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Proposed U.S.-Bahrain Free Trade Agreement

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Summary

U.S. Trade Representative Robert B. Zoellick signed the U.S.-Bahrain Free Trade Agreement (FTA) on September 14, 2004. Negotiations with Bahrain, a close U.S. partner in the Persian Gulf, were concluded on May 27, 2004. Under the agreement, all bilateral trade in consumer and industrial goods will be duty free and 98% of U.S. agricultural exports will be duty free. The proposed FTA would also support economic reform, both within Bahrain, and throughout the Middle East. For an agreement to take effect, Congress would need to pass implementing legislation. This report will be updated as events warrant.

Introduction

On September 14, 2004, U.S. Trade Representative Robert B. Zoellick signed a free trade agreement (FTA) between Bahrain and the United States. Formal negotiations were launched in Manama, Bahrain on January 26, 2004 and were completed on May 27, 2004. In accordance with the Trade Act of 2002, the President must notify Congress at least 90 days prior to signing any FTA agreement.

For a U.S.-Bahrain FTA to go into effect, Congress would need to ratify the agreement and pass implementing legislation. It is expected that the U.S. Congress may consider implementing legislation shortly.[1] A Bahrain FTA would be the third agreement reached with an Arab country following FTAs with Jordan and Morocco, signed in 2000 and 2004 respectively. This FTA is also an integral part of President Bush's strategy to create a Middle East Free Trade Area by 2013.

To date, there has been no significant U.S. opposition to a U.S.-Bahrain FTA. The FTA is supported by the National Association of Manufacturers, the Bankers' Association

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[1] Pejman, Peyman, "U.S. Eyes Bilateral FTAs in Gulf," *Inter-Press News Agency*, March 29, 2005

for Finance and Trade, the Motion Picture Association of America, and PhRMA, the association of pharmaceutical manufacturers, among other groups.[2]

Saudi Arabia, a member of the Gulf Co-operation Council (GCC),[3] has alleged that GCC countries that sign bilateral trade agreements with the United States violate a GCC economic agreement that members cannot grant greater trade preferences to non-GCC countries. According to press reports, Saudi Arabia has threatened imposing a 5% duty on any U.S. goods that are imported into the GCC and then exported to Saudi Arabia. According to one source, Saudi Arabia may be concerned that U.S. agricultural products, especially wheat, may be exported to Saudi Arabia via other GCC countries such as Bahrain. Bahrain officials have argued that Saudi Arabia has not contested other bilateral FTAs that Bahrain has signed, and alleges that Saudi Arabia's complaints are political, not economic, in nature.[4]

Some analysts have raised concern that the U.S. government strategy of completing FTAs with countries such as Bahrain, whose U.S. trade is relatively small, is not necessarily the best use of USTR's resources.[5] Others argue that the USTR should be investing more resources into potentially more economically significant agreements such as the proposed Free Trade Area of the Americas (FTAA). The Administration contends that its FTA agreements are effective as building blocks to future agreements and increased political and economic reform.

Why Bahrain?

Many attribute Bahrain's selection as the first proposed U.S. free trade agreement in the Persian Gulf to (1) the strong U.S.-Bahrain political military relationship, and (2) political and economic reform in Bahrain. This FTA is intended to be a building block for President Bush and Congress's Middle East free trade initiatives.[6]

U.S.-Bahrain Political/Military Relationship. Bahrain is a close U.S. partner in the Persian Gulf. It consists of 35 islands along the Persian Gulf between the east coast of Saudi Arabia and Qatar along the Persian Gulf. Virtually its entire domestic population of 667,000 is Muslim (70 % Shi'a / 30% Sunni). It is a constitutional monarchy, ruled by the al-Khalifa family since 1783.

Bahrain has hosted a U.S. military presence since World War II. It currently hosts the Fifth Fleet, which is the headquarters for the U.S. Persian Gulf naval forces. The Fifth Fleet headquarters is a command and administrative facility only; no U.S. warships are

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[2] Elizabeth Becker, "U.S. and Bahrain Reach a Free Trade Agreement,"*New York Times*, May 28, 2004.

