC measure that was found to be inconsistent, and that was the level of retaliation that we were allowed to impose.

Senator COBURN. OK. And so we collect that?

Mr. MENDENHALL. Yes.

Senator COBURN. We collect a payment from them because they don't allow us——

Mr. MENDENHALL. We collect a payment by virtue of increasing our tariffs on certain imports from the European Community.

Senator COBURN. Do you happen to know specifically what we responded to in terms of—we had a favorable ruling with the WTO on beef, and where did we increase tariffs?

Mr. MENDENHALL. That is a public list. I would be happy to provide it to you. I don't have the list in my head.

Senator COBURN. Have we complied—other than the two you mentioned, all the other WTO rulings we have complied with?

Mr. MENDENHALL. We have complied with the vast majority. I would be happy to get you more information on the specifics of that. But we have complied with the vast majority.

Senator COBURN. In your testimony you state WTO decisions are taken by consensus, which means that any member may, in theory, exercise a veto. Later in your record, you go on to state that any interpretation of the rules—that is, a type of WTO decision that involves binding trade rule interpretation—requires the agreement by three-quarters of all members.

Mr. MENDENHALL. Right.

Senator COBURN. Can you explain the difference to me there? In other words, we can exercise a veto, but it can still be binding. How can it be binding?

Mr. MENDENHALL. Right. Interpretations, that is right. The interpretation rules are slightly different from the general rule. There is a general rule in the WTO that consensus is needed for decisionmaking. That is made explicit or reinforced elsewhere in the WTO agreements when it comes to particularly important procedures, such as the amendment procedure, such as particularly

important substantive rules like nondiscrimination, MFN treatment, and the like.

The interpretation procedures are a bit different. You are right, they require three-quarters, which I believe, although I would have to double-check it, was increased from—I believe it was increased from a majority in the GATT, although I would have to double-check that. So that is not consensus.

Now, I can tell you as a matter of practice that there has never been a vote in the WTO. Members try extremely hard to only take decisions by consensus, regardless of what the rule written on paper may be. If we ever did go to a vote, it would be a landmark event, and we have never done that. In fact, on the interpretation procedure that you cite specifically, I don't believe it has ever been invoked since the beginning of the WTO. I don't think it has ever been invoked even in the GATT, although, again, I would have to double-check that history.

So it is theoretically possibly to have a three-quarter vote on an interpretation—but practice is consensus. Interpretation, though, is vastly different than amendment. And the rules make clear that an interpretation cannot go beyond, cannot amend the rules and should not be used as such. And I think members are cognizant of that cautionary rule.

Senator COBURN. Is it not a fact that rulings are not supposed to be precedent-setting, but in fact many times precedents are used to justify new rulings?

Mr. MENDENHALL. They are—you are correct that they are not formally precedent-setting. There is no formal rule of stare decisis in the WTO as there would be in a common law system, like the United States. At the same time, you are also right, and as I said, I think, in my written testimony, that panels and appellate bodies do look to previous decisions for guidance.

Senator COBURN. Has that been harmful or helpful for the United States?

Mr. MENDENHALL. I think it is helpful—by and large, it is helpful for the United States and the system as a whole. It improves the stability, predictability of the system and helps ensure that people understand, countries understand how the rules will be interpreted and applied. So it has been helpful. Which isn't to say that every decision has been in our favor, or that we have agreed with every single finding that any panel and appellate body decision has rendered. But by and large, it has been helpful.

Senator COBURN. I understand that the United States has proposed to the WTO body at least two resolutions that would modify the WTO's judicial system and allow for greater transparency and flexibility for disputing parties to work things out through bilateral negotiations. Can you tell me what the outcome of these resolutions are and if these were resisted or accepted by the WTO, and what are in the impact of these outcomes?

Mr. MENDENHALL. There is no outcome as of yet. Those negotiations are continuing. I think people are taking the proposals seriously. There is an interest by, certainly, a large number of countries in improving transparency and control. But those discussions are ongoing, so I can't tell you what the outcome will be.

Senator COBURN. Can you educate me as to why somebody would be resistant to transparency at the WTO?

Mr. MENDENHALL. Sure. I don't think they should be, of course, but there are a lot of countries in the world—some countries in the world, anyway, that don't have domestic legal systems that operate in the same way as the United States system does, which is highly transparent. It is a concept that they aren't necessarily familiar with. They need to get used to the idea of opening up the court proceedings and opening up the submissions and so on.

So in many cases, it is simply an education process more than anything else, that it is new and different, and there are some who may feel that, on top of that, that international proceedings of this sort should be between governments and not open.

Now, the United States obviously disagrees strongly with that, and so we have pushed for greater transparency.

Senator COBURN. One of the problems CAFTA is facing is the difficulty in Congress being informed prior to decisions being made and, to quote the chairman of the Agriculture Committee, is "it is not going to happen again in terms of the lack of input. The complications over sugar could have been handled had the Congress been involved."

The other thing I spoke with Representative Portman about was enforcement of intellectual property rights. And it is my opinion—it may not be a correct opinion—that we lose all the time, even though people are "in compliance," as China supposedly is in compliance. But then they don't carry out the effect of their own internal laws.

How is the WTO helping us on the intellectual property? Because that is the only thing that we really have an advantage on today. And where are we going with that in terms of them enforcing? In fact China agrees with WTO rulings on intellectual property rights and yet they don't enforce the law in their own country, what are our options?

Mr. MENDENHALL. Right. Yes, I think we have an advantage in a lot of areas in addition to intellectual property—services, and certainly a lot of our manufacturing sector, and others. Agriculture is highly competitive. But obviously intellectual property is critical. It is a growing part of our economy. It is an area where we do have a very marked comparative advantage. And so we do need to do all we can to protect the value of our innovation and create incentives to continue innovation in the future.

To determine what the benefit of the—let me break your question into two parts. One is the progress we have made so far, and then next steps, where we go from here.

On the first part about where we are now and how we got there, I think it is important to look back where we were 10 years ago, when the WTO was first put in place. At that point, a large number of countries in the world didn't have very developed laws on intellectual property, even apart from enforcement. We were in a sense in Phase I of the IP rulemaking world, where we just needed to put the rules into place so at least they had them on the books.

We did that through the TRIPS agreement. There has been a dramatic improvement in the rules in the books around the world, including in China, but also in other countries as well. And we are

continuing to ensure that happens when countries accede to the WTO, including Russia, for example. We are seeking to do that. The rules in the TRIPS agreement are by and large designed to improve the rules on the books.

Enforcement is much harder. I call this Phase II, which is the challenge that is now facing us: How to develop enforcement rules that work. Because as you implied, you can have all the rules on the books that you want, but if you don't enforce them, they are not worth the paper they are written on. So we do need to focus now on enforcement. There are rules in the WTO on enforcement. Unfortunately, they aren't as precise as they could be. They say the enforcement procedures have to be deterrent, sufficiently severe to be deterrent. That standard, we all know, in some degrees is not met in countries like China, and we know that.

What we are now in the process of doing on China is working closely with our industry to gather all the information that we can, and evidence that we can, and working closely with our trading partners and with their industries as well to gather all the information we can to demonstrate that we have tried the system, it has been tested, and it hasn't worked, and here is why it hasn't worked, and as a result we have 90 plus percent piracy rates in the country. We could then move forward and demonstrate that in fact there is an inconsistency.

The WTO dispute settlement process—which a lot of folks are asking us to use and which we are willing to use if we are confident we can move forward successfully—it is a judicial process, or it is a quasi-judicial process, at least, and we need to prove our case. So even though we all know that it is a huge problem, we need to gather the evidence to do it. And that is a complicated process and that is a time-consuming process, but that is what we are doing. And we are working very closely with our industry to do it. And once we have gone down that road, if we have not seen a significant improvement in China, we have signaled quite strongly that we are willing to go forward and use all the options available to us in the WTO.

In the meantime, we intend to use the procedures short of formal dispute settlement in the WTO to see what we can do to pressure China to move forward, including utilizing the transparency rules in the WTO that allow us to go to China and say give us all of your information on your cases so we can see exactly how your court system works and whether it has worked or not, whether it is effective or not. We are going to go forward with that. And we are working with our allies to see if they will join us in that effort.

And then even outside the WTO process we are working through a formal bilateral dialogue with the Chinese, through the Joint Committee on Commerce and Trade, to improve IP enforcement in China, including setting benchmarks, setting standards, specific objectives that we would like them to meet. If we don't see dramatic improvement, then, as I said, all options remain on the table.

Senator COBURN. I am trying to understand how the WTO helps us in intellectual property. You have the software manufacturers who are hesitant to go forward with a sanction against China, or a case, because they are being blackmailed, in essence, that if you

do this, you are going to have worse problems participating in China.

The very advantages that you list that we have are dependent—other than agriculture—on our intellectual properties, whether it is manufacturing techniques. We know things are reverse engineered in China, from patented items in this country, and then they are duplicated and the intellectual property is totally ignored.

So how is WTO helping us at this time? Ten years from now may be too late for most of our software, most of our drugs, most of our copyrighted music and other things. Once that is gone down the road, then the advantages that we have in these other areas—manufacturing, service industries, and everything else. My question to you is why have we not filed through the WTO for an enforcement action on intellectual property in China? Are we afraid that we are not going to be able to continue the sales growth of our exports there through a blackmail process?

I am having trouble understanding how the WTO is working effectively to control and protect American intellectual property. Even though we have the TRIPS agreement, if you have no enforcement, you have no law.

Mr. MENDENHALL. Right, I agree with everything that you said. It is absolutely critical that we act and we act quickly to address the problem of IP piracy and counterfeiting in China. I couldn't agree more. What we are doing now is trying to find the most effective way to do that. There are several tools that are available at our disposal, but they are not——

Senator COBURN. What are they?

Mr. MENDENHALL. Well, I went through a number of them in my last statement. We have the ability to work with them bilaterally, which we are doing through the Joint Committee on Commerce and Trade, to address—to reach agreement on specific IP benchmarks and objectives for them to obtain. Now, we did it last year, and we did it just recently—last week, I believe, in China. They haven't fully met all of those objectives. We recognize that. But we are working with them closely——

Senator LEVIN. May I just interrupt for one second? What is the "it" that you did? You said you did it recently.

Mr. MENDENHALL. The "it" is setting forth common objectives with the Chinese——

Senator LEVIN. Proposing. Excuse my interruption, but be real clear. The "it" is proposing benchmarks. Is that what you are saying?

Mr. MENDENHALL. Proposing specific objectives, including significant reduction in piracy and counterfeiting.

Senator LEVIN. Not achieving them, just proposing them.

Mr. MENDENHALL. We have reached with China agreement on obtaining a set—or reaching a set of objectives, including significant reduction in piracy and counterfeiting. Have they met those objectives, all of them? No, they have not. They have not significantly reduced piracy and counterfeiting to the level that we would wish them to do so. It is an ongoing process. We are continuing to work with them.

But getting back to the question about what the tools are that are available and how we are utilizing them, this is one but not

the only tool that we are utilizing. So we are using the Joint Committee on Commerce and Trade to enter into a serious bilateral dialogue with the Chinese to try to set forth a set of common agreed objectives that the Chinese should meet with respect to reducing piracy and counterfeiting.

There is a general objective of significantly reducing piracy and counterfeiting in China as well as a series of specific objectives dealing with, for example, accession and implementation of the WIPO Internet treaties to bring their IP laws—to modernize them, allow them to address digital piracy online. We are also working on software procurement issues, working on a variety of other issues. We can provide more information on the specifics, if you would like.

That is one tool. It is not the only tool. And it hasn't yet produced the dramatic and necessary results that we would like to see.

So that is one tool. Another tool that we have is working through the WTO, and there are a number of procedures that are available to us on that front. One is working together with our allies through the TRIPS Council in the WTO, which is an IP forum, to bring pressure on the Chinese to—international pressure to bear on the Chinese to try to get them to comply. We have done that. Again, and I am not saying we have achieved all the goals we would like to achieve, but these are the tools available to us.

Third, we are using the transparency procedures in the WTO to demand that China provide us information on why they believe, if they can put their money where their mouth is and prove to the world that in fact their system is effective in enforcing intellectual property.

The last option available to us is dispute settlement, and that is an option that is certainly on the table. We have said to the Chinese that is a very serious possibility, and we are working closely with our industries, all segments of our industry who are interested in having us move forward on a case, to gather all the appropriate information, test the system, have a comprehensive program to make sure the system works in China. If it doesn't work, to provide the evidence to us so that we have a very compelling dossier of evidence that we can go to the WTO and say they failed in the following ways, their court system doesn't work, we have 90 percent piracy rates, or whatever rate it is that we are able to glean from the information that we are collecting, and prove our case in court, essentially, through the dispute settlement mechanism, that in fact the enforcement procedures are not deterrent.

Those are all the options that we have available to us, and we are working hard. We are working to utilize all of them to maximize their potential and to ensure that they will actually succeed at the end of the day.

Senator COBURN. I am going to defer to Senator Levin here in just a minute. Can you give us a time frame? In other words, the risk to U.S. intellectual property over a period of time not being enforced creates more and more damage to us as a Nation in terms of our future economic model. Because we really don't have a tool, or we refuse to use a tool to enforce this in China. How long can we wait until we bring them into compliance?

Mr. MENDENHALL. How long can we wait? Well, obviously we need to get them into compliance as soon as we can. That almost goes without saying. But we do need to be able to have all the evidence before us. Now, we have been working very hard over the past several years to gather what we can to demonstrate the case.

And just to give you an example of what we have done, last year we submitted, or issued, a survey to all—an open survey to anyone who wanted to respond. We sent it to every Member of Congress, we put it up on the Web site, we sent it directly to companies, every company and trade association that came to us and said they have a problem with IP in China. We sent it to all of them, asking for information on the particular problems they have, how they have sought to enforce their rights, whether it worked, whether it didn't work, and so on. And we have done that. We conducted a special out-of-cycle review under our special 301 process—which is a tool I forgot to mention—to continue that process, gather additional information. We put China in a special category this year. We indicated that they are back on the priority watch list in addition to being under what we call Section 306 monitoring, which I can explain if you want. But they are in a category of their own, indicating that this is a matter of critical importance to us. We set out a work plan in that OCR and we are continuing to work with our industries now to gather any remaining information that we can.

Now, obviously we need to move as quickly as possible. But we can't move unless we have all the information that we need. And to a large degree, it is up to our industries to work with us to do that. So we are in the process of doing it. I can't give you a precise timeframe, but we are working with all due haste to try to get it all together and be prepared to move forward, if that is where we need to be at the end of the day.

Senator COBURN. All right. Thank you.

Senator Levin, you are next for an opening statement and questions.

**OPENING STATEMENT OF SENATOR LEVIN**

Senator LEVIN. Thank you, Mr. Chairman, most importantly for holding this hearing, and you are, it seems to me, performing an extraordinarily important function in terms of trying to weed out what is the wheat and what is the chaff when it comes to WTO.

I must tell you, when it comes to trade enforcement, I have seen talk as a substitute for action for so many years around here that I am not surprised to hear more talk this morning. What does this mean, "all due haste"? It sounds like "all deliberate speed" to me.

Mr. MENDENHALL. What I mean by that is we are——

Senator LEVIN. The Chairman asked you for a timetable.

Mr. MENDENHALL. Right. And I gave the best I can give.

Senator LEVIN. "As quickly as possible." That is not a timetable.

Mr. MENDENHALL. Would you like me to respond?

Senator LEVIN. Yes. I would love you to respond, but with a timetable. This year? Next year? This decade? I mean, China is absolutely not only continuing to close its country to our products, violating our intellectual property agreements, violating WTO, running up a huge trade surplus, manipulating currency, and what we

hear is "we're gathering evidence." You have told us they have not even complied with agreements, and that is true. You know it. You have said this again here. What more will it take, and when do you contemplate we are going to get to the WTO if they do not shape up—which they are not going to do. They will enter into an agreement and break it. When are we going to the WTO? Will it be this year? Do we have a commitment that you will go this year to WTO?

Mr. MENDENHALL. I can't give you a commitment. I can tell you that we are working extremely closely with our industries, all industries that are interested in bringing a case. And it depends in large part on their ability to pull together all the information that we are going to need. Now, I can't speak for industry and tell you when they are going to do that. But they are working on it. And I know they are working on it, so I don't mean this as a criticism of them. But it is in large part dependent upon them. And we are working with them to try to design a program to ensure that we get the information that we need. And that is the rate-limiting step here, if you will.

Senator LEVIN. At the rate you are going, when will we file a case?

Mr. MENDENHALL. I am not sure what more I can add to what I have said already.

Senator LEVIN. You talk a little too fast for me, I am sorry. Just a little slower on that. At the rate we are going, the current rate—you know what the rate is—gathering information, when will we be in a position to file a case?

Mr. MENDENHALL. I can't give you an answer to that. I can't foresee everything that is going to come up over the next few months. I don't know the answer to that. I can tell you we have pulled out all the stops to try to move this. It is one of our highest priorities to try to ensure that in fact we are moving forward on this.

Senator LEVIN. Agreements have been violated. Is that correct? Did you not just say that again this morning? We have entered into agreements; they haven't lived up to them.

Mr. MENDENHALL. What I said was——

Senator LEVIN. Is it true, they haven't lived up to our agreements that we have reached with them?

Mr. MENDENHALL. It is true that they have not significantly reduced piracy and counterfeiting to the levels we would like to see them to do so, that is correct.

Senator LEVIN. Is it true that they have not lived up to agreements we have reached with them?

Mr. MENDENHALL. It is critical for us, if we are going to move forward in a dispute settlement case, that we be able to demonstrate it with all of the evidence as if this were a court. Now, we may all know it to be true intuitively, because we have all heard the horror stories, whether it be—largely anecdotal, but widespread anecdotal evidence that in fact there is a serious problem with IP enforcement in China. We know that. We know that it hurts small businesses, we know that it hurts large businesses. It is a top priority of this Administration to deal with this problem.

However, knowing it intuitively is different from proving it in dispute settlement. I think we can—we will be able to prove it in

dispute settlement, but we are in the process of gathering all the information we need to do that.

