



Silver Users Association

Washington Report

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November, 2007

Market Watch: Silver Price

2007 Comex Spot Settlement

| Month | High | Low | Avg. |
|-----------|-------|-------|-------|
| January | 13.51 | 12.13 | 12.83 |
| February | 14.69 | 13.33 | 13.95 |
| March | 13.53 | 12.13 | 12.83 |
| April | 14.06 | 13.29 | 13.74 |
| May | 13.53 | 12.81 | 13.15 |
| June | 13.76 | 12.21 | 13.09 |
| July | 13.36 | 12.47 | 12.93 |
| August | 13.12 | 11.47 | 12.28 |
| September | 13.79 | 12.19 | 12.91 |
| October | 14.38 | 13.25 | 13.57 |
| November | | | |
| December | | | |

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Association News:

- Press Releases: Please send us your press releases and/or company announcements, so that we can include them in SUA's monthly newsletter.
- Web Site: Visit our web site at: <http://www.silverusersassociation.org>
- **SUA Board Votes to Cut 2007 Dues by \$1,700.** Contact Paul Miller for news on the new 2007 dues structure and how you can get involved. Paul can be reached at (703) 930-7790 or at pmiller@mwcapitol.com

Note:

- Please send us any updates to your company profile so that we can update our records and web site.
- If you are interested in sponsoring the newsletter, please e-mail Paul Miller today at pmiller@mwcapitol.com

Silver Users Association Names New Leadership Team

At its November 6-7, 2007, the Silver Users Association membership elected Jon Potts, FidelityTrade as it's 2007-2008 President, John Gannon, Gannon & Scott as Vice President, Bill Hamelin, Ames Goldsmith as Treasurer, and John King, Gannon & Scott as Secretary.

"Were excited about the team we have in place. Today's vote by the member's shows that SUA is on the right track with a great team leading the way," stated Paul Miller, executive director of the Silver Users Association.

The Silver Users Association is a non-profit organization that was established in 1947 to represent the interests of companies that make, sell and distribute products and services in which silver is an essential component.

The Association's members employ more than 200,000 workers and process 80% of all silver used in the United States. Members include representatives from photographic, electronic, silverware, mirror and jewelry industries, producers of semi-fabricated and industrial products, and trading and service organizations responding to member needs.

Speakers at this year's event included:

John Tobon, Dept. Homeland Security
Topic: Government Scrutiny of Precious Metal Imports

Jerry Kilgor, Former VA Attorney General and Giuliani for President Campaign Adviser
Topic: 2008 Presidential Race

Caroline Braibant, REACH
Topic: Update on the EU's new registration system for Chemicals and Metals, called REACH.

Jeff Christian, CPM Group
Topic: Using Silver in an Era of High Prices

Michael Floskis, Tiffany's
Topic: Sustainability – Our Most Important Design

Bill Tierney, Computer Associates, Inc.
Topic: Finding Markets for Your Silver Inventory

Stacy Ettinger, Senator Chuck Schumer (D-NY)
Topic: Trade with China

Dan Berkovitz, U.S. Senate Agriculture Committee
Topic: Senate attempt to regulate commodities

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Precision Engineered Products, Inc.
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SUA Welcomes New Members

The Silver Users Association is proud to announce that seven new companies joined the organization this year. They are:

Handy & Harman of Canada
Heraeus Precious Metals Management
International Commodities, Inc.
Metalor Technologies USA Corporation
Pyromet
ScotiaMocatta
Technic Inc.

Energy Traders Avoid Scrutiny

As Commodities Market Grows, Oversight Is Slight
By David Cho
Washington Post Staff Writer

One year ago, a 32-year-old trader at a giant hedge fund named Amaranth held huge sway over the price the country paid for natural gas. Trading on unregulated commodity exchanges, he made risky bets that led to the fund's collapse -- and, according to a congressional investigation, higher gas bills for homeowners.

But as another winter approaches, lawmakers and federal regulators have yet to set up a system to prevent another big fund from cornering a vital commodity market. Called by some insiders the Wild West of Wall Street, commodity trading is a world where many goods that are key to national security or public consumption, such as oil, pork bellies or uranium, are traded with almost no oversight.

Part of the problem is that the regulator, the federal Commodity Futures Trading Commission, has had a hard time keeping up with the sector it oversees. Commodity trading has exploded in complexity and popularity, growing six-fold in trading volume since 2000 -- the year that a handful of giant energy companies, including Enron, successfully lobbied to get Congress to exempt energy markets from government regulation.

Meanwhile CFTC's staffing has dropped to its lowest level in the agency's 33-year history. Its computer systems that monitor trades are outdated. Its leadership has seen frequent turnover. "We are facing flat budgets and exponential growth in the industry," said CFTC Acting Chairman Walter Lukken. "Over the long term this type of budgetary situation is not sustainable."

The House Agriculture Committee is holding a hearing Wednesday on whether to expand the CFTC's authority and budget. In the Senate, Carl M. Levin (D-Mich.) has proposed a bill that would require all energy commodity exchanges to register with the agency and establish trading limits on investors. But similar efforts over the last few years have failed to make it out of committee. And this year, getting the House and Senate to vote on the matter may not be easy, given their busy agendas. Some who work in the commodities markets question whether the CFTC, even if it got more money, would be an effective monitor because much of the trading occurs in private and is untraceable. Others criticized Levin's bill as overly broad, saying it could stifle markets that, Amaranth notwithstanding, have been working well.