[3] Other GCC members are Bahrain, Oman, the United Arab Emirates (UAE), Kuwait, and Qatar

[4] "Saudi Arabia Threatens Tariff Hikes in Retaliation for U.S. Middle East FTAs,"*Inside U.S. Trade,* January 28, 2005.

[5] See General Accounting Office (GAO) Report, *GAO-04-233 International Trade, Intensifying Free Trade Negotiating Agenda Calls for Better Allocation of Staff and Resources*, January 2004.

[6] See CRS Report RL32335, *Middle East Trade Initiatives: S. 1121/H.R. 2267 and the Administration's Plan.*

actually based in Bahrain's ports. In October 2001, Bahrain was designated a Major Non-NATO Ally (MNNA).[7] Bahrain endorsed the U.S. campaign in Afghanistan and deployed a frigate to support allied operations during Operation Enduring Freedom. While Bahrain did not endorse the Iraq campaign, King al-Khalifa did not criticize it.

In FY2002, the United States provided $28.5 million in Foreign Military Financing (FMF) to Bahrain. No FMF was requested for FY2003. Bahrain also receives assistance under the International Military Education and Training (IMET) program. For FY2004, $600,000 has been allocated for Bahrain in IMET and close to $25 million in FMF. For FY2005, the Administration is requesting $650,000 in IMET and $20 million in FMF for Bahrain.[8]

Political Reform and the Bahraini Economy. King al-Khalifa, installed in 1999, has pushed for political and economic liberalization. In February 2001, Bahraini voters approved a referendum on the National Action Charter — the centerpiece of the King's political liberalization program. Since then, parliamentary elections have been held (October 2002), and in December 2002, the first legislative session since 1975 was held.

Oil was discovered in Bahrain in 1932 by Standard Oil Company of California. Current production is around 40,000 barrels per day (b/d). The Bahrain National Gas Company operates a gas liquification plant that utilizes gas piped directly from Bahrain's oilfields. Gas reserves should last about 50 years at present rates of consumption. Revenues from oil and natural gas currently account for 16.5% of GDP and provide about 60% of government income. Among the Cooperation Council of the Arab States of the Gulf (GCC) — Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates — Bahrain has the smallest proven oil reserves. The International Monetary Fund (IMF) estimates that Bahrain will run out of petroleum in 2018 if pumping continues at current levels.[9] Bahrain and Saudi Arabia share ownership of the Abu Saafa oilfield, and since 1997, Saudi Arabia has given Bahrain the entire proceeds of the 140,000 b/d field.

Financial institutions operate in Bahrain, both offshore and onshore,[10] without impediments, and the financial sector is currently the second largest contributor to GDP.

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[7] MNNA Status does not entail the same mutual defense and security guarantees afforded to North Atlantic Treaty Organization (NATO) members. Title 10 U.S. Code Section 2350a authorizes the Secretary of Defense, with the concurrence of the Secretary of State, to designate MNNAs for purposes of participating with the Department of Defense (DOD) in cooperative research and development programs. Section 517 of the Foreign Assistance Act of 1961 (FAA), as amended, authorizes the President to designate a country as a MNNA after 30-days notification to Congress, for purposes of the FAA and the Arms Export Control Act (AECA).

[8] For more information, see CRS Report 95-1013, *Bahrain: Post-Was Issues and U.S. Policy*, by Kenneth Katzman.

[9] Ugo Fasano and Zubair Iqbal, *GCC Countries: From Oil Dependence to Diversification*, International Monetary Fund, 2003, available at [http://www.imf.org/external/pubs/ft/med/2003/eng/fasano/]

[10] Onshore financing is the provision of financial services to residents, offshore finance is the provision to non-residents.

There are no restrictions on capital flows. More than 100 offshore banking units and representative offices are located in Bahrain, as well as 65 American firms. In the past two years, Bahrain has passed laws liberalizing foreign property ownership and tightening its anti-money laundering laws.