Senator LEVIN. And when you say "proving it," are you talking about proving violation of WTO or proving breach of agreements that we have already reached with China?

Mr. MENDENHALL. I was talking in the context of dispute settlement, but the same would be true otherwise, for any other reason.

Senator LEVIN. You are talking about proof of both or proof of WTO violations? Is it agreements that have already been reached, or violation of WTO rules? Or both?

Mr. MENDENHALL. Well, I suppose it is both. But what I had in mind was WTO dispute settlement, since that was the context of our discussion.

Senator LEVIN. OK, now, we have also entered into agreements with China. Is that not true?

Mr. MENDENHALL. We entered into an agreement in the mid-1990s on intellectual property enforcement. We reached common objectives last year, not as a formal agreement, but common objectives last year in the context of the JCCT, which provided further elaboration.

Senator LEVIN. And the agreement that was reached on intellectual property in the mid-1990s, have they complied with that agreement?

Mr. MENDENHALL. That agreement is now 10 years old. Hard to say which of those commitments are now applicable and which are not. When the agreement was first reached, there was a significant reduction in export of pirated materials, which was a key objective. We have seen recently an increase in that. To say that they have definitively breached it or not, if you parse through that agreement, would be difficult to say. Clearly, though, if the overall objective of that agreement, under the TRIPS Agreement, is that they reduce piracy and counterfeiting to an acceptable level, they haven't done that. That is true.

Senator LEVIN. Is part of the agreement that we have reached with China that they will comply with the WTO standard procedural norms, respond in writing to requests for information?

Mr. MENDENHALL. We are going to——

Senator LEVIN. No, is that part of the agreement? Is that part of the WTO requirement, that they respond in writing to requests for information from other member countries?

Mr. MENDENHALL. They are supposed to do that, yes.

Senator LEVIN. Have they?

Mr. MENDENHALL. We haven't made the request yet. We are doing that—well, let me—I don't know which specific provision you are talking about, but there are a couple of provisions that pertain to transparency. There is a process called the Transitional Review Mechanism developed under the TRIPS Council which is a review mechanism which is done periodically. IP is a prominent part of that. We have requested information, as have other countries. They have provided responses to those requests. There is a separate provision in the TRIPS agreement that allows countries to ask for specific information on specific cases. We are working with our industry on this request. They are happy with the results, with the working relationship we have, to put together that request, and we

are working now with our trading partners to see if we can work jointly on that. We expect that request to go in soon. And then China will then have a period of time to respond thereafter.

Senator LEVIN. The transitional review mechanism, is that called "trim"?

Mr. MENDENHALL. T–R–M, yes.

Senator LEVIN. It is called T–R–M. Have they abided by accepted WTO procedures relative to that transitional review mechanism?

Mr. MENDENHALL. Have they responded to questions?

Senator LEVIN. Yes.

Mr. MENDENHALL. Yes, they have responded to questions.

Senator LEVIN. So we don't have any cases where they have not responded to questions?

Mr. MENDENHALL. Not that I am aware of, although I can get back to you if there is a specific problem there.

Senator LEVIN. And what does USTR mean when it says it is going to take more forceful action aimed at enforcing China's implementation of those WTO commitments? What do you mean when you say it?

Mr. MENDENHALL. I mean what I explained earlier. There are a number of procedures available in the WTO that are available to us.

Senator LEVIN. Are there instances where China has not carried out its WTO commitments, in your judgment?

Mr. MENDENHALL. I think there is a very strong sense that there is a problem that they have on enforcement, that they have not lived up to the standard on enforcement in the WTO. Again, that is much different than saying we have all of the evidence that we need to gather to bring a case. Now, I think we can gather that evidence, but we are in the process of doing that now.

Senator LEVIN. I am way over my time. Thank you, Mr. Chairman.

Senator COBURN. I just have a couple more questions for you, if I might, and then we will be free.

First of all, thank you for your candor. I understand you can't say something here that puts us in a limited negotiating position by what you testify here, and I understand that and I am appreciative of your position and recognize that.

The National Conference of State Legislatures wrote to U.S. Trade Representative Rob Portman in March of this year and expressed concerns with the implications of WTO decisions on States rights, which are in fact major in many instances. What is the USTR doing to remedy the current problem of State lawmakers being out of the loop even though trade negotiations will affect their laws? In what stage of a trade dispute does USTR typically reach out to the States?

Mr. MENDENHALL. I will answer the latter question first and get back to the former.

If there is a dispute that implicates State laws, we begin consultations immediately with the State, particularly the Attorney General's Office and others who have an interest in that. We did that, for example, in the gambling case, which prompted in part, I think, that letter. So we fully consult with the States who are implicated with any dispute all along the way. In fact, I think we are

required to by statute, and we would do it anyway because it is absolutely critical that they be involved in the process throughout the time if any of their interests are implicated.

So on dispute settlement, that is what we do. On negotiations, we have a similar process, where we have State points of contact that we work with in each individual State. We work with the Governor's Office. We of course have formal or informal dialogue with anybody, including State legislators, that individually or collectively want to ask us questions. We are happy to answer them at any time.

But when we put forward negotiating positions, for example, as in the services context, that implicate State laws, we consult fully with the States on them. They have a chance to review the content of the submissions that we would make, the negotiating proposals we put down. They consent or not—in most cases they do. We work with professional associations, including State bar associations if we are talking about legal services, or whatever the appropriate association would be in a given case.

So we have extensive contacts with the States at all times. And we will continue to do all we can to improve those lines of communication if a particular problem arises.

Senator COBURN. Mr. Barfield is going to be on our second panel, and I read his testimony yesterday or the day before. And he seems to have some pretty good ideas or recommendations for us in terms of changing the WTO. I would consider it a personal favor if both you and Representative Portman would look at some of the recommendations in terms of—actually it is more in terms of transparency and solutions to problems that don't take us down some of these other paths. So I would consider it a great favor if you all would look at his testimony, because I found it very insightful.

Do you have additional question, Mr. Levin?

Senator LEVIN. I do. Thank you, Mr. Chairman, just a few.

First, on the currency evaluation issue, Article 15 of the GATT prohibits WTO members from using currency exchange action to frustrate the intent of GATT. Has China manipulated their currency, in your judgment? Currency exchange?

Mr. MENDENHALL. My judgment isn't the determinative judgment.

Senator LEVIN. I know that. But in your judgment, have they? I know it is not determinative.

Mr. MENDENHALL. I am going to have to defer to the Treasury Department on that.

Senator LEVIN. Well, is it not true that the Treasury Department has said that current Chinese policies are highly distortionary and pose a risk to not just their economy but to trading partners and the global economic growth? Does that sound familiar?

Mr. MENDENHALL. I am assuming you are quoting a document. They could very well have said that. I would defer to them.

Senator LEVIN. Do you accept that?

Mr. MENDENHALL. Again, on currency policy, I am going to have to defer to the Treasury Department.

Senator LEVIN. Well, who challenges that policy at WTO?

Mr. MENDENHALL. Who challenges the policy?

Senator LEVIN. Is that the Treasury Department, or you?

Mr. MENDENHALL. We would work in close consultation with the Treasury Department, as we do on all issues. We have an extensive interagency process on any matter that may implicate any agency's interest.

Senator LEVIN. But who would actually file the document?

Mr. MENDENHALL. Yes, USTR would actually file it.

Senator LEVIN. Are you considering filing such a case?

Mr. MENDENHALL. Well——

Senator LEVIN. Given their finding and you work closely with them, are you considering filing that case?

Mr. MENDENHALL. I don't believe they found manipulation.

Senator LEVIN. No, they found current policies are distortionary.

Mr. MENDENHALL. But they didn't find manipulation.

Senator LEVIN. OK, so you are not prepared to file a case at this time?

Mr. MENDENHALL. It is not currently under consideration.

Senator LEVIN. Would you be willing to file a case if you found manipulation?

Mr. MENDENHALL. If we found a violation of the WTO agreements, it would be something that we would always consider.

Senator LEVIN. And if there is an artificial undervaluation of their currency through manipulation, would you file a case?

Mr. MENDENHALL. I can't commit to filing a case.

Senator LEVIN. Even under that circumstance?

Mr. MENDENHALL. You are asking me a hypothetical question on whether we would bring a case if particular findings were made. I can't answer that question. It is a hypothetical question.

Senator LEVIN. I think it is a very real question, actually. It is not hypothetical at all. If you can't say you would file a case if you find a violation of WTO, I don't know why you can't answer that case. Why isn't that "of course you would"?

Mr. MENDENHALL. The question is whether or not the facts are out there to support——

Senator LEVIN. No, I didn't. I said "if you found".

Mr. MENDENHALL. If we found it a violation of the WTO, it would be something that we would always consider. I can't speak definitively as to whether or not we would bring a case, since this is a request you are making to me in a hearing. I can't answer that.

Senator LEVIN. OK. Just a couple of questions on auto policy. China's distribution registration system does not appear to allow for imports to be sold in China on a nondiscriminatory basis. For instance, China requires to sell cars in China you have to be a registered manufacturer in China. Is that legal under WTO?

Mr. MENDENHALL. If you are asking me specific questions about specific cases, we would be pleased to answer those in writing. So if you would like to ask me those questions, that would be fine. We will be happy to respond to them. The topic of the hearing was sovereignty.

Senator LEVIN. It was—I am sorry?

Mr. MENDENHALL. Protecting American sovereignty. I would be happy to answer questions you may have in that regard. If you have questions on specific cases, specific potential cases, we would be happy to answer them, but I am not prepared today to talk in depth about potential cases.

Senator LEVIN. Well, we talked about intellectual property. Was that American sovereignty?

Mr. MENDENHALL. I was trying to be as responsive as I could to the questions that you asked. I don't have all the facts available to answer all of the questions that you have on issues that are outside the topic.

Senator LEVIN. I will just conclude, then, by asking you will you, for the record, review China's auto policy and report to the Subcommittee as to whether, in your judgment, there is violations of WTO involved in those policies?

Mr. MENDENHALL. I will certainly take that back and I will discuss it with my folks, and we would be happy to get back to you and discuss it with you.

Senator LEVIN. As to whether you will do that, is that what you will get back to us? In other words, you are not going to commit to review the China auto policy and tell us whether in your judgment there are violations in that policy of WTO? Is that what you are—you are not committing to do that.

Mr. MENDENHALL. To tell you whether or not there is a violation?

Senator LEVIN. In your judgment. What I am asking you to do, would you be willing to review China's auto policies and to report to this Subcommittee as to whether, in your judgment, those policies contain violations of WTO? Are you willing to make that commitment?

Mr. MENDENHALL. I am willing to look at it and see what is available, what the answer is.

Senator LEVIN. Thank you, Mr. Chairman.

Senator COBURN. Mr. Mendenhall, I am sorry we moved off of the subject. I know you did not come here prepared to answer a lot of questions on specific trade functions between us and China. So for that, thank you for being forbearing.

One last question on our anti-gambling cases through the WTO, in terms of sovereignty. We won three of those, I believe, out of the four. The final outcome of the WTO ruling, there is a particular note because the first time the WTO cited a "moral exception clause" in its rules and said the United States had a moral right to restrict marketing access to gambling. Allowing the WTO to discern whether U.S. laws can stand on their moral basis if not their economic raises the WTO to a whole new level.

Will other U.S. laws, such as child pornography bans, be subject to the same moral examination? What about Internet child pornography? And what if the WTO rules against us on that?

Mr. MENDENHALL. Sure.

Senator COBURN. Using this moral definition. And I am going back to sovereignty, because we do have the right to do that.

Mr. MENDENHALL. Sure. Absolutely we do. And it is not the WTO's role to second-guess whether or not our standards of morality fit with any particular panel or appellate body or any other country's standards of morality. And they don't do that. It is up to each country to decide what its standards of morality are.

The question that the WTO was trying to answer in the context of a specific exception that allows us an "out" to act inconsistently with the WTO for seeking to protect morality is whether or not the measures that we have adopted in fact achieve the ends that we

have sought. So we set whatever standard of morality that we would like, whether it be gambling or pornography or what have you. And the WTO doesn't second-guess it. But what it looks to see is whether in fact the measures that we have sought to protect our moral values are truly designed to meet those goals or whether they are an arbitrary protectionist measure.

They certainly would not second-guess child pornography and say that is something that ought to be permitted. They didn't say gambling is something that ought to be permitted. We are perfectly within our rights to say it is not.

Senator COBURN. But their actual decisionmaking process makes a value judgment on whether or not we as a Nation have a right to set a certain moral standard and whether or not we were using that appropriately?

Mr. MENDENHALL. No. Sorry if I didn't explain myself properly. It is entirely up to the United States to decide what moral standard it seeks to achieve, and that is across the board, whether we are talking about pornography or gambling or what have you. They do not second-guess that.

Senator COBURN. Well, if they are making an evaluation if we were using that properly, is that what you are saying, too? For example, let's talk about the gambling case. They obviously—three out of the four. There is some dispute whether we won all that or not. But three out of the four, if they could prove that our laws on Internet gambling were protectionist instead of we don't want Internet gambling, then its moral purpose is then presumed allowed, or not allowed? In other words, if it is their judgment that we did it from a protectionist standpoint instead of from a moral standpoint, and they rule against us, and they don't allow us to use the moral exception, then in fact they are making a judgment on our sovereign law. Is that not correct?

Mr. MENDENHALL. Let me respond to that in a couple of parts. The way they would analyze it is they would say—whether it is pornography or gambling of what have you, they would say the United States has authority, ability under the WTO rules to decide for itself whether or not to permit gambling, whether or not to allow child pornography, or any other moral value we would seek to vindicate. What they would then say is, is there a particular reason that you—the United States or another country is, for example, singling out foreigners and saying—what they said in the gambling case is we singled out for a particular type of Internet services, we had different rules for domestic and foreign operators. And the question is why would you do that? It is not that you can't prohibit gambling, or permit it, whatever you want to do, but why would you differentiate between the U.S. and foreign nationals? If truly you are trying to vindicate a moral value, why would you discriminate?

That would be the question that they would ask. They wouldn't be questioning the underlying moral judgment that the United States put forward.

Senator COBURN. Thank you very much. I appreciate your testimony and I would hope somebody from your staff will hang around to hear our second panel.

Mr. MENDENHALL. Thank you.

Senator LEVIN. Just on the gambling issue, could I follow that up? What you are saying, then, is they are saying they are not going to interfere with our moral judgment, they want to make sure that it is applied equally to domestic and to foreign services, gambling services? Is that the heart of their judgment?

Mr. MENDENHALL. The way the exception is established is it says you can discriminate in certain—they realize that in some cases you may have to discriminate in order to vindicate whatever it is that you are trying to vindicate. But it can't be arbitrary. There would have to be a reason why you would need to discriminate between foreign and domestic individuals——

Senator LEVIN. Does that reason have to relate to the underlying moral purpose?

Mr. MENDENHALL. It would have to—yes. Well, it would have to—the discrimination that you would seek to be justifying, you would have to argue that in fact the discrimination was necessary to vindicate the moral value.

Senator LEVIN. Thank you.

Senator COBURN. Mr. Mendenhall, thank you so much for being here.

Mr. MENDENHALL. Thank you. I appreciate it.

Senator COBURN. Panel number two will please come forward. We have Claude Barfield, resident scholar at the American Enterprise Institute; Robert Stumberg, professor of law, Harrison Institute for Public Law, Georgetown Law School; and J. Robert Vastine, president, Coalition of Service Industries.

Mr. Barfield will begin our testimony. Your written testimony will be made a part of the record. If you could, limit your initial comments to 5 minutes.

Mr. Barfield.

## TESTIMONY OF CLAUDE BARFIELD, PH.D.,[1] RESIDENT SCHOLAR, AND DIRECTOR, SCIENCE AND TECHNOLOGY POLICY STUDIES, AMERICAN ENTERPRISE INSTITUTE

Mr. BARFIELD. Thank you very much for inviting me today. You have my written testimony, and so I am just going to hop, skip and jump around. I would like to make three preliminary points.

One is that despite the criticisms that I level in my testimony about the dispute settlement system, I am a strong supporter of the World Trade Organization.

Second—and we can come back to this—often, and I think sometimes this is true, the critics of the dispute settlement system, of them it is said that they are kind of sore losers, that they somehow represent interests that lost a case or some cases, for instance, of the anti-dumping case or whatever. I should say that in my own case I have this odd dysjunction. I am a very strong critic of the U.S. anti-dumping system, and yet I think the decisions that went against us are wrong. I think the FSC legislation was terrible, but I think the decision that went against us was also terrible. I think the Byrd amendment is a terrible piece of legislation, but it is in the Congress prerogative to pass bad pieces of legislation.

[1] The prepared statement of Mr. Barfield appears in the Appendix on page 54.

So I do not come at this as someone who thinks just because he lost cases that we ought to change things. I am in favor of the outcome, I just did not like the way it——

And then finally, I would say that in my own case, what my position represents today is a change of my own views about the WTO and how it works, and how it works particularly with national systems, with national democracies. I would say as late as 10 years ago, 5 years ago, in my judgment, when you looked at trade negotiations, more is better, and that is, the deeper you went, the farther you went, the better you are. I also thought that the Congress really was an organization of mischief, basically often represented protectionist groups, and that the Executive really was the place one had to look for salvation, as it were, in the trade area.

I no longer think that. That is, I still think that Congress can do, in my judgment, make some bad judgments, whether it is Byrd or whatever, but I think the problem we face is that the international rules—and I will come back to this because this is really the theme of what I would be saying—really have a dramatic impact on the domestic priorities and the domestic rationale for individual nation-states, and particularly they have an impact, I think, and we have to look more and more in terms of impact on the legislative and the representative system of governments in individual nation-states I am talking about.

Let me just go more specifically to the WTO, and to take you back to a history here. From the beginning of the GATT and then the WTO, there were two traditions that kind of were juxtaposed against each other. On the one hand, there were those who looked at the GATT as an inter-governmental organization that was an extension of diplomacy, and that if you had disagreements among nations, between nations, you ought to really try to handle it diplomatically, not really worry so much about legal principles or international law principles, but just do what you needed to do to settle the issue.