Lawmakers acknowledged there are issues that have to be ironed out. But they are also concerned about time running out this year. "We need to put a cop back on the beat in U.S. energy markets to stop excessive speculation and trading abuses," Levin said. "We have all seen what can happen if we don't act." He was talking about Amaranth and its former

star trader, Brian Hunter. Hunter started trading energy commodities at age 24. After a tumultuous stint at Deutsche Bank, he was hired in 2004 by Amaranth Advisors, a hedge fund in Greenwich, Conn.

After making the fund \$100 million in profits in natural gas in 2005, Hunter was promoted to head of energy trading. He began to take gigantic positions in natural gas on a regulated exchange called the New York Mercantile Exchange, or Nymex. Hunter largely traded highly volatile futures contracts, which allow investors to make complex bets on what price a commodity will fetch at various points in the future.

At one point in the summer of 2006, Hunter controlled up to 70 percent of natural gas commodities on Nymex that were scheduled to supply companies and homes in November of last year and more than 40 percent of contracts for the entire winter season, according to a report into Amaranth's activities by the Senate permanent subcommittee on investigations. His positions were so big he could cause the price to move in the way he wanted by buying or selling massive amounts of his holdings in the last 30 minutes of trading on Nymex, a move known as "smashing the close," federal regulators say. Nymex expressed concern over Hunter's activities and sent several warnings. Finally, in August 2006, Nymex ordered him to reduce his holdings. Hunter obeyed, but then simply replicated his positions on an unregulated commodity exchange run by Intercontinental Exchange (ICE), one of dozens in the industry, the congressional report said. And Hunter kept making trades.

Because ICE was not subject to any oversight, neither Nymex nor federal regulators could see what he was doing. Nevertheless, the volatility in gas prices that summer became so severe that even Hunter predicted it might draw official attention. "Boy I bet you see some CFTC inquiries," Hunter wrote in an e-mail to another trader, according to the congressional report. "Until they monitor [unregulated exchanges] no big deal," came the response. In August, natural gas prices remained unusually high due to Amaranth's activity, according to the Senate investigation, even though adequate supplies combined with unusually warm forecasts made it apparent there would be plenty for the winter.

At the same time, many utilities across the country were locking in prices they would pay for the natural gas they would receive in the winter. They had no way of knowing what Amaranth was doing, said David Schryver, executive vice president of the American Public Gas Association. But a few hedge funds became suspicious. One of those, Centaurus, appeared to figure out the pattern behind Amaranth's investment strategy and positioned itself to make a profit at Amaranth's expense. On the last day of trading in August, Amaranth started selling off its gas contracts for September, but Centaurus countered by buying up Amaranth's positions. The two funds battled frantically over gas prices until the closing bell. Prices moved in the way that Centaurus had bet on.

Eventually Amaranth's losses totaled \$6 billion. It lost the ability to pay back its debtors and closed its doors. But homeowners lost out, too, because many utilities locked in prices for natural gas at just the wrong moment when gas prices were high. The ultimate cost nationwide has not been tallied, but one utility, the Municipal Gas Authority of Georgia, calculated that its 243,000 customers paid an extra \$18 million in the 2006-07 winter season because of Amaranth. More than half of American homes are heated by natural gas.

The CFTC filed a civil suit this summer accusing Hunter, who is still trading natural gas, of attempting to manipulate natural gas prices in 2006. Hunter, through his spokesman, denied the charge and said he would prove his innocence in court. "It is worth asking whether the CFTC's sudden decision to file a headline-grabbing action against Brian Hunter was politically motivated," Brian Maddox, Hunter's spokesman, wrote in an e-mail. "The CFTC's action came after several days of hearings conducted by the [Senate] criticizing the CFTC for ineffective regulation of natural gas." Lawmakers and even some in the industry say more oversight of commodities is needed. ICE, the unregulated exchange that hosted the debacle, has begun to share some trading information with the CFTC. But there is little agreement on how far a new law should go, or whether commodity trading can be effectively monitored.

That's in part because a significant percentage of commodity trading doesn't happen on any organized exchanges, regulated or not. They take place in private, as over-the-counter trades. It is difficult to know how many of these are occurring.

Commodities markets also have become complex with many trading futures contracts as well as financial tools called derivatives and swaps, whose value is based on the risk of futures contracts. Gathering data on these products has been a challenge for the CFTC. The evolution of the markets has led to some tension between the CFTC and the Federal Energy Regulatory Commission, the agency that oversees the commercial use of energy resources, which is directly impacted by commodity trading. The two agencies have both gone after unscrupulous traders.

For now lawmakers are focusing on increasing the authority of the CFTC, which has a stronger relationship with the commodity exchanges. Levin's bill would require unregulated exchanges to comply with some of the same standards that the CFTC requires of a regulated body such as Nymex. For instance, unregulated markets would have to set limits on trader positions and share trading information with the CFTC. Levin's proposal would not seek to regulate trades that occur in private. Levin hopes to attach the measure to a farm bill currently moving through the Senate.

Exchanges are wary of these moves, warning of unintended consequences. Jeff Sprecher, the chairman and chief executive of ICE, said active unregulated exchanges serve an important function in helping determine the price of a commodity. Over-regulating them could squash that activity and encourage traders to flee to the less transparent venue of over-the-counter trading. "No one could have imagined that you would have a [commodity] energy market develop the way it did," added James Newsome, chief executive of Nymex. "The markets are changing so quickly that there is no way you could keep up with the changes from a rules standpoint."

But Dan Berkovitz, a top Levin aide, said traders "hesitate when somebody's watching. And when nobody's watching, traders will go wild."