U.S. exports to Bahrain totaled $407 million in 2002. Aircraft, miscellaneous manufactures and agricultural products account for the majority of U.S. exports. In 2002, the largest categories of U.S. imports from Bahrain were textiles and apparel and refined petroleum products. Since tariffs between the United States and Bahrain are already low, the USTR estimates that the proposed FTA will have little effect on U.S. imports from Bahrain.

As a member of the Arab League, trade between Bahrain and Israel is technically subject to the Arab boycott. However, in the case of Bahrain, this is not strictly enforced and of little commercial significance. The Arab League boycott of Israel was raised at a June 2003 joint press conference by USTR Robert Zoellick and Bahraini Minister of Finance Abdullah Saif. Both Ambassador Zoellick and Minister Saif stressed that Bahrain was a member in good standing of the WTO, which does not permit boycotts of any kind. Nonetheless, neither specifically addressed if Bahrain would officially remove itself from the boycott.[11]

Promoting Middle Eastern Economic Reform. In May 2003, President Bush announced his goal of creating a free trade area of the Middle East by 2013, by accumulating bilateral agreements with individual countries in the region. A Middle East Free Trade Area (MEFTA) is an Administration strategy to create a free trade area among 20 Middle Eastern and North African countries and the United States by 2013. Currently, the United States has signed FTAs with Jordan, Morocco, and Israel. The Morocco agreement is pending congressional action. The proposed MEFTA plan was announced by President Bush on May 9, 2003. Later that month, Senators Max Baucus and John McCain, and Representatives Adam Smith and Cal Dooley introduced legislation (S. 1121/H.R. 2267), to authorize trade preferences to many Middle Eastern countries to act as a "stepping stone to an FTA." These preferences would expire in 2011, two years before President Bush's target MEFTA completion date of 2013. In 2004, the United States will push Saudi Arabia to pursue needed economic reforms in order to gain entry into the WTO.[12]

The United States also plans to expand its network of trade and investment framework agreements (TIFAs) and bilateral investment treaties (BITs)[13] throughout the

[11] In September 1994, Bahrain and the other five Persian Gulf monarchies agreed to stop enforcing the secondary and tertiary boycotts while retaining the primary (direct) boycott.

[12] *Saudi WTO Bid on "Faster Track" - USTR Zoellick*, Reuters, March 3, 2004.

[13] A Bilateral Investment Treaty (BIT) is an agreement establishing the terms and conditions for private investment by nationals and companies of one country in the another. The objective is to create a legal environment conducive to cross-border investment. For more information on BITs, see [http://www.ustr.gov/agreements/bit.pdf].

region.[14] The United States now has nine TIFAs in the region, most recently signing agreements with Saudi Arabia, Kuwait, Yemen, Qatar, and the United Arab Emirates.

The Road to the Agreement and Key Provisions[15]

In May 2001, the United States and Bahrain entered into a bilateral investment treaty, the first BIT between the United States and a Gulf Cooperation Council (GCC) country. In June 2002, the U.S. and Bahrain signed a Trade and Investment Framework Agreement (TIFA). The TIFA created a joint U.S.-Bahrain council to consider a wide range of commercial issues and set out basic principles underlying the U.S.-Bahrain trade and investment relationship. The TIFA established a permanent dialogue with the expectation of expanding trade and investment between the United States and Bahrain. The BIT and TIFA set the stage for the May 2003 announcement by the USTR to seek to negotiate a free trade agreement with Bahrain.

The FTA negotiations included thirteen working groups: Services, Financial Services, Telecommunications and E-Commerce, Sanitary and Phytosanitary Measures (SPS), Environment, Government Procurement, Legal, Technical Barriers to Trade (TBT), Customs, Market Access (both industrial and agricultural products), Intellectual Property Rights (IPR), Textiles, and Labor.