Europeans tended at that time to have that view of the international trading system. The United States was always on the other side, and that is, given our highly legalistic society, we always pushed for strong legal rules, legal interpretations. And the old GATT, I think, was much more European, the new WTO is much more, I think, in what had been a traditional U.S. point of view. I guess in my own case I would say that in terms of the change, be careful what you wish for.

And let me just go back to what happened with the move to WTO. Two things happened, and what I think was playing out are the unintended consequences—and any generation would have to go back and look at what you had done. Two things happened in the Uruguay Round. One, there was the creation of the WTO with a new, much more at least quasi-legal if not totally international legal system, international legal rules of trade. At the time you changed the way the system operated, and that is, you went from a system in which when you had a complaint under the GATT, you could not really get—you did not get a resolution in favor of the complainant unless you could get consensus from everyone. That is, a panel could rule, but the United States could overrule that.

Now, the United States and other countries were quite restive with that system, and let me be very clear because of where I am coming out. It was the United States who pushed for this change, that you would go in another direction. So the system was changed actually in the WTO so that it went from where you had to have a consensus to reach a ruling, to where once a panel in the appellate body in the new WTO ruled, you had to have a consensus, in other words, unanimous virtually against that in order for that to change.

At the same time we kept a system where—as you asked Mr. Mendenhall—in order to have new rules you had to have consensus, or if you had to interpret old rules, three-quarters. In other words, what we set up was a very efficient judicial system, and it continued a very inefficient rulemaking, as it were, or legislative system. In terms of the analogy in the United States, it is as if when the Supreme Court ruled—forget about, I am not talking about things about the first 10 amendments now—when it rules on an issue of commercial, or the Federal courts ruled, it was as if that ruling could only be overturned by the Congress if you had virtual unanimity in the House and Senate.

Now, one other thing happened to complicate matters. In the Uruguay Round, for the first time—you had seen this before in other rounds—but really in the Uruguay Round, you had the construction and the implementation of rules that went far beyond the border and deep into the national regulatory systems, or at least in their potential of telecommunications, of financial services, of health and safety, in other words, issues would have been before counted as domestic issues, and in some ways still were domestic issues.

And so you put up a fairly rigid new legal system, which would be very difficult to change, juxtaposed against a rulemaking system that you could not change, and the authority of the WTO going deep into matters that had been counted as matters of the nation-state. That I think is the problem that we face. I do not think that there is a conspiracy in the WTO or the panel——

Senator COBURN. Let me get you to sum up, if you would, please.

Mr. BARFIELD [continuing]. To go into or second guess national governments. But I think inevitably what has happened—and we can talk about this in individual cases and we could argue individual cases—what has happened is, is an all too human trait that if somebody asks you a question, there is the temptation always to answer it, even if, as it is widely known, that in many cases the rules that are negotiated by diplomats in the WTO are unclear, they are contradictory. They sometimes are in opposition to each other. And so there is the temptation when that happens to answer the question even though you cannot.

I have suggested a variety of ways of fixing this. You could have some sort of blocking mechanism, whereas you have some minority, a substantial minority does not agree with the system, you block it until you can negotiate it out, or you could have—without getting technical in international legal terms, the panels in the appellate body invoke the doctrine of "non liquet." In other words, what they would be—the Latin term means "it is not clear," and to send it back to the negotiators. Or you could put in what we have flirted

with in the United States, a so-called political issues doctrine, in which the panel would say, look—I would put the FSC to some degree in that—this is a volatile political issue that we are not comfortable in answering, and you should negotiate this yourselves, and not put it to a dispute settlement system.

I will leave it there.

Senator COBURN. Thank you. Mr. Stumberg, thank you for being here.

**TESTIMONY OF ROBERT STUMBERG,[1] PROFESSOR OF LAW, HARRISON INSTITUTE FOR PUBLIC LAW, GEORGETOWN UNIVERSITY LAW CENTER**

Mr. STUMBERG. Thank you very much for inviting me. Senator Levin, good morning.

I have provided a written statement with four points. Let me just frame those points and then spend the rest of my time responding to some of the questions you raised about the gambling case, Senator Coburn.

My first point is that trade agreements have a constitutional character, and if, as Members of this Subcommittee, you are familiar with domestic constitutional debates about preemption or about privatization or about takings, you will quickly recognize these debates in the international context. You will see some of the same language in the actual text of trade rules, and you will see the same issues basically argued before the WTO and other fora.

Trade agreements are constitutional in the sense that they are designed to limit governing authority, even in areas where discrimination against foreign goods or services is not an issue, and they are also constitutional in the sense that the rules are very general, even vague in the way they are formulated.

My second point, which I will return to, is that a good case study to see all these things at work is the WTO's decision on Internet gambling.

But before I return to the gambling issues, let me also mention that there has been a developing dialogue between USTR and State and local governments on the so-called sovereignty issues. USTR has made a number of very clear statements on its web page. You can view them there. I have spoken to a number of State and local officials who feel like the responses just are not attentive to their concerns. In other words, you have two groups that are coming from very different cultures and perspectives, and the kind of consultation that is necessary to avoid problems like the gambling case presented has really not taken hold yet.

There is no traction yet in terms of any meaningful, Federal-State consultation, and that is really my fourth point. Congress can play an important role by creating a forum to encourage people to come together and have a public dialogue about such issues as you raised about the gambling case.

So let me just spend the rest of my time making a few points that I think are responsive. Even when the United States wins a case, there is a lot you can learn from it. This is one of the very few cases on the services agreement, the General Agreement on

[1] The prepared statement of Mr. Stumberg appears in the Appendix on page 59.

Trade in Service (GATS). Mr. Vastine's coalition has worked very hard to GATS put in place in order to promote American exports of services abroad.economy.

What the gambling case says to me is that making a commitment in a sector like gambling services is like hugging a porcupine; it can be done, but you have to do it very carefully if you do not want to get hurt.

Among the lessons we have learned from that case are, first of all, as the WTO appellate body recognized, the U.S.'s commitment on gambling services, which was made back in 1993 and 1994, was essentially a mistake. It was a mistake that could have been avoided had there been effective consultation between U.S. trade negotiators and the legions of State-level officials who regulate this industry on a day-to-day basis.

Second, the GATS rule that the island Nation of Antigua used to challenge the United States was interpreted very expansively by the WTO appellate body. It is a rule called "market access." What is interesting about that rule is that it has nothing to do with discrimination against foreign firms. It is a rule that has to do with whether or not governments at any level may impose quantitative limits such as licensing monopolies or a limited number of service providers or imposing a quota. The WTO ruled that in this case, a ban on Internet gambling amounted to a zero quota.

That is a very controversial decision. You might say it is a bad decision. But that is the job of the Appellate Body, to interpret language that is so vague and open-ended. They did their job, and used the role to find the United States in violation.

The U.S. Trade Representative (USTR) effectively defended the United States with respect to all but one measure, the Interstate Horse-Racing Act, which permits remote betting for horse races.

What is interesting about the public morals exception, as interpreted by the WTO, is if the USTR persuaded the Appellate Body that there were public morals concerns that were specific to remote gambling. In the Internet gambling context, these include accessibility to children through the Internet or the potential for money laundering or other connections to organized crime through Internet financial transactions. But those rationales do not apply to the kind of economic regulation that State and local governments have in terms of creation of monopolies, tribal casino concessions, State lotteries, and other sorts of quantitative limits that are common in the United States.

Finally, one of the most interesting things about the case is to anticipate the end game. If the Congress does not move expeditiously with respect to amending the Interstate Horse-Racing Act, the WTO dispute process provides sanctions that include alternatives even for a small country like Antigua, which I think has about 90,000 residents. It is a country which is obviously too small to have any meaningful options in terms of a trade sanction when it comes to imposing tariffs on imports from U.S. goods and services. We would not even notice. The academic literature suggests that Antigua will follow the lead from Brazil, which just this past week has published its blueprint for how it will apply sanctions in a cotton case which Brazil recently won against United States with

respect to a number of commodity subsidies and export promotion credits for cotton exports.

Even a tiny country like Antigua can decide to withdraw its trade commitments with respect to honoring U.S. intellectual property rights. And the list of property rights that Brazil used, and which Antigua can use as a model, include copyrights, trademarks, industrial designs, patents, and protection of undisclosed information. That is a significant sanction stick, and it raises important questions about how the United States should make its future GATS commitments.

Senator COBURN. Thank you, Mr. Stumberg. Mr. Vastine, thank you.

**TESTIMONY OF ROBERT VASTINE,[1] PRESIDENT, COALITION OF SERVICE INDUSTRIES**

Mr. VASTINE. Thank you very much. I am Bob Vastine, President of CSI. Under another hat, I am Chairman of the Inter-Agency International Trade Committee on Services, an official advisory body of the U.S. Government, created in the 1974 Trade Act.

I appreciate the opportunity to be here today. This is the first time I have had the pleasure of testifying to a committee of which I was once the staff director. Since Senator Levin has left the room, I'll confess I was a Republican staff director.

I want to say that my testimony is mainly focused on U.S. commercial stake in the WTO, though I am going to try to ad lib about regulation.

First of all I want to make the point that CSI's member companies include virtually every aspect of U.S. services, tradeable services. We operate in more than 100 countries. Our global sales are over 800 billion. We employ about 2.2 million people globally. These companies are absolutely committed to the WTO and to the Doha Round as the best means of obtaining global trade liberalization to expand their foreign markets and create more jobs here.

U.S. services trade consists of two elements, cross-border trade and sales by U.S. foreign affiliates to foreigners. The total of this trade, cross-border and affiliate trade, is $740 billion, more than the GDP of Canada. Cross-border trade, is like financial services that are traded electronically, but it also means trade conducted by people, people who travel, who come here to buy health services, who come here to buy education services. Every time a foreign student matriculates at a U.S. university, that is an export. We are very good at this. We are also very good at sending our experts, our lawyers, our accountants, our computer consultants, abroad to other countries to provide their services personally. All of this amounts to total cross-border exports, as I said, of $338 billion, where we have a $50 billion annual surplus.

We are also the most competitive country in sales from foreign affiliates, $402 billion in sales in 2002. By the way, since you are the Governmental Affairs Committee, responsible for oversight of our statistics programs, I would love to talk to somebody on this Subcommittee about needed changes in the government's programs

[1] The prepared statement of Mr. Vastine with attachments appears in the Appendix on page 63.

for compiling these statistics. We are dealing with 2002 data. It is too old.

As I said, we are committed to the WTO. CSI was created in 1982 because there was at that time no mechanism, no legal framework, for conducting trade in services, for creating rules for free trade in services, and CSI had a great deal to do with the writing of the General Agreement on Trade and Services (GATS).

We believe that GATS is essential, because, Senator, it is the only way we can obtain legally binding commitments as to the treatment of our foreign investments and our export industries. In order to invest millions, sometimes a billion or more dollars in a foreign affiliate, a U.S. company needs legal certainty. The best way to get that legal certainty under the WTO is commitments in the GATS which are legally binding and therefore subject to dispute settlement.

So in spite of the flaws, the discussion we have had today about dispute settlement, it is really an essential part of the post-Uruguay Round world, and very important for our member companies. Achieving legally binding commitments subject to dispute settlement is very important.

I am going to skip a lot of my text, and I wanted to tell you how the Doha Round is in crisis, and ask your help in dealing with that, but I want to talk a little bit about regulation from my standpoint as having observed closely, the trade negotiations process really since 1965.

The U.S. Trade Regulation is acutely aware of the need to preserve the right to regulate federally, State and locally. We know that USTR is very aware of these State regulation issues, for example, insurance. Insurance is regulated State by State under the McCarron Act, there is no Federal regulator for insurance. There are State commissioners. There is no common standard of State regulation insurance. It is bad for U.S. insurance companies operating nationally. It is very bad as well for foreign insurance companies that have to operate with a 50-state regulatory system.

Other countries have asked in the Doha Round that we change that system. We cannot change that system. We are not going to be able to change that system. We are not going to be able to override the States. The best we can do is try to urge on these commissioners the need to consult among themselves and create harmonious, sensible regulation. But for now the whole insurance industry is held back domestically and globally by this system of State regulation, which is not going to be changed by the WTO.

The Federal system creates equally complex problems for the law profession, for the engineering profession, for the construction profession. So we are very aware that in the areas where State regulation—and it is a big piece of our services trade—prevails, we have problems.

Now, in my experience, in no case has the United States obligated any State to regulatory rules that a State has not voluntarily accepted. We just made a new offer in the WTO. We revised our previous offer. That offer included some changes in regulation that States had voluntarily adopted in the last 2 years. Before including those changes in our offer, the USTR went to every single one of those States and got their permission to do that. Now, that does

not mean that the professor is not correct. I would say the greatest crying need right now in this era of when some State legislators are rebelling against the WTO—based often on hearsay, innuendo and frankly, wrong-headed stories about the evils of the WTO—the best thing USTR could do would be to beef up its state-wide operation. They need a former governor, a former noted head of assembly or Senate or the State legislature to come be a counselor to the USTR, to be at Portman's right hand, to be a main point of contact for the States, to call the 50 States Attorneys General, the Supreme Court Justices, etc.

Senator COBURN. Let me get you to sum up, if you would.

Mr. VASTINE. So I think I have made my point. I think we do have an issue with State regulation. In my own experience, the USTR is extremely sensitive to the need not to tread on the States, but we need to do a lot more work with the States themselves.

Thank you.

Senator COBURN. Thank you.

Mr. Vastine, you just said we need the legal certainty of the WTO, and let me bring a case to you: Zippo lighter. Total piracy, there is no legal certainty for them. There is no enforcement mechanism. There is no punitive action that is going to be taken against the Chinese because the Chinese did not enforce it.

So tell me what the legal certainty is when you have laws that are not enforceable, or we will not through our own political benefit enforce the sanctions that are available to protect intellectual property or piracy. I do not know if you have read the article on that. The Chinese make three or four times the number of Zippo lighters than Zippo makes, and with Zippo's lifetime guarantee, they all started coming back in because they were junk. Here is an American company whose intellectual property—i.e., a quality product with its name brand on it—was pirated, and yet we have done nothing about that.

So tell me what you mean by "legal certainty."

Mr. VASTINE. I will try to do that. It is difficult not to get caught in the China problem, which is a vast problem. But let me give you some background.

We worked very closely with the USTR in writing the agreement with China, the bilateral agreement between China and the United States, which laid out most of the rules that China is now supposed to be implementing. And we worked very hard for PNTR passage in Congress because we felt that agreement was a very good agreement.

Now, we have a large number of industries and companies that have been having adjustment problems working with the Chinese to get them to implement their agreements. I don't know anything about Zippo, so I can talk to you only——

Senator COBURN. You know zippo about Zippo. [Laughter.]

Mr. VASTINE. Thank you. But I can talk to you about our service's experience. Some of these companies are software companies, and some are entertainment companies, and they are all acutely aware of the IPR problems. And we join them in bringing constant expressions of concern to bear on USTR and on the Commerce Department about these violations.

Senator COBURN. Let me interrupt you for a minute. Is it not a fact that the software manufacturers chose not to push for enforcement of the very laws that the Chinese were violating in terms of intellectual property?

Mr. VASTINE. Well, that is what I am getting to. The decision to go to the WTO and file a case is a complex decision. It is a difficult decision for a company. We have companies in, say, express delivery who, on the one hand, are doing extremely well. Their sales in China have vastly increased. On the other hand, they have unfair competition with the local Chinese postal office, which is giving them a hard time in a number of ways.

What does a company do in a situation like that? You have to put yourselves in the shoes of the company, and you can understand that they want to protect their position. They are doing well. On the other hand, they need to continue to argue for fair treatment vis-á-vis the China post or whatever entity may be in competition with them; the same thing in the insurance sector. It has taken years to get the insurance regulators in China to come around to beginning to implement their commitments in insurance services.

Senator COBURN. Let me get you to answer my question.

Mr. VASTINE. So I am having a hard time answering your question.

Senator COBURN. Is it true or not?

Mr. VASTINE. Is what true?

Senator COBURN. That the software companies felt intimidated for their future market to not file a complaint.

Mr. VASTINE. I do not know that, Senator. I do not know the facts. I just do not know.

Senator COBURN. Well, the problem I see with your statement, legal certainty, is there is no legal certainty when it comes to China. I am just talking about China. I am not talking about all of it because I know we have wonderful trading partners that do protect our intellectual property. But, in fact, if you have a system where the leverage is such that even if you have a legal remedy, the leverage is such by the country that is working it will not carry out the proper factors of that, you really have no legal certainty. We do not have that in terms of intellectual property.

Mr. VASTINE. There was a case—and maybe Mr. Barfield knows the case.

Senator COBURN. Mr. Barfield——

Mr. VASTINE. We brought a dispute settlement case 6 months ago to the Chinese. We took it to Geneva. They settled immediately.

Senator COBURN. Which case was that?

Mr. BARFIELD. I do not know the case.

Senator COBURN. Mr. Barfield, would you like to comment?

Mr. BARFIELD. My only point is that I do not—the answer to your question is yes. But I do not think we can limit this to China. We can take up an issue that is about to maybe got to the WTO, very much, I am sure, on Congress' mind and the Administration's mind, and that is the Boeing-Airbus. For a decade, at least, the United States did not bring that case because the Boeing Company had reservations about what it would do with its markets in Europe, a sort of open secret. So I think you are right in terms of

what is happening in China, but that is part of a calculation, as Mr. Vastine was saying. When you bring this case, a company or the government has to think, well, how does it fit with—this or any other case, how does it fit with our overall trade relations and, in some cases, diplomatic relations or security relations.

We ought to admit that all of these things work as a piece of that decisionmaking process. But it is not just China. It is true with our other trading partners, too. It would be true probably with—we have relations with Brazil. We are calculating what we would do there.

Senator COBURN. For example, the recent negotiations with Merck where they told them that they would reproduce the drug themselves unless Merck dropped the price.