DOD Waives Specialty Metals Restrictions For Buys of Commercial-off-the-Shelf Items

The Defense Department Oct. 26 issued new guidance that allows the department to buy commercial-off-the-shelf (COTS) items without regard to the domestic source restrictions that otherwise apply to DOD acquisitions of specialty metals--such as titanium and certain metal alloys--or of end items that contain such metals.

The guidance, which takes the form of a class deviation, narrowly defines a COTS item as one that is offered to the government, without modification, in the same form in which it is sold in the commercial marketplace. "A component can be a COTS item if it is offered to the Government, without modification, as part of an end item purchased by the Government," Director of Defense Procurement and Acquisition Policy Shay Assad explained in the guidance.

"The installation of a component in the end product is not in itself a modification. COTS items that are modified prior to incorporation in the end item are no longer COTS items," he continued. The new class deviation (Class Deviation 2007-00011) lists 10 U.S.C. 2533(b)(a)(1)--which was included in the fiscal year 2007 defense authorization act to codify the specialty metals domestic source restrictions that previously were addressed by the Berry Amendment--as a statute that is inapplicable to the acquisition of COTS items, in accordance with 41 U.S.C. 431. Section 431 requires that the Federal Acquisition Regulation list provisions of law that are inapplicable to acquisitions of COTS items.

During the legislative back-and-forth that culminated in 10 U.S.C. 2533(b)(a)(1), contractors argued strongly for a commercial item exemption to any specialty metal domestic source restriction, but such an exemption, which was included in the Senate version of the FY 2007 authorization bill, was dropped from the final measure by House and

Senate conferees. However, the new class deviation is limited to COTS items, and defines these items more narrowly than the current regulatory definition of commercial item, which can include items "of a type" sold to the commercial marketplace.

DOD initially implemented 10 U.S.C. 2533(b)(a)(1) in a class deviation issued Dec. 6, 2006 (Class Deviation 2006-O0004). "The basic memo of Class Deviation 2006-O0004 remains in effect, except for two minor corrections," Assad said in issuing the new guidance. These corrections involve the earlier use of the term "end product" and a change in the date applicable to the one-time waiver for inadvertent noncompliance with the restrictions.

The new class deviation remains in effect until incorporated in the Defense Federal Acquisition Regulation Supplement (DFARS) or rescinded. DOD July 2 proposed a DFARS rule that would waive the domestic source restrictions under 10 U.S.C. 2533(b) when the department buys COTS items.

In issuing the proposed rule, DOD said the waiver "is critical to DOD's access to the commercial marketplace." COTS manufacturers make component purchasing decisions based on market factors including cost, quantity, and availability, but "not the county in which the specialty metals in the components are melted," DOD explained.

Given that DOD often acquires commercial items in large quantities, it is costly and burdensome for the department to track the source of the specialty metals it purchases, it said in the proposed rule. Further, since Pentagon purchases of COTS items typically represent a small percentage of a commercial manufacturer's revenue, those companies are often unwilling to incur the large costs required to track the source of COTS speciality metal components, and therefore are unable to provide COTS items to DOD. DOD also said that the domestic nonavailability determination process prescribed under domestic sourcing statute to specialty metals "poses difficulties for DOD in meeting mission-sensitive requirements in a timely manner."

Industry applauded the proposed rule, reinforcing DOD's concerns about the cost and difficulties of compliance with the restrictions. However, House lawmakers, including Rep. Duncan Hunter (R-Calif.), the ranking Republican on the House Armed Services Committee, and an advocate for domestic specialty metals acquisition, argued strongly against the proposed rule. The rule would "gut the law" and repeal large portions of the specialty metals restrictions contained in 10 U.S.C. 2533(b), Hunter and Reps. Robin Hayes (R-N.C.) and Tim Ryan (D-Ohio) said in comments to the department.

The lawmakers argued that the legislative process should be allowed to play out. The House version of the FY 2008 defense authorization bill (H.R. 1585) includes language that would make modifications to the current speciality metals domestic sourcing law. Separately, Hunter said in a Sept. 24 letter to Army Secretary Peter Geren that he believes the United States "must preserve domestic access to certain specialty materials," but the current domestic source law, applied appropriately, allows DOD to fulfill urgent military requirements.

The class deviation and an attachment are available at: <http://www.acq.osd.mil/dpap/policy/policyvault/2007-1439-DPAP.pdf>.

Rule Waives Specialty Metals Restrictions When Defense Department Buys COTS Items

The Defense Department Nov. 8 released a final rule waiving the statutory domestic sourcing restrictions that otherwise apply to DOD acquisition of specialty metals when the department is buying commercial off-the-shelf (COTS) items.

Under the rule, a COTS item is defined as any item of supply that is: (i) a commercial item as defined in the Federal Acquisition Regulation (FAR 2.101); (ii) sold in substantial quantities in the commercial marketplace; and (iii) offered to the government, without modification, in the same form it is sold in the commercial marketplace.

"Unless this COTS waiver is implemented, DOD will not have access to many U.S. COTS items that contain noncompliant specialty metals. The status quo is unacceptable if DOD is to meet its commitments to our warfighters," said rule writers said.

The rule is accompanied by a lengthy and detailed discussion of the legal and practical concerns expressed in comments received from 34 supporters and seven opponents of the proposed rule issued in July. This discussion makes clear that the department agrees with the defense industry commenters that said compliance with the specialty metals domestic source restrictions--codified at 10 U.S.C. 2533(b) in accordance with the fiscal year 2007 defense authorization act (Pub. L. 109-364)--is ultimately so costly, time consuming, and burdensome as to deter manufacturers of COTS items from participating in the DOD marketplace, and makes it difficult for the department to fulfill military equipment requirements.