Upon entering into force, the proposed agreement would eliminate tariffs on all consumer and industrial products. For agricultural products, 98% of U.S. exports to Bahrain would be immediately duty free, with 10-year phase-outs for the remaining items. Textiles and apparel trade will be duty free immediately if the product contains either U.S. or Bahraini yarn. A temporary transitional allowance would allow duty free trade in products that do not yet meet these standards.

Services. According to the USTR, the proposed agreement would provide U.S. firms among the highest degree of access to service markets of any U.S. FTA to date. Key services sectors covered by the Agreement include audiovisual, express delivery, telecommunications, computer and related services, distribution, healthcare, services incidental to mining, construction, architecture and engineering. U.S. financial service suppliers will have the right to establish subsidiaries, branches, and joint ventures in Bahrain and enjoy the benefits of strong regulatory transparency, including prior notice and comment and license approval within 120 days. For life and medical insurance, Bahrain agreed to allow access upon entry into force of the Agreement, and for non-life insurance will allow access within six months after entry into force of the Agreement. Bahrain has agreed that in revising its insurance laws and regulations, it will not discriminate against U.S. insurance suppliers and will allow existing insurance suppliers to continue current business activities.

The agreement underscores Bahrain's open and developed financial sector, which includes both conventional and Islamic financial services. Bahrain will allow U.S.-based

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[14] Office of the United States Trade Representative, Middle East Trade Initiative: Trade Facts, June 23, 2003.

[15] Office of the United States Trade Representative, "Free Trade With Bahrain: Trade Facts,"May 27, 2004.

firms to offer services cross-border to Bahrainis in areas such as financial information and data processing, and financial advisory services. Bahrain will also allow U.S.-based asset managers (including insurance companies) to manage the portfolios of collective investment schemes established in Bahrain.

Under the proposed FTA, each government agreed that users of the telecom network will have reasonable and nondiscriminatory access to the network, preventing local firms from having preferential or "first right" of access to telecom networks. U.S. phone companies will have the right to interconnect with former monopoly networks in Bahrain at nondiscriminatory, cost-based rates, and will be able to build a physical network in Bahrain with nondiscriminatory access to key facilities, such as telephone switches and submarine cable landing stations.

Intellectual Property Rights (IPR). The Agreement requires each government to criminalize end-user piracy, providing strong deterrence against piracy and counterfeiting. Each government commits to having and maintaining authority to seize, forfeit, and destroy counterfeit and pirated goods and the equipment used to produce them. IPR laws will be enforced against goods-in-transit, to deter violators from using U.S. or Bahraini ports or free-trade zones to traffic in pirated products. Ex officio action may be taken in border and criminal IPR cases, thus providing more effective enforcement. The Agreement mandates both statutory and actual damages under Bahraini law for IPR violations, which will deter piracy. Under these provisions, monetary damages can be awarded even if actual economic harm (retail value, profits made by violators) cannot be determined.

According to both countries, the intellectual property chapter does not "affect the ability of either Party to take necessary measures to protect public health by promoting access to medicines for all, in particular concerning cases such as HIV/AIDS, tuberculosis, malaria, and other epidemics as well as circumstances of extreme urgency or national emergency." The FTA also expressly states that it will not prevent effective utilization of the 2003 WTO consensus allowing developing countries that lack pharmaceutical manufacturing capacity to import drugs under compulsory licenses.[16]

Workers Rights. According to the Bush Administration, the agreement fully meets the labor objectives set out by the Congress. Labor obligations are part of the core text of the Agreement. Each government commits to strive to ensure that its laws provide for labor standards consistent with internationally recognized labor rights. The Agreement includes a cooperative mechanism to promote respect for the principles embodied in the ILO Declaration on Fundamental Principles and Rights at Work, and compliance with ILO Convention 182 on the Worst Forms of Child Labor. The labor ministries, together with other appropriate agencies, agree to establish priorities and develop specific cooperative activities.

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[16] Office of the United States Trade Representative,"U.S.-Bahrain FTA: Fact Sheet on Access to Medicines," September 14, 2004.