Mr. BARFIELD. That ended up—I think the U.S. Government did not get involved in it, but——

Senator COBURN. No, we settled it.

Mr. BARFIELD. Merck had to calculate what does this do about in this case Merck's overall international corporate strategies, and Merck decided that it would be better to fold on this. In other cases, if you take, let's say, the pharmaceutical companies in terms of Canada, for instance, and cross-border, they are holding the line. But these are—in each case——

Senator COBURN. My point is there is no legal certainty.

Mr. BARFIELD. That is true—well, the legal system is embedded in a larger political system.

Senator COBURN. Right. So it is not a legal certainty because if, in fact, I make XYZ product and I have to make a way, not on a legal basis but on an economic basis, an international relations basis, diplomacy basis. So, in fact, we are to a position——

Mr. BARFIELD. Well, legal——

Senator COBURN [continuing]. Where the purposes of the WTO are good and long term maybe very positive. The real fact is there are a lot of other players, things that play into whether or not we get enforced trade law as to whether it is, and we turn a blind eye when it is not necessarily in our total national interest.

Mr. BARFIELD. That is right. And I would hope—and I would agree with this or the Clinton Administration or whichever Administration it was that did it. The President has to look at this in terms of not just our trade policy but our total diplomatic and security——

Senator COBURN. Let me come back to you. I asked Mr. Mendenhall this. How many years can we afford to continue to lose in the international markets the very intellectual property that Mr. Vastine represents through his service industry and continue to be able to compete?

Mr. BARFIELD. Well, I actually think we could go for a long time, because I think actually what is happening is that other countries are kind of chasing their tail and we are—the aim that we—I think, as I would have said 10 years ago about Japan or others, I would look internally as to how we are handling our own innovation system. This is not to say that I do not think at some point the United States should not bring a set of cases on intellectual property. You were hammering Mr. Mendenhall correctly, but what he is dancing around is that the Administration basically thinks

that if you look at our total relations with China, if you look at the way they are at least attempting to live up to their WTO obligations, which were far beyond the obligations that any other big country has ever undertake, just for membership, they figured—and this is true with the Europeans—we do not want to inundate the system. We could hammer the Chinese with a number of cases, but their worry has been—and maybe we are coming to the end of that—that this would really overload the system. If you really just sort of—a dozen cases against Chinese and, you could second-guess that or say that is an incorrect judgment. But I think that—he could not say this, but I would say it, that, yes, they are calculating a number of political things beyond just intellectual property and beyond trade. They are probably looking at Korea. They are looking at other things.

Senator COBURN. Let me get back to sovereignty for a minute, our sovereignty as we have patent laws, we have internationally negotiated both through bilateral agreements and WTO the recognition of intellectual property and patent laws. Let's say I am Merck and I spend $1 billion a year researching HIV drugs. And then wherever I go around the world, because of our lack of trade sanction enforcement, all the companies say we are not going to allow you the return on investment to pay for the research that you had on this drug.

Why is Merck in the future going to invest capital in research and the production of intellectual property if, in fact, they cannot get a return and we will not reinforce or enforce the very agreements that we have? Let me just background that for a minute. In this country, we pay 50 percent more than anybody else in the world does for pharmaceuticals. Part of the reason is because we have not enforced our intellectual property rights because we have been blackmailed to say, well, we will just allow somebody else to make it under your patent and we will not honor your patent. And they know that will be a long fight, and it will come through WTO. But, in fact, we are being blackmailed.

So, consequently, the American people are paying, they are subsidizing the rest of the world's pharmaceuticals through the prices they pay. We are getting ready to have Medicare D, which is going to, again, subsidize the rest of the world's pharmaceuticals, because we do not have a cogent trade policy because we have fixed in this overall parameter of things that maybe it is better for us not to.

The costs of not recognizing that are weighing a tremendous burden on this country, and it is very short-sighted for us to not look at that.

So the very consequences—and this gets back to the sovereignty of our intellectual property, i.e., the sovereignty of a patent of rationalizing that it is in our best short-term interest to not enforce it, but it ignores our long-term interest. Who is going to invest the capital in our drugs in the future if, in fact, our intellectual property is not done. And there you are challenging our own sovereignty because we undermine our sovereignty because we will not enforce it.

Mr. BARFIELD. Well, I would say that, in general, whether it was—I could be bipartisan. I think it was the Clinton Administration and it is true with the Bush Administration. We are enforcing

it in the big markets, and I think we will continue to do that, and I think we will back our companies—I hope we will back our companies, for instance, in the whole—I mean, you may be on the other side of this, the whole—the way they are reacting to parallel imports from Canada, because you have got to maintain the price structure. And, indeed, I fully agree with you that the proponents of just giving away all these pharmaceutical products in terms of let's take AIDS, the market signal you are giving to the pharmaceutical companies is do not invest in AIDS drugs because they are going to hammer us, we will not be able to get our return. And that is a terrible signal, and I think the Administration and previous Administrations have been cognizant of that.

I think where it gets complicated is with—I do not know anything about Brazil, but with African countries, for instance, where there is no infrastructure and indeed the price is probably not the question. But you at least have to do something about that. The key to the answer—and we are off the subject, I think, of sovereignty. The key answer here is that we have got to enforce parallel import restrictions. It is perfectly good to allow our companies and encourage our companies to send drugs at much cheaper prices to lower economic developing countries in Africa, as long as those drugs don't come back to Sweden, because that is what will really kill Merck, that it is the developed country markets, and that I think is the answer.

Senator COBURN. Well, but that subsidy—that is not a real market. What you are saying is we are going to allow, through the international——

Mr. BARFIELD. No, we—Merck is producing at market rates. They are pricing for the world. If we undercut that—and the biggest way you would undercut that would be to have—we are not saying——

Senator COBURN. We are not——

Mr. BARFIELD [continuing]. To Merck you have got to send those drugs to Africa. They are not——

Senator COBURN. We are pricing——

Mr. BARFIELD [continuing]. Protecting Merck from——

Senator COBURN. We are pricing for the United States and subsidizing the world with pharmaceuticals.

Mr. BARFIELD. We have a worldwide pricing——

Senator COBURN. Mr. Stumberg, do you agree with Mr. Vastine that the States are voluntarily changing laws, or are they feeling pressure to change laws?

Mr. STUMBERG. Probably neither, sir. Most State legislatures and State officials are not in the loop whatsoever. They are continuing to make their decisions like they used to. Some of them wake up in the morning, read the newspaper and are surprised to learn that a kind of law they have been making for years is now the subject of a trade dispute or at least it is being negotiated for the first time. I think that is perhaps a more realistic description of what is really going on.

If you look at the U.S. schedule of GATS commitments, which is the progeny of the Coalition of Service Industries work in partnership with USTR over more than a decade, you will see that there

are a number of specific sector commitments that represent the priorities of the United States in terms of those big markets.

Within that big schedule, you will see that there are some States that are—I am using jargon here—listed as limits on U.S. commitments; in other words, some specific State laws are being carved out because USTR talked to those States.

I will give you one example because Oklahoma is on the list, I believe. There are a number of States that have explicit limits on who may actually own land, including ranch land. By my count, there are 17 such States. USTR intended to carve out those States with respect to a GATS commitment on access to real estate for purposes of commercial wholesale and retail distribution services. There are only seven States listed on the U.S. schedule, which does not reflect the 17 that actually have these kind of laws, two of which are actually constitutional. I think Oklahoma and Nebraska are the ones that actually have constitutional provisions.

Senator COBURN. This is corporate farming prohibitions.

Mr. STUMBERG. Right, exactly. I interviewed a number of lawyers who worked for Western State governors just to see whether these turn-of-the-century—the prior century—laws really were a priority of the governors, and somewhat to my surprise, the answer was "yes." These are laws they want to safeguard.

So I cite this just as an example that there sometimes is consultation. Even when there is an attempt at consultation, it is often incomplete because the process is so complex and so hurried. I think your point, Mr. Vastine, that USTR does not have the person power to effectively manage its relationships with States is well put. But I would go farther. I would say it is not just a matter of perhaps making a mistake with respect to reserving State authority about regulation of land use or ownership. And it is not just about making a mistake with respect to a gambling sector. It is a much deeper question of managing that complexity but at the same time appreciating that the bottom-up perspective of American federalism, which champions laboratories of democracy and local experimentation, is a very different and in some ways conflicting idea with the essential purpose of the WTO trade rules, which is to make for a more uniform set of rules by which the global economy can operate. Both are positive values——

Mr. VASTINE. And I think we have been accommodating them, and I hate to hear you say that there is some sort of effort to undermine the States.

Mr. STUMBERG. I did not say that there was an effort to undermine the States. I am saying that the system appears not to be working very well, and I have given you an example. The example is that in the context of gambling, where there appears not to have been effective consultation in 1993, which 10 years later led to a major trade dispute. That is the time frame—you have to plan your legal moves anticipating something that might happen in 10 or 15 years. Now we are on the cusp of another decision. Should the United States withdraw its commitment to gambling or not? That is a big strategy question in terms of the current round of GATS negotiations. Are Attorneys General being consulted by USTR with respect to the strategic tradeoffs on that very important decision?

And according to the Attorneys General, just a month ago, the answer is "no."

Senator COBURN. They are not being consulted.

Mr. STUMBERG. They are not.

Senator COBURN. So are there specific recommendations other than the ombudsman position that Mr. Vastine—that you would make to the USTR in terms of how to make this more fluid, competent, and consistent with States so that we can negotiate reservations, if that need to be the case, for State positions?

Mr. STUMBERG. Well, let me start with something safe, and then venture out from there. The USTR's own advisory committee called IGPAC, the Inter-Governmental Policy Advisory Committee, which USTR appoints (these are hand-picked State and local officials), wrote a report this spring which called for much deeper and broader consultation with States. Their point was that USTR needs to be talking not to the governor's policy adviser for trade, who wears a lot of hats and is basically a political agent for the governor, but rather, the people in the State governments who actually make decisions about protecting State sovereignty: The lawyers in the Attorney General's office and people such as utility regulators, whoever is the relevant agency.

That level of consultation has only occurred in rare circumstances, for example, insurance and accounting. It has not occurred across the board, and that leads to a second obvious need, which is capacity.

But I would argue that while USTR is obviously understaffed to take on meaningful consultation with State and local governments, the real step forward will come when the State and local governments themselves organize in such a way that they can bring their issues to USTR, just like the Coalition of Service Industries brings its issues to USTR.

You cannot make USTR big enough to handle a country as complex as the United States and its Federal system; rather, I think the movement has to come from the bottom up. But if you think about the role of Congress—and this is the final point in my testimony—Congress I think could play not only a catalytic role with hearings like the one you called today, Congress could provide a friendly forum, a neutral forum, where State officials and USTR are encouraged to come and have a public dialogue where it has not happened before. And the kind of close questioning that you showed earlier with respect to USTR and its China policy, if applied to American federalism, would open some eyes and help USTR understand that federalism is a priority in trade negotiations.

Remember, the USTR's job description is set by the President of the United States and the Congress when you authorize negotiations every several years. If federalism is not spoken from either branch of government, then——

Senator COBURN. You are referring to the fast-track legislation.

Mr. STUMBERG. I am.

Senator COBURN. Thank you.

Mr. Barfield, are you concerned that WTO may become a mechanism for political international activists, that we look at this—what can potentially come out of this gambling, like the Kyoto treaty or

something like that? Is there a potential for it to move to a position where the implication of other policies outside trade implicate and influence trade decisions?

Mr. BARFIELD. Yes, there is that possibility, and this is not sort of Henny Penny, the sky is falling, but let me walk you through the way another new character of the WTO beginning in 1995 was that in legal terms, without getting heavy into legalese, the WTO much more became a part of what is called public international law. And there are certainly legal scholars who argue that precepts of public international law now cover the WTO, that is, outside of trading rules.

There are articles, for instance, in legal journals and some governments have commissioned pieces about, well, could we bring the United States to heel because they have not signed the Kyoto treaty through some Article 20——

Senator COBURN. Would you be kind enough to reference those to the Subcommittee?

Mr. BARFIELD. Sure.

Senator COBURN. Thank you.

Mr. BARFIELD. And other, the so-called morals clauses that Mr. Mendenhall talked about, the escape clauses, that is, that nations can implement particular—and then enforce them, particular policies and then try to enforce them with trade sanctions, so that there are also discussions about how human rights would come into the WTO.

Now, let me be very careful here. That is something that I would hope that the Congress of the United States and other countries would be very careful to watch. The United States has to decide what it wants to do here. But to pick up on this discussion that was talking about State versus Federal, I think the same thing is true at the congressional level.

The truth of the matter is I am in favor of fast track, but I have to say that I know the reasons from the trade side that is important. You are not going to get people to come to the table. That is what Mr. Vastine would say. It is what I have said. On the other hand, the truth of the matter is Congress in the Uruguay Round was presented with a mass of new rules, which, again, no conspiracy here, it was just impossible, even with much larger staffs than you had, much larger staffs than the government had, the implication which you could not particularly fathom, particularly, as I say, in services and health. This is all inside the border.

The other thing is true that, again, when you look at the way negotiations are handled, USTR is being asked to make judgments about telecommunications policy or financial services policy. Now, they often depend on the other agencies, but these are issues that I think should be front and center with the Congress as it goes forward. And I say this as a supporter of the system. But these rules do have an impact on what we have counted as domestic issues. And we should be very careful—I am not suggesting that we should stick our head in the hole and say there are no international rules. But we need a better system of judging where you will give up—"you" being the Congress—will give up authority to some international body, and you in speaking for the States will give up au-

thority to some international body. And I think that system is increasingly, it seems to me, under challenge.

As I say, it is the way of the world today that for a lot of reasons, because of globalism, there are a lot of people who are arguing for particular rules that we need across the board.

Industry, by the way, just as you find in the Federal system of the United States, will at some point sometimes be tempted to say, gosh, instead of going to the States, 50 States, let's go to the national government and settle it that way. You will find that same translation, I think, sooner or later—in the international level. Why do we have to deal with the rules of the United States versus the rules of the Europeans versus the rules of the Brazilians if you are—take the name of a company, if you are a multinational. But from the point of view of the elected representatives of United States democracy or the European Union evolution or Brazil or whatever, I think that ought to be a very much more careful process than we have had so far. And in my judgment, the dispute settlement system kind of adds to that.

Mr. Mendenhall was not, I think, purposely being evasive or disingenuous when he said, yes, the Congress can—correctly, yes, the Congress—nobody can overturn the congressional rule. A WTO rule, the Congress does not have to agree to it.

The problem with that is the way the system works. Your only alternative would be to withdraw from the WTO, and so you get these—you get a FSC case or another case, and it is kind of individual cases, none of which add up, in my judgment, to a decision the United States should pull out of the WTO. But your alternative is to swallow the case and say, all right, well, and we will negotiate it. And then the problem there is that once you have won a case in the WTO today, it is very difficult then to get somebody to go back and—if the European Union—they won on the FSC. Do you honestly think the European Union will go back and then negotiate a rule that allows us—it is just not in the cards for that to happen?

Senator COBURN. So, in fact, there is significant impact.

Mr. BARFIELD. Sure there is.

Senator COBURN. Yes. Any other comments?

Mr. VASTINE. Senator, I cannot let you—well, you wanted to make the point about——

Senator COBURN. I want to make a broader point, so go ahead.

Mr. VASTINE. I will make my broader point, too. Senator, our companies care deeply about obtaining legal commitments to the WTO. I cannot let the hearing end with you thinking that the Chinese accession and the membership in the WTO does not have legal value. We would not be discussing the potential for a dispute settlement process if it did not. At least China's accession gives us the ability to come to the Chinese in a number of forums and try to enforce our rights. It gives us rights to enforce which we did not have previously.

So China's accession to the WTO and its membership there are very valuable. We are very lucky that the Chinese did it when they did and that leadership was willing to take the extraordinary bold step of subjecting that very rigid state-owned economy to market discipline. And it is a difficult process for them. It is a difficult process for us to adjust to globalizing the Chinese economy, but at

least if they are in the WTO, at least we have these avenues to approach them.

As to legal certainty, I hear your point. But our companies do believe——

Senator COBURN. Those were your words, not mine.

Mr. VASTINE. I know.

Senator COBURN. I was quoting back your words.

Mr. VASTINE. I accept that, and I stand by them. They do want the legal—they want it in writing. They want to see that, for example, the Saudis in the negotiation that is going on this very minute do not have the right to mandate sessions, insurance sessions to internal parties. I mean, we fight these agreements down to the last word.

Senator COBURN. I recognize their value.

Mr. VASTINE. OK.

Senator COBURN. But a right not exercised is a right not used——

Mr. VASTINE. And there are——

Senator COBURN [continuing]. And a right not used is a right lost. And when we choose in the short term, on a short-term economic model—and that is the whole question. The real thing that is in front of Congress that is worrying us about the Chinese, just to be—it is not that we are not sitting up and that we are not progressing. It is will we progress to the place where they are a legal, aboveboard player in time to save our own economy.

Mr. VASTINE. Yes.

Senator COBURN. And that is the real question in front of the Members of the Senate and the Members of the House. They are not playing by the rules now, period. Even though they are in the structure and on the team, they are like the bully that does not play by the rules. They go behind the barn and change the rules and then come out. And that is on intellectual property. That is on reverse engineering. And it is happening routinely.

Now, maybe it is less. Maybe it is not. And the Congress is for them being a part of that. That is not the issue. The issue is whether or not you use the tools that they have agreed to to enforce the very outcome rather than make a short-term situation that we are better off now for our business, but we lose the business in the long term.

So it is about a short-term view versus a long-term view. I just happen to think that we ought to be thinking about the long term. And it ought to cost them something now for stealing. And that is what it is. It is theft of intellectual property and future for the companies of the United States.

Mr. VASTINE. It is infuriating.

Senator COBURN. I want to thank you each for being here. We have gone over our time. I appreciate you waiting for the long time that we had Mr. Mendenhall. And I thank you for your contribution.

We will have some questions, and, Mr. Barfield, if you would give us those references, I would very much appreciate it.