Further, DOD must comply with 10 U.S.C. 2377, which mandates that it procure commercial items to the "maximum extent practicable," the rule writers pointed out.

The DOD final rule:

- creates a new Defense FAR Supplement (DFARS) Section 212.570 to list 10 U.S.C. 2533b as inapplicable to contracts and subcontracts for the acquisition of COTS items; and
- includes acquisitions of COTS items containing specialty metals as an exception to the domestic source restrictions at DFARS 225.7002-2.

The COTS definition does not include "bulk cargo" defined under Section 3 of the Shipping Act of 1984. The rule essentially puts in the DFARS the terms of the class deviation from the FAR that was issued by DOD Oct. 26 to waive specialty metals restrictions in acquisitions of COTS items. The rule is effective immediately, and the rule writers noted that FAR 1.108(d) allows contracting officers, at their discretion, to include FAR and DFARS changes in existing contracts if given "appropriate consideration."

A key issue for many commenters was the costs of complying with requirements to use specialty metals melted or produced in the United States or qualifying countries. "Twenty-seven respondents, more than for any other issue raised, expressed concern that the law increases costs, contributes to longer lead times, and creates quality and availability problems, and that it is either impossible, time consuming, or too burdensome to comply with this statute in the COTS marketplace," the rule writers said.

Even if the price of the specialty metals themselves is not significantly different for U.S. and foreign metals, as two commenters asserted, numerous commenters indicated that DOD incurs greater costs for COTS items that contain specialty metals because manufacturers pass on the expense of having to track and segregate compliant from noncompliant COTS items.

"While the cost of the compliant and noncompliant specialty metal contained in COTS items might be relatively the same, the added costs (which may be significant) to ensure that the final COTS part or sub-assembly is compliant must also be taken into consideration," DOD said. "Further, the cost of setting up dual lines (at which point it is no longer really a COTS item), is usually prohibitive," DOD said.

DOD also said several commenters indicated that COTS producers make purchasing decisions according to costs, quality, delivery time, availability, and maintaining state-of-the-art products, "not on the country in which the specialty metal contained in the components were melted." As a result, it said, DOD frequently finds itself in situations where it is

impossible to accept common COTS items that are embedded within the "big six" classes of products covered in the specialty metals law.

DOD used the example of a military truck with an electronically controlled COTS transmission, not modified for military use, where the manufacturer is uncertain whether the specialty metal used in the transmission is compliant with domestic sourcing restrictions. In fact, this scenario recently played out, when the Army's refusal to accept the delivery 1,000 Family of Medium Tactical Vehicles due to domestic sourcing concerns drew an objection from Rep. Duncan Hunter (R-Calif.), the ranking Republican on the House Armed Services Committee and a vigorous proponent of domestic sourcing requirements for specialty metals.

In such a case, DOD has two alternatives, the rule writers said: shut down the supplier's line to obtain compliant transmissions, or process and approve a domestic nonavailability determination (DNAD), which requires extensive market research and documentation. As for the first alternative, DOD said the law does not require manufacturers in the United States to make changes to their processes or systems in order to comply with DOD-unique restrictions.

On the second alternative, DOD said obtaining a DNAD may entail "thousands of hours of work, at considerable cost to the taxpayer and a significant addition in lead-time to the acquisition cycle." DOD rejected assertions made by some commenters that the department has failed to perform sufficient market research and analysis in issuing DNADs. "DOD takes great care to fully support each DNAD and does not approve a DNAD casually," the rule writers said. "DOD procures commercial items to reduce costs, speed acquisition, reduce development risks, gain access to most leading-edge commercial technology, increase its ability to secure increased production, and leverage the competition inherence in the global commercial market," DOD said.

Commenters who expressed opposition to the rule, including the specialty metals industry and some members of Congress, contend, however, that DOD risks gutting the law on domestic specialty metals restrictions that Congress modified last year in an effort to protect the U.S. industrial base while providing DOD with some flexibilities to procure specialty metals to meet warfighter demands.

In Aug. 1 comments on the then-proposed rule, Reps. Hunter, Robin Hayes (R-N.C.) and Tim Ryan (D-Ohio) said a COTS exemption regarding specialty metals restrictions could establish a precedent where similar exemptions might be apply to other items--such as textiles covered by the Berry amendment. Following the release of the DOD class deviation that served as a precursor to the rule, a spokesperson for Hunter told reporters that the congressman stands by his comments on the proposed rule. Hunter "still has quite a few concerns" that DOD's interpretation of the domestic sourcing restrictions for specialty metals set out in the FY 2007 defense authorization act is inconsistent with congressional intent, the spokesperson said.

Defense authorization language now in the hands of House and Senate conferees could alter the specialty metals debate, as provisions included the House bill would modify the specialty metals sourcing language Congress agreed to last year and curtail DOD's use of some of the increased flexibilities provided at that time (see related story in this issue).

The DOD final rule on the COTS waiver of domestic specialty metals restrictions (72 Fed. Reg. 63,113, 11/8/2007) is available at: <http://frwebgate1.access.gpo.gov/cgi-bin/waisgate.cgi?WAIIdocID=562011165864+0+0+0&WAIAction=retrieve>.