Thank you all very much. The hearing is adjourned.

[Whereupon, at 11:33 a.m., the Subcommittee was adjourned.]

# APPENDIX

## PREPARED STATEMENT OF SENATOR CARPER

I would like to thank our witnesses for being here today to discuss the important role that the World Trade Organization plays in arbitrating and enforcing international trade rules and agreements. This work protects American businesses' access to foreign markets and ensures that foreign producers do not engage in unfair trade practices in the United States, such as dumping, that can undermine our domestic goods and service providers. This is the very essence of free trade.

We, in the Senate, recently passed the Central America Free Trade Agreement in an effort to liberalize trade with Central American countries and in doing so promote reform in these developing nations. In fact bilateral agreements, particularly with developing countries, provide us an essential tool to press for such change. But we often overlook the role that the World Trade Organization plays in laying the necessary groundwork for our bilateral trade agreements.

One hundred and forty-eight countries currently belong to the World Trade Organization and close to thirty countries are seeking admission. To gain entry, these countries must negotiate bilateral agreements with other World Trade Organization members, leading to specific commitments—such as judicial reforms, government transparency, patent protections, labor and environment standards, etc.

The United States is currently negotiating bilateral trade agreements with several countries seeking membership in the World Trade Organization, including Russia, Ukraine, and Saudi Arabia. In these bilateral agreements and through the World Trade Organization we hope to secure the enforcement of intellectual property rights, tax reforms, improving food health and safety standards, and more.

The World Trade Organization also provides the only multilateral dispute settlement mechanism for international trade. In fact, this is an important tool that the Bush Administration has not used proactively. Whereas the Clinton Administration brought an average of 11 cases per year in World Trade Organization, the Bush Administration has filed only 12 in their first 4 years. We are not adequately using this important resource to protect our nation's businesses.

I look forward to hearing from the witnesses today and discussing ways to better use the World Trade Organization and the ongoing Doha Round negotiations to encourage reforms in developing nations and to even the playing field for American goods and services both at home and abroad.

**TESTIMONY OF**

**JAMES E. MENDENHALL**

**ACTING GENERAL COUNSEL**

**BEFORE THE**

**SUBCOMMITTEE ON FEDERAL FINANCIAL MANAGEMENT, GOVERNMENT INFORMATION, AND INTERNATIONAL SECURITY**

July 15, 2005

Thank you Chairman Coburn, Ranking Member Carper and members of the committee. I appreciate this opportunity to speak to you today about the relationship between the United States and the World Trade Organization (WTO).

The specific title of today's hearing is "Securing American Sovereignty." An equally appropriate topic would be "Securing American Economic Strength." For those two complementary objectives together form our guiding principles in the WTO. U.S. participation in the WTO and the world trading system is absolutely critical to our continued economic growth. At the same time, the safeguards that are built into the system fully preserve our sovereign right to regulate as we -- the U.S. Government, state and local governments, and the people of America to whom we answer -- see fit.

Since 1994, when the Uruguay Round Agreements were completed, the United States has experienced an extraordinary period of economic growth. USTR's Annual Report, issued in May of this year, details these benefits at great length. I won't discuss them all here today, but will highlight some of the key statistics covering the period 1994-2004:

- Real gross domestic production of the United States has risen a strong 38% since 1994 and average per capita income increased by a quarter. Growth last year alone was 4.4%.

- Moreover, Americans have average real incomes 40% greater than the nearly 700 million people living in the other countries that the World Bank classifies as "high income."

- U.S. industrial production -- 78% of which is manufactures -- rose by 35 percent between 1994 and 2004, exceeding the 27% increase achieved between 1984 and 1994.

- The 35% increase in U.S. industrial production in the last 10 years was greater than in many of our trading partners: 18% in France, 17% in Germany, 9% in Japan and 5% in the U.K.

- Productive investment, central to healthy growth and rising living standards, has increased. Even excluding housing, U.S. non-residential fixed, or business, investment has risen by 78% since 1994, compared to a 34% rise between 1984 and 1994.

- 17.2 million net new U.S. jobs were created between 1994 and 2004. This resulted in an average unemployment rate of 5.1% in the ten years ending 2004, compared to an average unemployment rate of 6.4% during the prior decade (1984-1994).

- Trade in goods and services now accounts for 25% of U.S. GDP, up from 18% in 1984, and 22% in 1994.

- NAFTA and the WTO agreements together are estimated to increase the annual income of the average U.S. family of four by between $1,300 and $2,000.

In short, the benefits of U.S. participation in the WTO are large, tangible, and widespread, as recognized by the House of Representatives last month, when it voted 338-86 to defeat a resolution calling for U.S. withdrawal from the WTO.

*Protection of American Sovereignty*

During the Uruguay Round negotiations that led to the creation of the WTO, and in the current round of negotiations under the Doha Development Agenda, U.S. trade negotiators have been ever mindful of the need to protect U.S. sovereignty. It is critical that, at the same time we work to integrate the global economy and maximize opportunities for U.S. workers, farmers and businesses, we fully preserve our sovereign prerogatives.

To better explain how we have sought to achieve that objective, I will break my testimony into three parts – first, a discussion of the substantive rules; second, a discussion of the administrative structure of the WTO; and third, a discussion of the landmark dispute settlement mechanism negotiated during the Uruguay Round.

Rules for a Modern World

The predecessor to the WTO, the General Agreement on Tariffs and Trade (GATT), lasted for approximately 50 years and covered only trade in goods. While many people still think of "trade" as solely trade in tangible goods, the global economy looks much different today than it did 50 or 60 years ago.

For example, the services sector now accounts for 60-80% of the U.S. economy, and is the one area of trade where the U.S. has a substantial trade surplus. Protection of intellectual property has also come to play a central role in U.S. economic growth. The

value of innovation, creativity and branding – covering everything from movies and music, to software, to pharmaceuticals, to basic trademarks – has become a key driver of U.S. competitiveness.

In recognition of the changing nature of global economy, new rules were developed in the Uruguay Round to cover services and intellectual property. At the same time, new rules were developed to modernize and elaborate on the older GATT disciplines, covering areas such as standards, sanitary and phytosanitary measures, and trade remedies. Yet, all of these rules share the same hallmarks of the previous GATT system. They set general parameters to liberalize trade and eliminate protectionist measures, while at the same time allowing within those general parameters ample flexibility to regulate in the public interest.

The GATT and the General Agreement on Trade in Services (GATS) contain general rules prohibiting discrimination on the basis of nationality, promoting transparency and the like. Outside of those general guidelines, however, they impose few constraints on a country's ability to regulate as it sees fit. In the context of the GATS, a country may agree to open, for example, its markets to foreign firms seeking to provide legal and architectural services, but governments retain their right to regulate admission, licensing and disciplinary standards. Indeed, the GATS Annex on Financial Services contains an explicit provision to allow regulators to take measures for prudential reasons. As another example, the Agreement on the Application of Sanitary and Phytosanitary Measures requires that governments base their food safety standards on science. Governments are free to adopt as high a standard of protection as they desire, provided that the standard is science-based.

The GATT and GATS also contain explicit exceptions for measures taken, for example, to protect health and safety, or national security. In addition, a WTO Member may change its specific tariff commitments under the GATT or specific commitments under the GATS through a formal negotiation process.

With respect to intellectual property, the negotiation of the Agreement on Trade-Related Aspects of Intellectual Property Rights codified, elaborated on, and made consistent a hundred years of international practice and rule making. At the end of the day, this exercise effectively obligated other countries to meet standards that the United States by and large already met.

But perhaps the most important safeguard with respect to the substantive rules is the way the United States, in accordance with our Constitution, has chosen to implement them. The rules negotiated in the WTO, in and of themselves, have no domestic legal effect. Instead, the United States implemented the WTO agreements by statute, through the Uruguay Round Agreements Act (URAA). Any and all changes to U.S. law necessary to implement the WTO agreements are contained in the URAA or in subsequent amendments to U.S. law that the Congress may choose to adopt. If Congress chooses not to amend a law that conflicts with a WTO rule, the domestic law prevails. Similarly, the WTO agreements do not automatically preempt state laws.

Section 102(a)(1) of the URAA explicitly states that "No provision of any of the Uruguay Round Agreements, nor the application of any such provision to any person or circumstance, that is inconsistent with any law of the United States shall have effect."

Other protections were built into the URAA as well. For example, no private cause of action may be brought in U.S. federal court on the basis that a particular measure is inconsistent with the WTO agreements. In addition, the URAA contains provisions establishing procedures between the federal and state governments regarding implementation of the WTO rules.

WTO Administration

The WTO is a Member-driven organization. The WTO Secretariat is relatively small with a total budget of $130 million, which is very small compared to other major international organizations. The WTO Secretariat is funded through Member contributions. Each Member's share is proportional to its share of global trade. The U.S. share is currently 15.735%, or roughly $22 million per year. The WTO Secretariat has virtually no independent decision-making ability.

As specified in Article IX of the WTO Agreement, the general rule in the WTO is that decisions are taken by consensus, which means that any Member may in theory exercise a veto. Countries with stronger economic and political clout can effectively use this threat to motivate other Members to reach compromises acceptable to all.

Special rules are spelled out for taking particularly important decisions such as amendments or binding interpretations of the rules.

- Core provisions on MFN and the amendment and decision-making rules may be amended only by consensus.
- No substantive amendment can apply to a Member that does not agree to its application.
- Any interpretation of the rules requires agreement by three-quarters of all Members.
- Waivers require approval of three-quarters of all WTO Members to take effect. However, consensus is required to adopt any waiver extending any transition period for compliance with a WTO commitment.

Dispute Settlement

Under the old GATT system, the utility of the dispute settlement system was significantly undermined by the fact that any contracting party, including the party that lost the dispute, could block the adoption of a report issued by a dispute settlement panel. As a result, the dispute settlement system was overhauled in the Uruguay Round. The WTO dispute settlement procedures are set forth in the Dispute Settlement Understanding (DSU).

The dispute settlement process is administered by the Dispute Settlement Body (DSB), which is composed of representatives from all Members.

As under the GATT, WTO dispute settlement is available only to governments, not to private parties. The process provides a forum for resolving complaints by one WTO Member that another has acted inconsistently with the WTO agreements or otherwise nullified or impaired the expected benefits of the agreements.

The process begins with consultation, and if that fails to produce a resolution, the complaining Member may submit the dispute to a panel for resolution. The panel is usually composed of 3 members, chosen by the disputing parties, or if no agreement is reached, then by the WTO Director-General. The panel will then issue findings as to whether the responding Member has acted inconsistently with its WTO obligations. If the panel makes an affirmative finding, it will recommend that the Member bring its measure into compliance.

Either Member may appeal the panel's decision to the Appellate Body, a standing body of seven members, one of which is from the United States. The Appellate Body will then issue its findings and correct errors in the panel's report.

The DSB will automatically adopt the panel report (if not appealed) or the Appellate Body report unless it agrees by consensus not to do so. This effectively means that all reports are adopted. Decisions do not have precedential value, though in practice panel and the Appellate Body look to prior decisions for guidance. The entire process from consultations through adoption of an Appellate Body report usually takes 15 months or more.

Additional procedures are built in for determining, for example, whether a Member has taken sufficient action to comply with a DSB decision.

Significantly, even though a panel or Appellate Body report may be adopted by the DSB, the WTO has no authority to require any Member to change a law, regulation or practice. If a Member fails to bring a measure into compliance, it can seek to negotiate compensation with the complaining Member, which could take the form, for example, of lowering tariffs on imports of specific products exported from the complaining Member.

Compensation is, however, rare. If no compensation agreement is sought or reached, then the complaining Member has a right to "retaliate," which means, for example, that it might raise tariffs on products exported from the other Member.

As noted earlier, the WTO cannot force any Member to change a law, regulation or practice. Thus, if a country refuses to comply with a finding, it cannot be forced to do so.

In a sense, this is no different than what could happen if the WTO did not exist – in such a world, any country could impose sanctions on any other country for whatever reason it deemed appropriate. But there are significant differences. For the complaining Member, the official authorization to use trade sanctions is important. For the responding government, the WTO mechanism may result in international pressure to comply with a given finding – but that is much different than a system that compels a government to comply.

The United States has fared well under this system. Since the start of the WTO, the United States has initiated 75 cases, of which it settled 24, won an additional 24, and the remainder are still in litigation, being monitored for progress or otherwise inactive. The United States has been challenged 84 times. Fifty-two of those cases have been completed, and of those, the United States has settled 15 and won 12.

The number of cases filed by the United States and all WTO Members combined has declined over time, as countries picked the low hanging fruit in the first few years of the WTO and the system worked to deter new breaches.

Negotiations are currently under way to improve the dispute settlement process, and the United States has played a central role in that process. We have advocated, for example, increased transparency by opening proceedings to the public, facilitating public access to documents, and consideration of establishing guidelines for accepting amicus curiae submissions. The United States has also suggested that WTO Members provide additional guidance to panels and the Appellate Body to help ensure that the process better serves its primary function of facilitating settlement of disputes and has recommended the development of new mechanisms to improve flexibility and Member control over the process.

*Conclusion*

Participation in the WTO has benefited the United States tremendously. We recognize, however, that efforts to strengthen integration and open foreign markets for U.S. farmers, workers and businesses must at all times be balanced with appropriate safeguards to protect our sovereignty. As in the past, we will continue to ensure that we preserve this balance as we continue the current round of negotiations.

**Attachment 1**

**U.S. Implementation of WTO Decisions Finding Against U.S. on Core Issue(s)**

(1) Gasoline (Venezuela, Brazil): **EPA changed the regulation**.

(2) Underwear (Costa Rica): **Measure expired**.

(3) Wool shirts (India): **Measure expired**.

(4) "Shrimp/turtle" law (India, et al.): **United States revised its regulation and negotiated with, and provided technical assistance to, complaining parties on meeting U.S. regulatory requirements. Malaysia challenged U.S. compliance in a follow-up proceeding which the United States won.**

(5) DRAMs (Korea): **United States revised its regulation and the determination in the domestic antidumping proceeding. Korea challenged whether the U.S. had complied, but the dispute was settled, requiring no further action on the part of the United States.**

(6) UK leaded bars (EU): **Revised privatization methodology, after which EC began new case (CVD Steel).**

(7) Music licensing provision in US copyright law (Irish Music) (EU): **Still need legislation to comply.**

(8) 1916 Revenue Act (EU, Japan): **United States repealed the law.**

(9) Bonding requirements (EU): **Measure expired before dispute decision.**

(10) Wheat gluten import safeguard (EU): **Measure expired**.

(11) Stainless steel AD (Korea): **United States revised determination.**

(12) Lamb meat import safeguard (Australia, New Zealand): **Measure expired.**

(13) Hot-rolled steel AD (Japan): **Revised determination, but still need legislation.**

(14) Cotton yarn (Pakistan): **Measure expired.**

(15) Section 211 of Omnibus Appropriations Act (EU): **Still need legislation to comply.**

(16) Taxes on Foreign Sales Corporations (EU): **Repealed FSC and replaced with ETI. EU successfully challenged ETI and United States repealed ETI. EC is now challenging transition provisions in compliance proceedings.**

(17) Line pipe safeguard (Korea): **Modified measure, which later expired.**

(18) CVD-steel products (EU): **Revised privatization methodology, EC challenging compliance.**

(19) CDSOA (Australia, et al.): **Still need legislation to comply.**

(20) CVD-softwood lumber (preliminary determination) (Canada): **Replaced by final determination, nothing to implement**.

(21) Steel safeguards (EU, et al.): **Measure expired**

(22) Injury-softwood lumber (Canada): **Revised determination, Canada now challenging compliance**.

(23) AD-sunset review (Argentina): **Now in implementation process**.

(24) Cotton subsidies (Brazil): **Now in implementation process**.

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[Federal Register: July 27, 1999 (Volume 64, Number 143)]
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OFFICE OF THE UNITED STATES TRADE REPRESENTATIVE

[Docket No. 301-62a]

Implementation of WTO Recommendations Concerning EC-Measures Concerning Meat and Meat Products (Hormones)

AGENCY: Office of the United States Trade Representative.

ACTION: Notice of the imposition of 100 percent ad valorem duties on certain articles.

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SUMMARY: The United States Trade Representative (USTR) has decided to suspend the application of tariff concessions and related obligations by imposing a 100% ad valorem rate of duty on three articles described in the Annex to this notice that are the products of certain member States of the European Communities (EC) as a result of the EC's failure to implement the recommendations and rulings of the World Trade Organization (WTO) Dispute Settlement Body (DSB) concerning the EC's ban on imports of U.S. meat from animals treated with certain hormones. This action constitutes the exercise of U.S. rights under Article 22 of the WTO Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU) and is taken pursuant to the authority granted to the USTR under section 301 of the Trade Act of 1974, as amended..

EFFECTIVE DATE: In accordance with U.S. rights under the DSU, effective July 29, 1999, a 100% ad valorem rate of duty shall be applied to the articles described in the Annex to this notice that are the products of one or more of the following EC member States--Austria, Belgium, Denmark, Finland, France, the Federal Republic of Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain, or Sweden--and that are entered, or withdrawn from warehouse, for consumption on or after July 29, 1999. Any merchandise subject to this determination that is admitted to U.S. foreign-trade zones on or after July 29, 1999 must be admitted as ``privileged foreign status'' as defined in 19 CFR 146.41. This action will follow authorization on July 26, 1999, by the DSB to suspend the application to the EC, and member States thereof, of concessions and related obligations under the General Agreement on Tariffs and Trade 1994 (GATT 1994).

ADDRESSES: 600 17th Street, NW., Washington, D.C. 20508.

FOR FURTHER INFORMATION CONTACT: Sybia Harrison, Staff Assistant to the Section 301 Committee, (202) 395-3419, for questions concerning documents and USTR procedures; William Busis, Associate General Counsel, (202) 395-3150 or Ralph Ives, Deputy Assistant U.S. Trade Representative, (202) 395-3320, for questions concerning WTO developments regarding the EC's hormone ban; John Valentine, Attorney,

International Agreements Staff, U.S. Customs Service, (202) 927-1219, for questions concerning classification; and Yvonne Tomenga, Program Officer, Office of Trade Compliance, U.S. Customs Service, (202) 927-0133, for questions concerning entries.

SUPPLEMENTARY INFORMATION: In December 1985, the EC adopted a directive on livestock production restricting the use of natural hormones to therapeutic purposes, banning the use of synthetic hormones, and prohibiting imports of animals, and meat from animals, to which hormones had been administered. That directive was later declared invalid by the European Court of Justice on procedural grounds and

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had to be re-adopted by the Council, unchanged, in 1988 (``the Hormone Director''). These measures, including the ban on the import of meat and meat products produced from animals to which certain hormones had been administered (the ``hormone ban''), because effective January 1, 1989.

Following entry into force on January 1, 1995, of the WTO Agreement on the Application of Sanitary and Phytosanitary Measures (``SPS Agreement''), the United States and, later, Canada, invoked formal WTO dispute settlement proceedings against the hormone ban. Prior to the establishment of the WTO panel, the EC replaced the Hormone Directive with another directive that re-codified and expanded the hormone ban. On May 20, 1996, the DSB established a dispute settlement panel (``the WTO panel'') to examine the consistency of the hormone ban with the EC's WTO obligations.

On August 18, 1997, the WTO panel issued its report finding that the hormone ban is not based on scientific evidence, a risk assessment, or relevant international standards, in contravention in of the EC's obligations under the SPS Agreement. Upon an appeal to the WTO Appellate Body, on January 16, 1998, the Appellate Body affirmed that the hormone ban is not consistent with the EC's obligations under the SPS Agreement. At a meeting held on February 13, 1998, the DSB adopted the Panel and Appellate Body reports regarding the EC's hormone ban.

The EC subsequently requested four years to implement the DSB recommendations. The United States could not agree to this proposed implementation period, and the matter was referred to a WTO arbitrator. The arbitrator determined that the reasonable period of time for implementation was fifteen months, and would expire on May 13, 1999.

The EC did not implement the DSB recommendations and rulings regarding its hormone ban by May 13, 1999. Accordingly, on May 17, 1999, and in accordance with U.S. rights under Article 22 of the DSU, the United States requested authorization from the DSB to suspend the application to the EC, and member States thereof, of tariff concessions and related obligations under the GATT covering trade in an amount of $202 million. The EC objected to the level of suspension proposed by the United States, and claimed that the trade damage suffered by the United States was only $53 million. Pursuant to Article 22.6 of the DSU, the matter was referred to arbitration. The DSU provides that such arbitrations must be completed within 60 days of the end of the reasonable period of time for implementation, or in this case, by July 12, 1999.

The arbitrators issued their final decision on July 12, 1999, and determined that the level of nullification or impairment suffered by the United States as a result of the EC's WTO-inconsistent hormone ban was $116.8 million per year. Accordingly, upon DSB authorization, the United States is entitled under the DSU to suspend the application to the European Communities and its member States of tariff concessions

and related obligations under the GATT covering trade up to that amount. A meeting of the DSB is scheduled for July 26, 1999, at which time the DSB, pursuant to Article 22.7 of the DSU, will grant authorization for such suspension of concessions.

Prior Notice and Comment

On March 25, 1999, the USTR announced preparations for exercising its right to request authorization to suspend tariff concessions on EC products if the EC failed to implement the DSB's recommendations and rulings concerning the EC's hormone ban by May 13, 1999. (64 FR 14,486). The March 25 notice sought public comment on a preliminary list of EC products with respect to which the United States was considering the suspension of tariff concessions. On April 19, 1999, USTR conducted a public hearing to receive testimony on the preliminary list.

Determination and Action

As a result of the EC's failure to implement the recommendations and rulings of the DSB concerning the EC's hormone ban, and pursuant to the WTO arbitrators' decision of July 12, 1999 and the authorization of the DSB on July 26, 1999, the USTR will suspend tariff concessions and related obligations under the GATT 1994 by imposing a 100% ad valorem rate of duty on the articles described in the Annex to this notice that are the products of certain EC member States. The amount of trade affected by this action, as measured by an average of 1996-1998 import values, is equivalent to the level of nullification or impairment ($116.8 million) determined by the WTO arbitrators in their decision of July 12, 1999.

This action exercises the rights of the United States under Article 22 of the DSU and is taken pursuant to the authority granted to the USTR under section 301 of the Trade Act. The articles affected by this determination were selected in light of the comments submitted to the Section 301 Committee in response to the March 25, 1999 notice and the testimony presented at the public hearing held on April 19, 1999.

Accordingly, effective July 29, 1999, with respect to articles that are the products of one or more of the following EC member States--Austria, Belgium, Denmark, Finland, France, the Federal Republic of Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain, or Sweden--and that are entered, or withdrawn from warehouse, for consumption on or after July 29, 1999, the Harmonized Tariff Schedule of the United States is hereby modified in accordance with the Annex to this notice. Any merchandise subject to this determination that is admitted to U.S. foreign-trade zones on or after July 29, 1999 must be admitted as ``privileged foreign status'' as defined in 19 CFR 146.41.

William L. Busis,
Chairman, Section 301 Committee.

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**RESPONSES TO QUESTIONS FROM MR. MENDENHALL**

RESPONSES TO QUESTIONS FROM SENATOR COBURN AND SENATOR LEVIN AT THE HEARING HELD ON JULY 15, 2005 BEFORE THE SUBCOMMITTEE ON HOMELAND SECURITY AND GOVERNMENT AFFAIRS.

Senator Coburn:

1. Please provide information on those WTO disputes in which the United States has complied with WTO rulings and those cases in which we have not complied.

Answer: We have attached a chart that lists the 24 disputes in which the WTO reached an adverse decision on a U.S. measure. The United States has come into compliance with all but four of these decisions where the period for implementation has expired. The time for compliance has not yet run in two disputes. A number of approaches and combinations of approaches, ranging from expiration of the measure at issue, to revision of an administrative determination to changes or repeal of laws, regulations and practices, have been used to come into compliance with WTO dispute results.

2. EU Hormones dispute: What products did the United States increase tariffs on and what was the value of those sanctions? How was this determined?

Answer: We have attached a copy of the notice published in the *Federal Register* (64 FR 40638)(July 27, 1999) announcing the imposition of 100 percent duties on articles that are set out in the annex to the notice. The notice also provides background information on the dispute and the determination of the amount of the nullification or impairment of WTO benefits that the United States suffered.

3. Please confirm whether or not the CONTRACTING PARTIES ever made a formal interpretation of GATT 1947.

Answer: One of the institutional improvements resulting from the creation of the World Trade Organization (WTO) was greater procedural clarity and detail for Members. Unlike the WTO and the WTO Agreement, the GATT 1947 did not have a separate specific provision dealing with interpretation of the Agreement. Article XXV:1 provides that "Representatives of the contracting parties shall meet from time to time for the purpose of giving effect to those provisions of this Agreement which involve joint action and, generally with a view to facilitating the operation and furthering the objectives of this Agreement...."

As early as 1949, GATT Contracting Parties relied on this language to interpret the Agreement. It was also noted that any Contracting Party that disagreed with the interpretation could take the issue which gave rise to the interpretation to the International Court of Justice.

Under GATT 1947, the Contracting Parties took many actions that could be considered "interpretations" of the Agreement. These took various forms, such as Decisions of the Contracting Parties, Council Action, and Chairman's rulings. Thus, it is difficult to find documents or decisions labeled "interpretations" of the GATT 1947, even though actions were often taken based on the Contracting Parties' common view of what the Agreement meant. As a practical matter, decisions, including interpretations, of GATT 1947 (especially after the early years) were taken by consensus. This same practice of consensus continues in the WTO, even though voting rules are present in the Agreement.

Senator Levin:

1. Has China complied with WTO practice in replying to questions in the Special Trade Policy Review for TRIPs and more generally. Do they answer all questions? In writing?

Answer: Although the special trade policy review for China, known as the Transitional Review Mechanism, or TRM, got off to a difficult start in the first year when China and other WTO members were attempting to develop workable procedures, operation of the review process has improved since then. While China does normally answer our IPR-related questions in writing when they fall under regular business agenda items, such as the implementation of laws and regulations, China only replies orally to TRM questions. China's TRM replies are generally responsive to the questions asked, but are not always as complete or detailed as we would prefer. Regarding information on enforcement of IPRs, China has not provided all of the information that we have requested, e.g., on administrative and criminal sanctions that it imposes on IPR infringers. We will soon be filing a transparency request pursuant to Article 63 of the TRIPs Agreement, to follow-up on key areas where we are not satisfied with China's responses or where China's procedures and results are not fully transparent.

2. Is China violating Article XV of GATT 1994 through its currency manipulation? If we found a violation, would be bring a WTO dispute?

Answer: As Treasury Secretary Snow has stated, the Administration welcomes China's announcement since the Hearing on July 15th that it is adopting a more flexible exchange rate regime. Reform of China's currency regime is important for China and the international financial system.

Treasury will monitor China's managed float as their exchange rate moves to alignment with underlying market conditions. China's full implementation of its new currency regime will be a significant contribution toward global financial stability.

3. Only registered auto manufacturers can engage in distribution. Do you view this as a violation of China's obligations?

Answer: We have followed-up on this question with industry representatives in the United States and China, and U.S. officials in China. To our knowledge, China is not imposing such a requirement. We are continuing to pursue this issue and will contact your staff with any further information that may develop.

Testimony of

Dr. Claude Barfield, Ph.D.
Resident Scholar and Director of
Science and Technology Policy Studies
American Enterprise Institute

To the Subcommittee on Federal Financial Management,
Government Information, and International Security

Of the Committee on Homeland Security and Governmental Affairs

United States Senate

Hearing: Securing American Sovereignty:
A Review of the United States' Relationship with the WTO

July 13, 2005

Good morning, Mr. Chairman and Members of the Subcommittee. I should like to submit the following article as my testimony. It deals directly with the subject of the hearing this morning.

"WTO Dispute Settlement System in Need of Change." *Intereconomics: Review of European Economic Policy* 37.3 (2002): 131-135.

Ironically, the United States and the European Union are victims of too much substantive success in multilateral trade negotiations, combined with overreaching in the area of dispute resolution. As unlikely as that proposition sounds, it is a highly plausible explanation of the most important conflicts that have beset trade relations between the two trade superpowers since the creation of the World Trade Organization in 1995. To understand how this occurred, a brief history of the GATT/WTO system is in order.

**"Diplomatic" vs. "Legalistic" Approach**

Throughout the history of the postwar multilateral trading system, presided over first by the General Agreement on Tariffs and Trade and since 1995 by the new WTO, two distinct theories regarding the settlement of trade disputes have competed for dominance. On one side are the "pragmatists" who argue for a "diplomatic" approach that stresses conciliation and problem-solving over legal precision. This view of dispute resolution was generally espoused by Europeans; and as late as the 1980s, a Swiss GATT Director General stated: "GATT cannot be a world trade court. Conciliation is our priority: it is not our job to determine who is right and wrong." On the other side were the "legalists" or "rules-oriented" proponents who hold that legally binding rules will produce more certainty, predictability and fairness for all GATT/WTO member states. US trade policymakers and scholars, particularly, have championed this approach.

Though the system today retains some blend of the diplomatic and legalistic philosophies,

decisions taken during the Uruguay Round (1986-1994) marked a clear shift toward a more judicialized, legally binding dispute settlement system. The most far-reaching change on the dispute settlement process was the introduction of "automaticity," whereby decisions by WTO panels or the Appellate Body will stand unless there is a consensus (virtual unanimity) among WTO members against the panel or Appellate Body decision. Given the extreme difficulty of amending or interpreting WTO rules (requirement of consensus or three-fourths majority), de facto the new system gives final say to these judicial bodies.

Given the imbalance between the very efficient, binding judicial system and the inefficient, cumbersome rulemaking apparatus, there is the danger - already identified by a number of WTO scholars - that WTO member states will increasingly look to the judicial system to "create" new law or amend existing laws. As Marco Bronckers, a leading European legal scholar has written: "Governments may too easily think that progress can be made in the WTO through enforcement; that litigation is a more convenient way to resolve difficult issues than an open exchange at the negotiating table. That is troubling because it undermines democratic control over international cooperation and rule-making ..."

Further, the mindset of the new legal culture is at odds with diplomatic accommodation. Professor J.H.H. Weiler, a strong advocate of the new system, has candidly admitted that though the rule of law is supposed to be dispassionate and objective, when two parties both believe that the law is on their side and litigate, "then it becomes a profession of passion, of rhetoric, of a desire to win... all inimical to compromise." Likewise, though legal professionals should act objectively on the merits of a case, in reality they are (like other professionals) "people with ambition, with a search for job satisfaction." Thus, according to Weiler: " 'We can win in court' becomes in the hands of all too many lawyers an almost automatic trigger to 'we should bring the case.' " The bottom line regarding the old system of consultation and conciliation, as one US trade lawyer has pointed out, is that it "has disappeared as a meaningful step in the process. To consult openly is to risk your country's case as an advocate, as any admission is going to be used against you. Only consult seriously if you wish to confess judgment and make amends that is the lesson of the DSU."

The triumph of binding legalism came just at the time when the results of the Uruguay Round had vastly expanded the substantive reach of the international trade regime. New rules in the area of health and safety, and for the services industries - banks, insurance companies, telecommunications and the Internet, energy services and transportation, for example - meant that the multilateral trading system would be asked to deal with complex issues that go deep into the economic and social structures of its member states. In addition, a wholly new regime for intellectual property was established, at a time of great ferment within individual nations over challenges to intellectual property emerging from new technologies such as software and biotechnology. Sylvia Ostry, a former Canadian trade negotiator now at the University of Toronto, has described the resulting new model: "The degree of obtrusiveness into domestic sovereignty bears little resemblance to the shallow integration of the GATT with its focus on border issues . . . The WTO has shifted from the GATT model of negative regulation--what governments must not do--to positive regulation, or what governments must do."

**Unsustainable Dispute Settlement System**

As the two leading superpowers of trade, the United States and Europe constitute the

indispensable central core of the multilateral trading system. And the seeming intractability of an increasing number of disputes between the two WTO leaders is a harbinger of greater systemic problems. Specifically, in a recent book, I have argued that the new WTO dispute settlement system is unsustainable, both politically and substantively.' It is not sustainable politically because the constitutional flaw stemming from the imbalance between the powerful judicial system and the weak and ineffective rulemaking procedures will, over time, create major questions of democratic legitimacy. In retrospect, it was relatively easy to rebut charges of democratic illegitimacy against the delegates to Seattle in 1999: they were appointed officials of (mostly) democratic governments. It will be another thing, however, to defend the actions of WTO judicial bodies when it is alleged that they are "legislating" new rights and obligations through judicial interpretation.

Substantively, there are two problems. First, even with the best of wills, panels and the Appellate Body face a daunting task in interpreting the underlying text and rules because, as even defenders of the new system admit, they contain numerous gaps and ambiguities, lacunae, and contradictory language that papers over basic policy differences among negotiators. More fundamentally, there is no consensus in a number of instances on the complex regulatory issues posed in such areas as services regulation, health and food safety, and national intellectual property regimes.

**The Beef Hormones Case**

For the purposes of this essay, two major WTO judicial confrontations between the US and the EU illustrate the political and the substantive conundrums engendered by the new system. The first is the well known Beef Hormones Case, which remains a standoff with Europe continuing to pay over $100 million in compensation for refusing to abide by a WTO ruling. There could be no better example of the folly of a promise of a legally "correct" decision in a program area than this case. Underlying the complicated facts of the dispute is a fundamental disagreement about how societies should handle risk. The EU is moving inexorably toward an expansive interpretation of the "cautionary principle," whereby nations can ban the import of goods with minimal (or no) scientific evidence. The US (and some other nations) are moving in the other direction - toward mandating credible scientific data before allowing trade restrictions. WTO rules seem to point to at least minimal scientific justification, and assume that invocation of the "precautionary principle" will be temporary, pending additional data.

When confronted with such dissonances, the Appellate Body produced a decision laced with a hodgepodge of creative, yet unintegrated rationales. It upheld the need for scientific evidence, while undercutting that mandate by allowing socioeconomic arguments (including public opinion) to rank with science in determining import policy. It denied the EU's contention that the "precautionary principle" had reached the status of customary international law at this time - a truly radical assertion - but held out the possibility that in the future the situation might change. (Subsequently, the EU compounded the problem by flouting the clear statement in WTO rules that the "precautionary principle" can only be utilized "provisionally" and temporarily; in effect, it defended an invocation virtually in perpetuity.) Whatever the specific outcome in each of these questions, the debate centered on issues that potentially altered the rights and obligations of WTO members--and thus should not have been confined to the single discretion of WTO judicial bodies.

**The FSC Cases**

The equally famous FSC cases concerning alleged WTO-illegal tax subsidies for US exporters is another illustration of both the incapacity of the Dispute Settlement Understanding to deal with a complex international economic issue (international taxation) and the dangerous consequences of pronouncing on highly charged political issues. (It should be noted that the author is a strong opponent of any subsidies for exporters and would abolish as corporate welfare such US programs as those administered by the US Export-import Bank and OPIC. The issue here, however, relates to WTO rules and adjudication--and not the wrongheadedness of export subsidies.)

Fundamentally, the issues in these cases stem from differing national approaches in taxing foreign source income of corporations. The United States generally uses a so-called worldwide system of taxation - that is, it taxes income of a person or corporation regardless of where the income is earned. European nations in general utilize the so-called territorial system under which countries tax all income within their border but do not tax income earned abroad. Conflicts have arisen for three decades as the United States has attempted to level the playing-field and replicate some part of the European foreign source income exemption. Suits and countersuits were launched in the 1970s under the old GATT. A standoff ensued when both the European (at least for several countries) and the US international tax system were found in violation of existing trade rules. In 1981, a political "Understanding," ratified by the GATT General Council, was reached that agreed that with respect to these cases "and in general, " economic processes, including transaction involving exported goods, need not be taxed by the exporting country. Fifteen years later, in a fit of pique and after much negotiating water had flowed over the dam, the EU challenged the then existing US export credit regime.