Senators, Aerospace Group, DOD Stand Opposed to House Specialty Metal Provisions

As House and Senate conferees continue to iron out the differences between the versions of the fiscal year 2007 defense authorization bill (H.R. 1585) passed by each body, the two bills' diverging approaches to domestic sourcing restrictions applicable Defense Department purchases of specialty metals are among the debated issues.

The conferees have before them not only the lengthy discussion that accompanies the final Defense Federal Acquisition Regulation Supplement rule waiving the application of the restrictions to purchases of commercial off-the-shelf (COTS) items (see story in this issue), but also letters from a bipartisan group of 10 senators and from the Aerospace Industry Association. In addition, the issues are addressed in a package of legislative "appeals" sent to the conferees by DOD.

In their separate letters urging Senate Armed Services Committee leaders to oppose the provisions contained the House version of the bill, both the 10 senators and AIA contend that these provisions would reduce the "limited" sourcing flexibilities granted to DOD last year for the acquisition of certain end items containing speciality metal when the domestic source restrictions applicable to such metals were codified at 10 U.S.C. 2533b. The specialty metals language inserted by the House Armed Services Committee in the FY 2008 bill--which subsequently passed the House May 17--"would create significant problems for our industrial base, including the likelihood of supply disruptions for major defense projects, and would result in increased costs to the American taxpayer," the senators said in an Oct. 19 letter to SASC Chairman Carl Levin (D-Mich.) and Ranking Republican John McCain (R-Ariz.).

The letter was signed by Sens. Pat Roberts (R-Kan.), Patrick Leahy (D-Vt.), Kit Bond (R-Mo.), Sam Brownback (R-Kan.), Jim DeMint (R-S.C.), Charles Grassley (R-Iowa), Tom Harkin (I-Iowa), Johnny Isakson (R-Ga.), Trent Lott (R-Miss.), and Ken Salazar (D-Colo.), none of whom currently serves on the SASC.

The senators referred specifically to four provisions in the House bill:

- Section 808, which would require that the under secretary of defense for acquisition, technology and logistics issue guidance for all DOD major system acquisitions that could contain strategic materials--such as specialty metals--to specify that a proposal evaluation criterion will be the supplier's record of sustained reinvestment in domestic production of such material.
- Section 809, which would tighten the requirements for issuance of a domestic nonavailability determination (DNAD) for specialty metals by providing that availability of such metals in "required form" is to be determined with reference to mill products--such as slab, plate and sheet--rather than end items, and also clarify that the specialty metal restrictions apply to COTS items.
- Section 845, which would require that costs related to compliance with limitations on acquisitions of items covered by domestic source restrictions--the Berry amendment (10 U.S.C. 2533a) and the specialty metals statute--be excluded from consideration in evaluations of offers.
- Section 846, which would set limits on specialty metals DNADs applying to more than one DOD prime contract.

These House provisions would "remove, or substantially reduce" what limited flexibilities were provided to DOD last year for the procurement of nondomestic specialty metals, the senators said. "If anything, even greater flexibility is justified" for DOD to procure specialty metals to supply the military, they said. Further, the senators backed language included by the SASC in the Senate version of the bill--which was passed by that body Oct. 1--that endorses DOD's implementation of last year's speciality metal procurement statute, including a DNAD issued in April 2007 for the procurement of fasteners containing speciality metals. Some members of the HASC and the U.S. speciality metals

industry have argued that DNADs issued by DOD, including the fasteners DNAD, are overly broad and lack sufficient market research establishing the basis of the domestic nonavailability.

In an Oct. 18 letter to Levin, AIA expressed views similar to those of the 10 senators. The specialty metal procurement provisions passed by Congress in the FY 2007 defense authorization act (Pub. L. No. 109-364) balanced the economic health of the U.S. specialty metals industry and the defense industry's ability to provide DOD with military equipment, AIA said. "Unfortunately, it is becoming more difficult for our aerospace and defense manufacturing industries to deliver the needed equipment to the men and women in uniform because of the specialty metals restrictions as they are being applied to certain components, subsystems, and commercial items," AIA said.

Meanwhile, DOD Oct. 9 sent to Capitol Hill a package of legislative appeals on the FY 2008 defense authorization bill, in which the department said it "strongly opposes" all four of the House provisions related to domestic sourcing restrictions. DOD said the following with regard to the four provisions:

- Section 808 would "introduce unnecessary, costly, ineffective, and counter-productive evaluations criteria on every sub-tier supplier providing items containing steel or specialty metals."
- Section 809's redefinition of "required form" would preclude DOD from issuing waivers for "small, widely-used items," including fasteners and populated circuits, and other items containing "trace amounts" of specialty metals.
- Section 845 would allow costs associated with compliance with domestic sourcing statutes "to be 'ignored' for purposes of evaluating proposals and awarding contracts," and would result "in the introduction of uncompetitive, duplicative, inefficient and ineffective processes into the commercial and dual use supply chain that the Department relies upon heavily."
- Section 846 would "negate the usefulness of DNADs for commercial and dual use items because the accounting requirements for the specialty metals included in end items and components would be so costly and inefficient."

House Passes Bill Implementing Peru Trade Pact

The House passed legislation Thursday that would implement a free-trade agreement with Peru, even though fewer than half the Democrats on hand voted for the measure.

The bill ([HR 3688](#)), which passed by 285-132, now heads to the Senate, which has 15 legislative days to act under fast-track trade negotiating rules ([PL 107-210](#)) that were in force when the pact was negotiated. The measure is expected to easily clear the Senate, though not until after the Thanksgiving recess.