Brushing past ample legal authority to uphold the validity of the 1981 Agreement, a WTO panel and the Appellate Body upheld the EU challenge. The US Congress then revised the export tax regime, only to have a panel and the Appellate Body once again find for the Europeans. In this last case, the Appellate Body put forward a standard that assumed the possibility of a "bright line" between foreign and domestic income - and struck down the US law for establishing formulas that partially mixed the two. As the US trade and tax expert, Gary Hufbauer, has stated, this interpretation could only have been advanced by a "firstyear law student . . . with only limited knowledge of tax law."

To conclude this section, these cases (and others that could be cited) illustrate the twin dangers inherent in the mindset of the panels and the Appellate Body that is, incautious incursions into highly volatile political areas such as food safety and international taxation, combined with a determination to provide a legally "correct" answer to all questions, even when it means--as with the FSC decisions--that they will be forced to venture into complex substantive areas beyond their competence.

**What is to be Done?**

The aim of the following recommendations for change in the WTO's dispute settlement system is: (1) to reintroduce some elements of the older GATT diplomatic approach, with an emphasis on mediation and conciliation rather than legal fiats; and (2) to rein in the judicial bodies and thereby lessen both sovereignty and legitimacy concerns. The recommendations are

complementary but independent - that is, the WTO could adopt them singly or in some combination.

1. *A Safety Valve: Mediation, Conciliation and Arbitration*: Under this proposal, the WTO Director General or, alternatively a Committee of the WTO Dispute Settlement Body, would be empowered to step in and direct the contending WTO members to settle their differences through bilateral negotiations, mediation or arbitration by an outside party. Such action would be taken in situations where, in the judgment of the Director General or the Committee, the highly divisive political nature of the contest would permanently damage the WTO, or where clearly the underlying text masked deep substantive divisions between WTO members.

2. *A Blocking Mechanism*: The goal of this proposal is to redress the current imbalance between the highly efficient dispute settlement system and the inefficient, ineffective consensus-plagued rulemaking process. At any time, at least one third of the members of the WTO Dispute Settlement Body, constituting at least one quarter of trade among WTO members, disagreed with a judicial decision, that decision would be set aside until the issue could be negotiated out in the WTO General Council, or as part of an overall round of trade negotiations.

In addition, two less radical changes should be considered. They would constitute new guidelines for future panels and the Appellate Body.

1. *Non liquet Doctrine*: This legal term literally means "it is not clear." Given the widespread agreement that WTO texts are replete with lacunae and contradictory provisions, and given that questions concerning the legitimacy of judicial decisions are magnified at the international level, the panels and the Appellate Body should be instructed to utilize this doctrine much more frequently - and throw the decision back to the WTO General Council or to trade round negotiations. Critics of non liquet have argued that it is prohibited because international law is necessarily "complete," or that it is the duty of judges to step in and fill gaps, particularly in contentious areas. WTO rules, by common consent, are certainly not "complete" and arguments for "gap-- filling" by judges reflect a dangerous - even antidemocratic - myopia.

2. *Political Question Doctrine*: Alternatively, the WTO could adopt a variation of the so-called "political issue doctrine," developed by the US Supreme Court. The doctrine is meant to provide a means for the judiciary to avoid decisions that have deeply divisive political ramifications and thus, in the opinion of the court, should be settled through more traditional democratic processes, involving both the legislature and the executive. Once again, if such a doctrine is deemed important for preserving checks and balances at the national level, an even more cogent argument can be advanced for its introduction in international law - where the sources of legitimacy of judicial bodies are much weaker than within democratically constructed nation states.

In summary, the proposition advanced here is that heading off corrosive conflicts between the US and the EU in the future will necessitate reform of the international trading rules that have enmeshed--and indeed entrapped--both trading superpowers.

**Note**

[1] Claude Barfield: *Free Trade, Sovereignty, Democracy: The Future of the World Trade Organization,* Washington, D.C. 2001, AEI Press.

Testimony of Robert Stumberg
Professor of Law, Georgetown University Law Center[1]

**Securing American Sovereignty:**
**A Review of the United States' Relationship with the WTO**
July 15, 2005

Before the U.S. Senate Committee on Homeland Security and Governmental Affairs
Subcommittee on Federal Financial Management, Government Information,
and International Security, Senator Tom Coburn, Chair

***Overview***

1. Trade agreements have constitutional character –
   They shift decisions on preemption and takings to the international arena.
2. The WTO's decision on gambling illustrates the threat to federalism.
3. USTR's sovereignty statements are not attentive to state and local concerns.
4. Congress can provide a forum for federal-state consultation on trade policy.

## 1. Trade agreements have constitutional character

The first director of the WTO described trade agreements as a constitution for the global economy. He accurately alludes to the constitutional function of limiting government authority.

**a.** ***Before the WTO*** – Trade agreements primarily dealt with tariffs and government measures that discriminate against foreign goods at the border.

**b.** ***With the WTO*** – Eighteen new agreements create trade rules that apply to laws that ***do not*** discriminate against foreign trade. Trade rules "prohibit" laws that are clearly constitutional and shift the balancing tests to determine whether a nondiscriminatory law is overly burdensome (compared to U.S. courts). The federal government has a legal obligation to enforce trade rules that apply to cities and states. One enforcement option is preemption: Congress adopted implementing legislation that authorizes the federal government to preempt state laws simply on grounds that they are "inconsistent with" a trade agreement.[1] Other enforcement options include withholding of federal funds or non-approval of state plans. If the federal government does not enforce trade rules against states, other countries may apply economic sanctions against U.S. goods, services, or property rights.

**c.** ***Since the WTO*** – The United States has negotiated "WTO-plus" agreements such as CAFTA and other Free Trade Agreements, which have added controversial policies such as:

(1) ***Foreign investor rights*** – in NAFTA, CAFTA and other Free Trade Agreements (FTAs). Investment chapters empower foreign investors to seek compensation for expropriation when laws have a "significant" impact on their "expectations of profit."[2] Investment agreements give greater rights to foreign investors – different procedures, a way to avoid U.S. courts, and a new book of legal rules like "expropriation" that will be defined by international tribunals.

(2) ***Principles of pharmaceutical trade*** – in CAFTA and the Australia FTA (AUSFTA). These agreements convert existing patent law into a trade obligation, which means that Congress cannot amend patent law (e.g., to authorize import of FDA-approved drugs) without risking

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[1] This testimony does not reflect the views of Georgetown University. *Contact* – Prof. Robert Stumberg, Harrison Institute for Public Law, Georgetown University Law Center, 600 New Jersey Avenue, NW, Washington, DC 20001; *phone* 202-662-9603, *email* stumberg@law.georgetown.edu.

trade sanctions. The Australia FTA also obligates governments to subsidize "innovative" drugs without reference to the cost-effectiveness of those drugs, which all governments are working to attain.[3]

To summarize, WTO trade agreements and their cousins, the FTAs that are "WTO-plus," have constitutional character. They shift the preemption and takings debate from state capitols to Washington, and then from Washington to Geneva and other international *fora*. Rather that speak about abstract ideas in 18 different WTO agreements, I will focus on one agreement that likely has the greatest reach into the domain of state legislatures and city councils – the General Agreement on Trade in Services, the GATS.

In May of this year the WTO decided a challenge by Antigua to U.S. laws that ban Internet or remote gambling and related laws in all 50 states. The United States avoided the brunt of this challenge (except for remote betting on horse racing) for two reasons. First, the WTO dismissed the claims against state laws because Antigua simply failed to brief the state issues. Second, the WTO ruled that violation of trade rules by the federal ban on Internet gambling is excused by the "public morals" exception in the GATS. Nonetheless, this case provides substantial guidance on the meaning of trade rules that cover regulation of services.

## 2. The WTO's decision on gambling illustrates the threat to federalism

a. ***GATS covers all gambling laws – by mistake.*** GATS applies to sectors where countries make "specific commitments" to follow trade rules on Market Access and National Treatments. While accepting that the United States did not mean to, the WTO ruled that vague language in the U.S. schedule of commitments is a commitment on all gambling services – not just Internet gambling. Other sectors where the United States has commitments include financial services, health facilities, business and professional services, and services incidental to distribution of energy.[4]

b. ***GATS prohibits monopolies and prohibitions.*** Once a country schedules a commitment, the Market Access rule prohibits governments at all levels from operating monopolies or setting limits on the number of service providers or service operations, including quotas.[5] The WTO ruled that any ban on Internet gambling is prohibited because it amounts to a "zero quota." In its briefs, the USTR warned the WTO that the "zero quota" interpretation would significantly limit the ability of governments to regulate certain sectors.

c. ***Public morals exception.*** The USTR persuaded the WTO that the Market Access violation should be excused under the general exception for measures necessary to protect public morals. However, the threats posed by remote gambling (*e.g.,* Internet access by children) cannot be used to justify economic monopolies like state lotteries or bans on casino gambling in Hawaii and Utah, particularly when neighboring states license many forms of gambling.

d. ***Sanctions strategy.*** The USTR says that it will ask Congress to amend the Interstate Horse Racing Act to comply with the WTO decision. If Congress does not, Antigua is far too small for punitive tariffs to work as a trade sanction. The academic literature strongly suggests that Antigua will follow Brazil's lead and withdraw trade commitments to honor U.S. intellectual property rights such as copyrights, trademarks, industrial designs, patents and protection of undisclosed information.[6]

In response to these outcomes of the WTO Internet gambling case, the attorneys general from 29 states wrote the USTR on May 31, 2005:

> The prospect of [future] WTO challenges to [state-level gambling] prohibitions should alone be sufficient to give U.S. negotiators enormous motivation to use the current GATS negotiations to secure a rule change that makes explicit the right of a WTO signatory to ban undesirable activity in a GATS covered sector.[7]

### 3. USTR sovereignty assurances are not attentive to state and local concerns

In May 2005, the U.S. Trade Representative (USTR) recently consulted with state officials with respect to the revised U.S. offer of trade commitments under the GATS. USTR provided the following assurances that GATS would not threaten state sovereignty.

a. ***"Like any trade agreement, GATS simply says that if a state chooses to allow private competition in services, it should give U.S. and foreign firms a chance to compete on an equal footing."*** GATS is not like "any" trade agreement. It is unique in its application of Market Access rules that prohibit even nondiscriminatory quantitative limits. For example, in the U.S.-Internet Gambling case, the WTO's Appellate Body held that the Market Access rule prohibits a ban on domestically illegal trade (*e.g.,* Internet gambling) because a ban is a "zero quota." In its brief, USTR stated that this interpretation would constrain government power to regulate in a nondiscriminatory manner.

b. ***"Trade agreements such as the GATS do not automatically preempt, invalidate or overturn state laws."*** This is *literally* true, but only in the sense that the federal government must always ask a court to preempt state law. In other words, preemption is never automatic, it is manual. The WTO implementing legislation specifically authorizes the Executive Branch to sue states in federal court to enforce the GATS, and sets the burden of proof to be that a state or local law "is inconsistent with the agreement in question."[8] (emphasis added) The way in which preemption under trade agreements differs from domestic preemption is that Congress denied standing under a trade agreement to private parties.[9] In addition to the threat of preemption, federal enforcement options include withholding federal funds, approval of state plans for spending federal funds, or other kinds of federal permission that a state may need.

c. ***"Nothing in any trade agreement prevents the United States or any state from enacting, modifying, or fully enforcing domestic laws."*** Again, this is *literally* true. However:

   (1) It is also true that another country may challenge federal or state laws under GATS, and if successful, may impose trade sanctions in the form of punitive tariffs on U.S. goods or services that have nothing to do with the dispute. WTO sanctions have the economic effect of a secondary or tertiary boycott. These sanctions are designed to have the maximum deterrent effect.

   (2) It is also true that the federal government has a legal obligation under GATS to enforce U.S. trade commitments that apply to cities and states.[10]

d. ***"GATS does not require deregulation or privatization of any public service."*** Again, this is *literally* true in the sense that countries are free to not make GATS commitments, and the WTO has yet to implement the general GATS rules on domestic regulation. However, once the United States makes a commitment in a service sector (*e.g.,* gambling or health facilities), GATS provides that the United States *"shall not maintain or adopt"* limits on the number of service suppliers, service operations, employees or types of legal entity. In domestic policy debates regarding electricity, health care or financial services, removal of these limits are typically described as "deregulation."

### 4. Conclusion - Congress can provide a forum federal-state consultation on trade policy

Concerned that the WTO decision opens the door to future disputes, the USTR's advisory committee for state and local officials, IGPAC (the Intergovernmental Policy Advisory Committee), asked USTR to respond to a set of questions. These included whether the GATS commitment on gambling covers all gambling operations in the United States, including state monopolies, tribal gaming, casinos, racing, slot machines, *etc.* – all of which are regulated with limits on the number of service providers and service operations. IGPAC then asked about plans to withdraw the gambling commitment (before the gambling market grows exponentially).[11] USTR's response was that:

> Since the Appellate Body rejected Antigua's challenge to state measures, the report provides no basis for reaching conclusions about how future hypothetical cases might affect state laws or regulations.[12]

IGPAC also asked whether CAFTA would open up broader risks of a challenge based on its services chapter or the rights of foreign investors to use a CAFTA country as a base to challenge federal or state laws. USTR's non-response to these questions indicates that federal-state consultations are not presently viable, at least as a public dialogue. The WTO gave ample basis for IGPAC's concerns, and IGPAC's suggestion of withdrawing the U.S. commitment is clearly an available option under WTO rules. IGPAC has proposed broader and deeper consultation on trade negotiations. As the IGPAC reports make clear, state and local governments support expanded trade. But they feel that with greater diligence and an open forum for consultation, the United States can have expanded trade while safeguarding its tradition of federalism.

Thank you for holding this hearing and airing the need for broader and deeper consultations between U.S. trade negotiators and the state and local guardians of federalism. You have demonstrated that Congress can provide a forum to air the sovereignty debate that is so often overshadowed by the arguments over jobs and economic security.

### Endnotes

[1] 19 U.S.C. § 3512(b)(2). "Inconsistent" has a range of meanings. In the sense of domestic preemption doctrine, it could mean meaning that a state law and a trade rule are in conflict: so related that both cannot be true. But "inconsistent" could also mean merely lacking in continuity of belief or purpose, synonymous with "different." Webster's Third New International Dictionary, unabridged, 1144.

[2] *See e.g.*, NAFTA ch. 11; CAFTA ch. 10.

[3] AUSFTA, Annex 2C.

[4] U.S. Schedule of Specific Commitments.

[5] GATS art. XVI:2.

[6] *See* WTO, United States – Subsidies on Upland Cotton, Recourse to Article 4.10 of the SCM Agreement and Article 22.2 of the DSU by Brazil, WT/DS/267/21 (5 July 2005) 3.

[7] Letter from Attorneys General Mark Shurtleff (Utah) and William Sorrell (Vermont) *et al.* to USTR Robert Portman (May 31, 2005) 2.

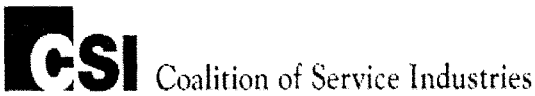
[8] 19 U.S.C. § 3512(b)(2).

[9] *Id.*

[10] GATS art. I:3(a).

[11] Intergovernmental Policy Advisory Committee, IGPAC Comments on the Updated U.S. Submission to the WTO on the General Agreement on Trade in Services (GATS) Negotiations (May 25, 2005) 4.

[12] USTR, USTR Response to IGPAC Memorandum on the Updated U.S. GATS Submission (June 30, 2005) 3.




Robert Vastine
President, Coalition of Service Industries

# Statement on US Participation in the World Trade Organization

**Committee on Homeland Security & Governmental Affairs**
**Subcommittee on Federal Financial Management, Government Information & International Security**

July 15, 2005

## INTRODUCTION

Thank you, Mr. Chairman, for the opportunity to testify today on U.S. engagement with the World Trade Organization (WTO). The Coalition of Service Industries (CSI) is the leading business organization dedicated to the reduction of barriers to US services exports. CSI was formed in 1982 to ensure that US trade in services, once considered outside the scope of U.S. trade negotiations, would become a central goal of future trade liberalization initiatives.

In my statement today, I will touch upon the benefits to the United States from our participation in the WTO, and the need for US leadership in the organization. I will then discuss the important role that the service sector plays in the US economy, and the potential gains that this vital sector will see from a successful WTO Doha Round. Finally, I will address the state of crisis that the services component of the Round currently faces.

* * * *

US leadership has driven multilateral trade liberalization since the establishment of the GATT in the immediate postwar period, and its successor organization, the WTO, in 1995. During this time, both Republican and Democratic Administrations have led in the effort to lower barriers to international trade, with tremendous benefits accruing to both the United States and its trading partners as a result.

The continued focused and determined engagement of the United States in the WTO is critical to US economic interests. In that regard, Congress' strong disapproval last month of a resolution to withdraw the US from the WTO, was welcomed by the business community. If the US is perceived to be abandoning the WTO, then many countries might quickly ignore WTO rules, with significant negative impact on US trade interests.

We support efforts to liberalize bilaterally and in that regard strongly support ratification of CAFTA. We were pleased with the Senate's recent vote in favor of the pact, and have been encouraging members of the House of Representatives to follow suit.

But we believe WTO negotiations must now take center stage in the US drive to obtain trade liberalization. It is the only means of achieving liberalization globally and drawing the maximum number of countries into the disciplines of a rules-based trading system. The Doha Round has itself reached a critical stage requiring concentrated attention by US negotiators. Unlike FTAs, which are negotiated bilaterally or with a small number of trading partners, WTO negotiations lead to liberalization by all WTO members.

The US joined the WTO because it was in our interest do so, the same reason why 147 other members have joined the organization, and why 31 other countries are working to join it. The US played a major role in writing most of the WTO rules, and as the world's largest trader, is a primary beneficiary of those rules. By adhering to those rules – as all other WTO members must also do – we foster an environment of predictability and certainty that facilitates international trade, and thus supports economic growth and jobs in the United States.

**BENEFITS TO THE UNITED STATES FROM PARTICIPATION IN THE WTO**

The WTO is the foundation of the world trading system. With a membership that includes 148 nations and nearly all the world's significant economies, it is the broadest forum within which trade barriers are reduced, market access is enlarged, rules for fair trade are set, and disputes are adjudicated. Without the WTO, there would be no vehicle for global services liberalization, and until its establishment ten years ago, there wasn't. It has been effective in removing trade barriers that had long restricted international trade, and US companies, workers, consumers, and families have benefited tremendously as a result. The institution is crucial for the United States to maximize its advantages from the global economy.

The relationship between higher economic growth and expanded international trade through reduction of trade barriers is well understood, and has been demonstrated by study upon study. According to one estimate, trade and investment liberalization, combined with advances in transportation and communication technology, has generated an increase in U.S. income of roughly $10,000 per household.[1]

Along with agricultural and industrial goods, services are one of the three "pillars" of the Doha Round. However, services are still a relatively new item on the multilateral trade agenda. Only during the 1980s did serious work begin to define and quantify services trade, and only during the Uruguay Round did services negotiations commence. The end of the Uruguay Round resulted in the adoption, by all GATT/WTO members, of the General Agreement on Trade in Services or GATS, which spelled out the terms under which liberalization of trade and investment in services would be pursued. The GATS provides a valuable framework for liberalization, while safeguarding the ability of members to regulate services. It does not force the privatization or deregulation of state-regulated services, as some groups contend, nor does it preempt the authority of US states in regulatory matters.

The inclusion of services in the Uruguay Round was a groundbreaking achievement. It opened up services markets and for the first time provided a means by which WTO members could make commitments to liberalize international trade and investment in a wide array of service sectors.

The WTO has produced successes for services. For example, the 1997 Financial Services Agreement and the Agreement on Basic Telecommunications provided market access, national treatment, and established important disciplines in two vital service sectors. Those agreements,

[1] "The payoff from Globalization." Gary Hufbauer and Paul Grieco, Washington Post, June 7, 2005.

combined with other services commitments made at the end of the Uruguay Round, formed the basis for further negotiation when broad-based services negotiations were launched in 2000 as required by the agenda built into the Uruguay Round. That negotiation was subsequently subsumed into the Doha Round.

Since the adoption of the agreement establishing the World Trade Organization, US crossborder services exports have grown steadily, from $186 billion in 1994 to $338 billion last year. The US is by far the world's largest service exporter, exporting twice the value of commercial services as the next largest exporter, the UK. As a share of world commercial services exports last year, the United States represented 15.2%, and the UK 8.1%. Other major service exporters include China (2.8% of the world total), Hong Kong (2.6%), Canada (2.2%) and Korea (1.9%). The United States also enjoys about a $50 billion *surplus* in services trade, partially offsetting our goods deficit and our shrinking agricultural surplus.

Sales of services by US affiliates in foreign markets is even larger, rising from $190 billion in 1995 to over $400 billion in 2002. The operations of these affiliates are vital to US companies' global competitiveness, and thus to American jobs. If we combine total US crossborder exports of services with sales by foreign affiliates, we get a sum roughly equal to the GDP of Canada.

By establishing a framework for services liberalization, the WTO has significantly advanced US economic interests. We believe that now is the time to build on that work by negotiating deeper, more liberalizing commitments that provide new commercial opportunities across the breadth of the service sector.

In the current Round, the United States has requested that its trading partners liberalize their market for numerous services, including banking, insurance, asset management, and other financial services; express delivery services; audiovisual & entertainment services; telecommunications services; computer & related services; legal, accounting, and other professional services; and many others. These are all areas in which US suppliers are extremely competitive and will benefit significantly from greater access to foreign markets. However, only through robust US participation and continued sharply focused leadership in the WTO will it be possible to realize these gains.

**THE IMPORTANCE OF SERVICES TO THE US ECONOMY**

The service sector is vital to US economic growth and vitality. To quote directly from a bipartisan Dear Colleague letter circulated in the House of Representatives in March, "Many of us may not fully appreciate that services represent the overwhelming share of our country's employment, economic output, a large and growing share of our foreign trade, and are key to the future growth of the American economy."[2]

We agree. I have already mentioned services' role in our international trade. In addition, services account for nearly four-fifths of US economic output, and 87 million Americans are employed in the service sector - 80% of the private sector workforce. By Labor Department reckoning, 90% of all the new jobs created in the US between now and 2012 will be in the service sector.

Viewed against that backdrop, the importance of securing meaningful services liberalization in the Doha Round is manifest. Congress clearly understands this too – late last month, 56 members

[2] "The Importance of Services to the US Economy." Dear Colleague letter, signed by Congressmen Ben Cardin and Jim Kolbe, March 18, 2005.

of the House sent a letter to USTR Portman strongly urging that the services component of the Round be given attention and priority commensurate with its importance to our economy.[3]

However, developing countries too have a big stake in services liberalization. Even in lower income developing countries, services account for an average of nearly 50% of GDP, and services is the fastest growing sector in many developing country economies. For example, China's commercial service exports have grown 95% since 2000. So while the United States clearly has the dominant interest in the WTO services negotiations, other countries have an important – and growing – stake in those talks as well.

**THE POTENTIAL GAINS FROM A SUCCESSFUL DOHA ROUND**

In 2004, global services trade was only about 24% of the value of global goods trade.[4] The figure is low in part because of the prevalence of barriers to services trade. While tariff and non-tariff barriers to goods and agricultural products have been reduced significantly over the course of successive multilateral trade Rounds, this process is only beginning in services. Thus, the marginal gains to be had from further services liberalization are much greater than in other sectors.

As previously noted, the US enjoys a services trade surplus. Foreigners have a high propensity to consume US services, so further liberalization, as is being pursued in the WTO, will materially stimulate US services exports. As a result, these exports could more significantly offset the structural goods deficit.

Catherine L. Mann, in a study for the Institute for International Economics wrote:
*"...as income in a foreign country grows, its imports of US services tend to rise disproportionately. Successful broad-based negotiations on trade in services will likely increase US exports of services even further, with a positive effect on the trade deficit. The long-term trajectory of the US external balances could be altered significantly by the combination of successful service-sector negotiations and broad-based liberalization and deregulation at home and especially abroad. These together would unleash higher productivity and faster growth at home and abroad, which would narrow the US current account deficit."* [5]

My point is that the United States has a powerful national economic security interest in making the Doha Round a major success. But so does the rest of the world economy. The potential benefits to the United States (and to all our trading partners) from a successful Round are tremendous. Moreover, a variety of studies have shown that the greatest gains for the US are to be had in the services sector, which is not surprising in light of its prominent role in our economy. According to one University of Michigan study, if all barriers to worldwide trade in goods, agricultural products, and services were dismantled, the US would enjoy a welfare benefit of an astonishing $542 billion, and the bulk of this - $466 billion – would result from the elimination of services barriers.[6]

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[3] Letter from 56 members of the House of Representatives to United States Trade Representative Robert Portman, June 24, 2005.
[4] World Trade Organization: "World Trade 2004, Prospects for 2005," April 14, 2005.
[5] Catherine L. Mann, "Is the U.S. Trade Deficit Sustainable?" Institute for International Economics, 1999.
[6] Brown, Drusilla K., Kozo Kiyota, and Robert M. Stern, "Computational Analysis of the U.S FTA with the Southern African Customs Union (SACU)," University of Michigan, July 6, 2004.

Unfortunately, the WTO services negotiations, and therefore the potential gains that I have just cited, are in jeopardy. They are in jeopardy because the services offers that have been tabled provide for very little new liberalization, and in many cases do not even reflect current practice. The political will necessary to formulate and table substantial services offers is simply absent in too many countries. This view is widely shared among trade officials and observers in Washington, in Geneva, and in many capitals, and has been echoed in several visits to the WTO and to foreign capitals that CSI has organized this year. Without a decisive push by the US (and other key WTO members) the Doha Round could well reach a point where, having finally achieved agreement on agricultural liberalization, for example, there simply will not be sufficient time left to adequately address services before the Round's conclusion.

**LOOKING AHEAD**

It has become a cliché to say that more than 95% of the world's population, and four-fifths of the world's economy, lies outside our borders. Cliché or not, we need to be able to compete, on better terms, in foreign markets in order to drive economic growth and job creation here in the United States. This is precisely the goal of our participation in the WTO.

As members of the House of Representatives said in their letter to Ambassador Portman last month, "The US is the most competitive services supplier in the world, but foreign barriers hinder the ability of American companies to sell services abroad. By pushing for a reduction in restrictions of trade in the services industry, we help create more American jobs, expand US trade, and grow the American economy. "

Top priority must be placed on a successful conclusion to the services negotiations. All members of the global trading system have a stake in the future of the WTO and the Doha Round, but it is the US that stands to gain the most, and we must therefore continue to participate actively and vigorously in the WTO.

Very important meetings are taking place in Geneva between now and the end of this month, when WTO members are to agree on the outlines of a package to be adopted at the next WTO Ministerial meeting in Hong Kong this December. The Hong Kong Ministerial itself will in large part determine whether it will be possible to successfully conclude the Doha Round by the end of 2006 or early 2007. We hope, as policymakers consider the US relationship with the WTO and the benefits our participation brings, that they will focus on ensuring that the Doha Round concludes successfully, which means comprehensive new liberalization across the range of service sectors, as well as in other areas under negotiation. We simply will not accept an outcome that relegates services to secondary status in a Round dominated by agriculture.

I thank you for your time, and would be glad to answer any questions you might have.

# Congressman Jim Kolbe
## 8TH DISTRICT ARIZONA

**and**

# Congressman Ben Cardin
## 3RD DISTRICT MARYLAND

## PRESS RELEASE

**For Immediate Release**
Friday, June 24, 2005
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## KOLBE, CARDIN URGE REDUCING RESTRICTIONS ON U.S. EXPORTS BEING SOLD AROUND THE WORLD

Washington, D.C. – Rep. Jim Kolbe (R-AZ) and Rep. Ben Cardin (D-MD), ranking member on the Trade Subcommittee of the Ways and Means Committee, today sent a letter to United States Trade Representative Robert Portman urging a higher priority be placed on removing barriers to the exports of US services in the Doha Round of negotiations in the World Trade Organization. A bipartisan group of 56 members joined Reps. Kolbe and Cardin in signing the letter to Ambassador Portman. The list of signers includes 31 Republican members and 25 Democrats. Committee assignments of the members cover over twelve jurisdictions, six members are chairmen of full committees in the House, and several members are on committees with considerable jurisdiction or interest over trade.

> **"Negotiations on services are charting down the wrong course, but with the current Doha Round, we have the chance to right the ship and steer towards greater liberalization of service trade,"** said Rep. Kolbe. **"Many governments are merely paying lip-service to this critical component of the negotiations, and we need to encourage them to remove restrictions that hamper our efforts to create jobs in this important sector of our economy. The US is the most**

**competitive services supplier in the world, but foreign barriers hinder the ability of American companies to sell services abroad. By pushing for a reduction in restrictions of trade in the services industry, we help create more American jobs, expand US trade, and grow the American economy. Our intention with this letter is to communicate to Ambassador Portman that a final trade deal needs to reflect what is in the interest of US firms and workers who export services. US interests in agriculture and manufacturing are important, but so too are those in services."**

**"Services represent 80% of U.S. GDP and one of the few sectors where America maintains a healthy trade surplus. Yet liberalization of trade in services has never been a priority in WTO talks. We must change this as expanded trade in services holds great promise for American workers and businesses,"** said Rep. Cardin, Ranking Member of the Trade Subcommittee. **"It is our hope that through this strong statement from Members of Congress and with a new USTR now in place, services talks can be energized leading up to the Hong Kong Ministerial Meeting."**

US services trade exports represented $338 billion in 2004, totaling more than 40% of the value of our goods exports. The text of the letter to Ambassador Portman, along with a list of signatories is below.

Ambassador Robert Portman
United States Trade Representative
Office of the United States Trade Representative
600 17th Street NW
Washington, DC 20508

Dear Ambassador Portman:

We are writing to encourage sharply increased U.S. emphasis on the liberalization of trade in services in the Doha Round of negotiations in the World Trade Organization (WTO).The Hong Kong ministerial meeting on WTO negotiations is now less than eight months away. Unfortunately, negotiations on services lack energy and momentum. Only half of the WTO's members have submitted initial offers, the deadline for which passed two years ago. Those offers that have been tabled provide for little new liberalization, and in many cases do not even reflect existing levels of openness. Many governments are simply not focused on services, and some countries are, at best, paying lip service to this critical component of the Round. The United States should not accept this circumstance; services are an integral part of the negotiations and should be accorded the same emphasis as agriculture and goods.

As you know, services represent 80 percent of U.S. GDP and 80 percent of private sector employment in our country, and services liberalization offers tremendous potential gains to both the United States and our trading partners. Nonetheless, there is a seemingly low priority placed on services in the Doha Round that is both striking and disturbing. This dynamic needs to be altered immediately to get services negotiations back on track.

U.S. service suppliers supported the effort to get agricultural negotiations back in gear because, without agriculture, there would be no comprehensive round. However, negotiations in services now need the same level of attention. The Doha Round represents the first opportunity in a decade to realize multilateral liberalization across the spectrum of services sectors; it is an opportunity we must not fail to seize.

Sincerely,

Ben Cardin, M.C.

Jim Kolbe, M.C.

## Signature Summary

Democrats

Rep. Ben Cardin
Rep. Charles B. Rangel
Rep. Howard L. Berman
Rep. Jim McDermott
Rep. Joseph Crowley
Rep. Richard E. Neal
Rep. Jim Davis (FL)
Rep. Michael R. McNulty
Rep. Gregory W. Meeks
Rep. William J. Jefferson
Rep. Harold E. Ford, Jr.
Rep. John S. Tanner
Rep. Elijah E. Cummings
Rep. Diana DeGette
Rep. David E. Price
Rep. Debbie Wasserman Schultz
Rep. Ellen O. Tauscher
Rep. Chris Van Hollen
Rep. Earl Blumenauer
Rep. Adam Smith
Rep. Lois Capps
Rep. Adam B. Schiff
Rep. Jim Matheson
Rep. James P. Moran
Rep. Brian Baird

Republicans

Rep. Jim Kolbe
Rep. Roy Blunt
Rep. Nancy L. Johnson
Rep. Michael G. Oxley
Rep. Dave Camp
Rep. David Dreier
Rep. Jim Ramstad
Rep. Tom Davis (VA)
Rep. Jim Nussle
Rep. Henry J. Hyde
Rep. Donald A. Manzullo
Rep. Phil English
Rep. Deborah Pryce
Rep. J.D. Hayworth
Rep. Mark Steven Kirk
Rep. Mark Foley
Rep. Charles W. "Chip" Pickering
Rep. Kevin Brady
Rep. Marsha Blackburn
Rep. Bob Beauprez
Rep. Joe Knollenberg
Rep. Ralph M. Hall
Rep. Chris Cannon
Rep. Richard H. Baker
Rep. Pete Sessions
Rep. Michael N. Castle
Rep. Jerry Weller
Rep. James A. Leach
Rep. Jeff Flake
Rep. Spencer Bachus
Rep. Mark R. Kennedy

# Congress of the United States

Washington, DC 20515

## The Importance of Services to the US Economy

**March 18th 2005**

Dear Colleague:

As the United States seeks to open up markets around the world through bilateral, regional, and multilateral trade negotiations, it is essential to understand the crucial role that services play in the US economy. Many of us may not fully appreciate that services represent the overwhelming share of our country's employment, economic output, a large and growing share of our foreign trade, and are key to the future growth of the American economy.

**Employment...**

The great majority of Americans earn their living in services jobs. There are over 87 million US workers employed in the services sector, representing approximately 80% of all non-farm, non-government workers in the US. From 1993 – 2003, the service sector added 17 million new US jobs, and of the 19.2 million new American jobs forecast to be created by 2012, 90% will be in the services sector.

Services jobs paid an average of $47,240 annually in 2003, and include a range of industries from information technology, financial services, trade, transportation, professional and business services, education and health, leisure and hospitality, and others.

**Output...**

The services sector generates the bulk of economic output in the United States; in 2003, services accounted for 78% of private sector GDP. Efficient, high-quality services are the essential infrastructure for our country's constant economic renewal, and are crucial inputs into production of virtually all products. The price and quality of services influences the costs and productivity of all sectors, including manufacturing and agriculture.

**Trade...**

The magnitude of US services trade is under-appreciated. The US market is in large part already open, and we have put tremendous effort into opening up foreign markets to US services. Our exports of services reached a record $338 billion in 2004, while our goods exports totaled $807 billion. Thus, our services exports are more than 40% of the value of our goods exports, and are growing rapidly. Moreover, the United States ran a healthy surplus of $48.5 billion in services trade last year, partially offsetting our goods trade deficit.

**Looking Ahead...**

Many trade barriers to American goods have been reduced or eliminated, but this is not necessarily the case for our services exports. In fact, foreign barriers in a host of industries - - such as financial services, telecommunications, insurance, logistics and express delivery, professional services, and entertainment, among others - - hinder the ability of US companies to sell services abroad.

The United States is the most competitive services supplier in the world, and the Doha Round of global trade talks presents a rare opportunity for the multilateral liberalization of services across the spectrum of service industries. Thus, the Round offers tremendous potential benefit to the United States, if we are steadfast in our effort to successfully conclude it.

Given its importance to the US economy and because barriers to services trade remain relatively high, services liberalization promises great benefits. According to a recent University of Michigan study, the elimination of all barriers to services trade worldwide would yield a welfare gain to the United States of an astonishing $466 billion.

Services are central to our economic interests. Worldwide liberalization of services, as is being pursued in the Doha Round, means more American jobs, expanded US trade, and stronger growth for the American economy.

Sincerely,

Ben Cardin

Ben Cardin, M.C.

Jim Kolbe

Jim Kolbe, M.C.

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