President Bush hailed the House vote and urged Congress to approve implementing legislation for three other pending trade deals — with Panama, Colombia and South Korea. "Today's vote in the House is the first on a free trade agreement since my administration and the leaders of both parties in Congress agreed on a new bipartisan way forward," Bush said in a statement. "I encourage the U.S. Senate to quickly approve this agreement, and for Congress then to move promptly to consideration of our free trade agreements with Colombia, Panama, and South Korea."

Bush is not likely to get his wish on the other trade pacts. Only 109 Democrats supported the Peru pact, even though a deal earlier this year strengthened its protections for the environment and workers. The measure drew support from 176

Republicans. The House had planned to vote on the bill Wednesday night, but delays and debate would have pushed the vote after 11 p.m., so leaders decided to wait until Thursday.

Supporters said the Peru pact opens up a small but important market to U.S. goods. And as a result of a deal negotiated in May by the Bush administration and congressional Democrats, they said the agreement adds significant protections for workers and the environment. "It shapes trade to expand the benefits and address the downsides," said Ways and Means Trade Subcommittee Chairman Sander M. Levin, D-Mich. "Enforceable worker rights and environmental standards have been at the core."

"In terms of liberalization, do you try to shape its course, or let it happen willy-nilly?" he asked. Opponents, however, said the labor provisions cannot be enforced. They were wary of a trade agreement negotiated by the Bush administration. "The new labor provisions supposedly will improve conditions for workers in Peru and create jobs here at home," said Rep. Michael H. Michaud, D-Maine. "So why is no single labor union actively supporting this trade agreement?"

Other critics said the lack of Democratic support suggests that three other pending free-trade pacts that President Bush negotiated will be dead on arrival in Congress. "If you can't get a majority of the majority for Peru, that has an economy the size of a postage stamp . . . you're not going to be able to pass the other ones," said Lori Wallach, director of Global Trade Watch, a critic of the free-trade pacts. "You don't have a new template for trade, you have a political nightmare."

But backers said that the Peru deal, first signed in April 2006, was long overdue for a vote. "If you don't like it, vote no," said Rep. Adam Smith, D-Wash. "But there is no argument that this is not the time to vote." The agreement would allow 80 percent of U.S. exports to Peru to become duty-free immediately, including such staples as beef, cotton, wheat and soybeans. "The elimination of tariffs and other trade barriers will help support the nearly 20 percent of manufacturing jobs and roughly 135,000 agriculture-related jobs in California that depend on exports," said Rep. Wally Herger of California, the ranking Republican on the Ways and Means Trade subcommittee.

Because of trade preferences extended to Peru and three other Andean nations through February 2008 (PL 110-42), 98 percent of goods from Peru already enjoy duty-free access to the U.S. market. Congress must still consider extending those preferences and renewing Trade Adjustment Assistance (TAA), the main federal program to help workers who lose jobs as a result of international trade.

A short-term extension of TAA (PL 110-89) expires Dec. 31. The House passed a long-term extension (HR 3920) on Oct. 31, which Pelosi said is designed to reassure wavering Democrats. The White House has threatened a veto. The pending trade agreements with South Korea, Panama and Colombia, all of which were negotiated before fast-track rules expired June 30, are not expected to advance in Congress this year.

White House Threatens to Veto House Tax Bill

The Bush administration has threatened to veto the tax bill expected to head to the House floor on Friday.

The White House objects to the core principle behind the bill (HR 3996): that a "patch" to prevent the expansion of the alternative minimum tax should be offset with new revenue. "The Administration does not believe the appropriate way to protect 21 million additional taxpayers from 2007 AMT liability is to impose a tax increase on other taxpayers," according to the Statement of Administration Policy released Thursday morning.

In addition to the AMT "patch," the \$82.5 billion bill extends dozens of expiring tax provisions and expands the child tax credit for low-income families. The administration also objected to several specific provisions: higher taxes on the "carried interest" of private equity fund managers and others, delay of a tax cut for some multinational corporations and the cancellation of an IRS program that uses private companies to contact tax debts.

The veto threat seems unlikely to deter House Democrats, who are sticking with the pay-as-you-go rules that require tax cuts to be offset with revenue increases or spending cuts. The bill is expected to pass with few, if any, GOP votes. Republicans argue that the AMT was never intended to hit the middle class, so stopping it isn't really a tax cut that should be offset.

Some conservative Democrats may also defect, because of dissatisfaction with the specific revenue raisers. The vote tally on Friday will likely not bode well for Democratic attempts to override any veto, even if the offsets survive in the Senate.

Finance Chairman Max Baucus, D-Mont., has already declared that the carried interest provision will likely be too steep a climb this year. But Baucus has not yet identified other offsets that could replace the \$25.6 billion hole that would be left behind, let alone the additional revenue needed to extend expiring provisions for an additional year, as he wants to do.

Senate Republicans, mirroring the president's position, do not want a revenue-neutral bill and may be able to block Democrats from reaching the 60-vote hurdle needed to move major legislation. If the Senate moves a bill with no offsets, and the House insists on pay-as-you-go rules, that sets up a "train wreck," said Ways and Means Chairman Charles B. Rangel, D-N.Y.

U.S. Records \$56.5 Billion Trade Deficit in September Risk of Recession Rises

Earlier this month the Commerce Department reported the September deficit on trade in goods and services was \$56.5 billion. This was down slightly from \$56.8 billion in August but was still 4.9 percent of GDP.

The trade deficit was lower than analysts expected, because the volume of petroleum and auto imports fell more than expected, and these enough to offset an increase in the trade deficit with China. These September data do not reflect the recent surge in crude oil prices, and the trade deficit will likely head up again in October and November.

The deficit on trade in goods was \$65.8 billion in September, down from \$66.1 billion in August, while the surplus on services was virtually unchanged at \$9.3 billion.

The dollar has weakened against the euro, pound and Canadian dollar, and this boosts exports. However, the trade deficit remains stubbornly large, because imports of petroleum and from Asia are not much affected by exchange rate movements.

Petroleum is priced in dollars. Consumer goods from China and automotive products from Japan and Korea remain strong, because these countries' central banks sell billions of yuan, yen and won in foreign exchange markets to keep their currencies undervalued against the dollar.

The stubbornly large trade deficit heightens the risk of recession. The prospect that the trade deficit will rise with the surging price of oil further raises the risk of recession.

The deficit subtracts about \$250 billion from GDP, and that amount could double if the economy slips into recession.

Breaking down the Deficit

Petroleum, China and automotive products account for nearly 100 percent of the trade deficit, and no solution to the overall trade imbalance is possible without addressing these segments.

Petroleum products accounted for \$24.1 billion of the monthly trade gap. Since December 2001, net petroleum imports have increased \$18.6 billion, as the average price of a barrel of imported oil has risen from \$15.46 to \$68.51, and monthly imports have increased from 353 million to 387 million barrels.

Retuning conventional gasoline engines and transmissions, hybrid systems, lighter weight steel and other materials, nuclear power, and other alternative energy sources could substantially reduce U.S. dependence on foreign oil. These solutions require national leadership, but both Republican and Democratic Party leaders have failed to champion policies that would reduce dependence on Middle East oil.

China accounted for \$23.8 billion of the September trade deficit, up from \$5.5 billion in December 2001. The bilateral deficit remains stubbornly high, because China undervalues the yuan, and this makes Chinese exports artificially inexpensive and U.S. products too expensive in China.

China revalued the yuan from 8.28 to 8.11 in July 2005 and has since permitted the yuan to rise 3.6 percent every twelve months. Modernization and productivity advances raise the implicit value of the yuan about 7 percent every 12 months, and the yuan remains undervalued against the dollar by 40 to 50 percent.

China's huge trade surplus creates an excess demand for yuan on global currency markets; however, to limit appreciation of the yuan against the dollar and drive its value down against the euro, the Peoples Bank of China sells yuan and buys dollars, euros and other currencies on foreign exchange markets.

In 2007, the Chinese central bank is on track to purchase about \$500 billion in U.S. and other foreign currency and securities. This comes to about 16 percent of China's GDP and about 45 percent of its exports. These purchases provide foreign consumers with 3.6 trillion yuan to purchase Chinese exports, and create a 45 percent "off budget" subsidy on foreign sales of Chinese products, and an even larger implicit tariff on Chinese imports.

In addition, China provides numerous tax incentives and rebates, and low interest loans, to encourage exports and replace imports with domestic products. These practices clearly violate China's obligations in the WTO, and it agreed to remove those when it joined the trade body.

Automotive products account for about \$9 billion of the monthly trade deficit. Japanese and Korean manufacturers have captured a larger market and are expanding their U.S. production. However, Asian manufacturers tend to use more imported components than domestic companies, and GM and Ford are pushing their parts suppliers to move to China.

GM, Ford and Chrysler carry a significant cost disadvantage against Toyota plants located in the United States, thanks to clumsy management and unrealistic wages, excessive fringe benefits and arcane work rules imposed by United Autoworker contracts.

Recently negotiated labor agreements should reduce, but not eliminate, these cost disadvantages. Even with retiree health care benefits moved off the books and a two tier wage structure, the cost disadvantage will remain well above \$1000 per vehicle.

Also, the central banks of Japan and Korea have aggressively stepped up sales of yen and won for U.S. dollars and other securities to keep their currencies cheap against the dollar. This discourages Toyota, Hyundai and others from moving more auto assembly and sourcing more parts in the United States.

Deficits, Debt and Growth

Trade deficits must be financed by foreigners investing in the U.S. economy or Americans borrowing money abroad. Direct investments in the United States provide only about a tenth of the needed funds, and Americans borrow more than 45 billion each month. The total debt is about \$6 trillion, and at five percent interest, the debt service comes to about \$2000 per U.S. worker each year.

High and rising trade deficits tax economic growth. Each dollar spent on imports, not matched by a dollar of exports, shifts workers into activities in non-trade competing industries like department stores and restaurants.

Manufacturers are particularly hard hit by this subsidized competition. Through recession and recovery, the manufacturing sector has lost 3.3 million jobs since 2000. Following the pattern of past economic recoveries, the manufacturing sector should have regained about 2 million of those jobs, especially given the very strong productivity growth accomplished in technology-intensive durable goods industries.

Productivity is at least 50 percent higher in industries that export and compete with imports. By reducing the demand for high-skill and technology-intensive products, and U.S. made goods and services, the deficit reduces GDP by about \$250 billion a year or about \$1750 for each worker.

Longer-term, persistent U.S. trade deficits are a substantial drag on growth. U.S. import-competing and export industries spend at least three-times the national average on industrial R&D, and encourage more investments in skills and education than other sectors of the economy. By shifting employment away from trade-competing industries, the trade deficit reduces U.S. investments in new methods and products, and skilled labor.

Cutting the trade deficit in half would boost U.S. GDP growth by one percentage point a year, and the trade deficits of the last two decades have reduced U.S. growth by one percentage point a year.

Lost growth is cumulative. Thanks to the record trade deficits accumulated over the last 10 years, the U.S. economy is about \$1.5 trillion smaller. This comes to about \$10000 per worker.

The damage grows larger each month, as the Bush administration dallies and ignores the corrosive consequences of the trade deficit.

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Silver Market Update :

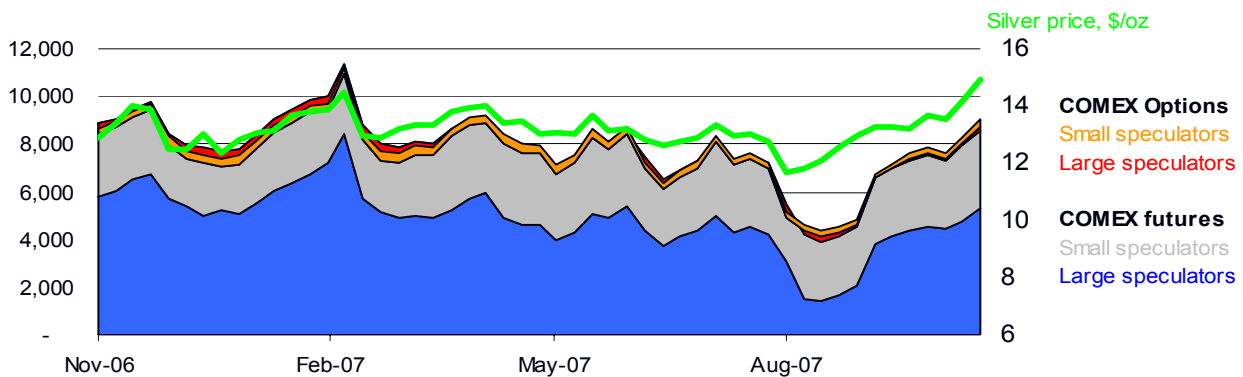
A lot can happen in a month, and the silver market is testament to this. At the beginning of November, silver finally immersed itself in the commodity rally. But while gold's steep upward rally over the previous two month period was of concern, the parabolic rise in the silver price over the course of 3 days, beginning on the 5th November, defied logic and we expected a steep correction. As a result of this price action, silver

volatility exploded on the 6th Nov with 1m +6%, 3m +5%, 6m +4.25 and 1 yr +3%.

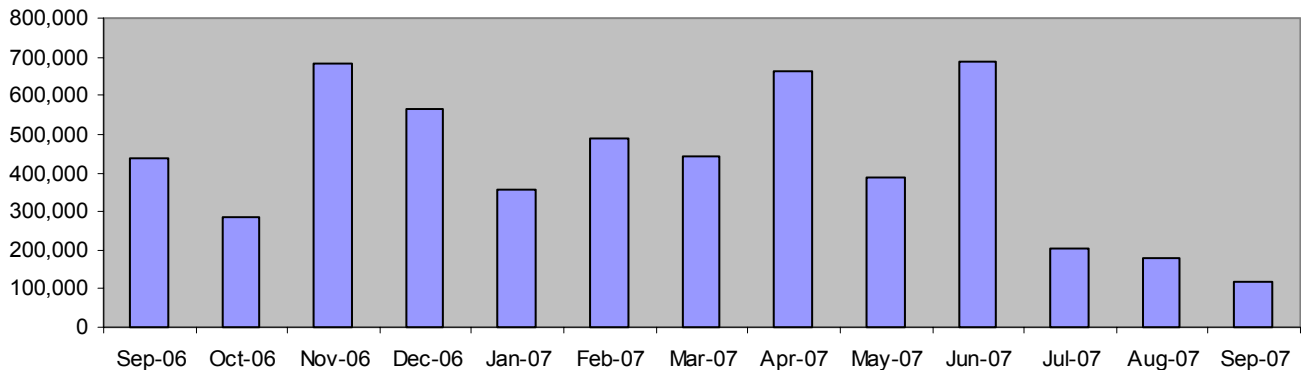
We have noted that on many occasions this year silver has revealed its innate ability to crash and burn when market conditions become turbulent. For this reason it regularly fails to inspire much investor confidence. Following a 12.5% appreciation over this three day period, there was an obvious danger that silver did not possess the required staying power to maintain a rally. Mirroring silver’s run over \$16, the metal fell from these lofty levels in very volatile trading conditions. Such an environment creates a nervous market.

The global silver book now stands at 9,028 tonnes, the first occasion over 9,000 in 27 weeks. While all this looks positive on paper for silver, when we delve behind the numbers, the global silver exchange book has been in excess of 9,000 tonnes on 6 occasions this year while it was exceeded 8,000 tonnes on 18 occasions in the last 44 weeks of 2007. With the global gold book at an all time record net long position, silver investors maintain an indifferent attitude to this metal at present. Despite gold’s tremendous run, silver has returned to the mid \$14 area. ETF investors have remained out of this market. It is most unlikely that this is the beginning of a real change in silver's fortune as the fundamental picture of the metal does not support an overly positive forecast.

COMEX Silver Investment, October 06 to October 07, tonnes



Chinese Silver Exports, Kg



Silver and China: Following cuts in Chinese tax rebates for silver exports last July, outflows of the white metal have contracted severely over the last three months. As shown in the graph below, silver exports in July were just 30% of the quantity that left the region in June. This pattern continued for August and

September. However, as the silver price appreciated in recent weeks along with the overall trend in the precious metals complex, recent exports from China have risen with a silver price in excess of \$14.