301 Cases

1. Japan - leather
   good, but:
   - social mentality involved; an opp occupational group (butchers, garbage collectors - caste group "Dōwa"
   - have avoided embarassment by going thru GATT (only special treatment)
   - e.g. U.S. set aside for Memorials
   - could be very neg reaction in J
   - → doesn't address real problem w/ gvt policy & exclusion of competitive products.

2. EC - canned Fruits
   - U.S. industry having second thoughts major concern more EC share of US mkt
   - processing subsidies may be better handled thru CVD case

3. Korea - Insurance

- no problem, cept Korea an LDC & new incl system
- why not Korea & Tobacco

4. Brazil - Informatics

- excellent, directed → incl policy, intell prop,
- prob - Brazil LDC & in debt (but domestic policy under attack, not export)

5. Japan - Tobacco

- U.S. same practice (equal tariff & excise tax
- J distr not reg. H150 - just easier
- poss. legit basis in many monolgy in J — but, US. many have no intention

6. U.K. Restrictions
   - good case, but ind doesn't want
   - "unreasonable" ⇒ retaliation

7. IR6 – trans border data
   - o/s GATT – "unreasonable" ⇒ retail
   - logic case not clear

8. Japan – Aluminum
   + · ind policy & restrict access for competitive, superior products (al. ingots & fabricated prod) cheaper – but tariff ↑ price fabricators in al downstream dumping (upstr subs)
   – · no GATT viol
   · reasonable – retail
   · alcoa dropt 30
   · CVD case duty free ingot

9. Taiwan – IP
   · good –
   · but another form (bilateral)
   · not stonewalling

10. EC – Export Subsidy
- no good case
- maj cases US chairs it – US embargo
- has to be better than cases

Labor Progrm

- no specifics
- no cost est
- ~~est~~ limited funds - discretionary

FT WEAR

1. who takes to TT?
2. will unfair be announced same time?
3. is no relief contingent on 301? if at impass?

301

GENERAL

1. lengthy - 1 yr +
2. retal - compensation
3. technical - esoteric don't ~~attack~~ engage emotions like Cong cases
4. most of list, not clearly illegal, guilty of same thing we accuse Cong of
5.

Specific

1. 1st 4 OK

   Korea - better tobacco - gain if smoke

(5) 2. Japan - Tobacco - same duty as U.S.
   - U.S. guilty of same
   - no restr on distrib - practical - monopoly

(6) 3. UK - incl

THE WHITE HOUSE

WASHINGTON

August 22, 1985

MEMORANDUM FOR THE ECONOMIC POLICY COUNCIL

FROM: EUGENE J. MCALLISTER EM

SUBJECT: Agenda and Paper for the August 27 Meeting

The agenda and paper for the August 27 meeting of the Economic Policy Council are attached. The meeting is scheduled for 2:00 p.m. in the Roosevelt Room.

The single agenda item is a review of potential Section 301 investigations to be initiated by the President. A list and analyses of ten possible cases, prepared by the Office of the United States Trade Representative, is attached.

Attachments

THE WHITE HOUSE

WASHINGTON

ECONOMIC POLICY COUNCIL

August 27, 1985

Roosevelt Room

AGENDA

1. Potential Section 301 Investigations

THE UNITED STATES TRADE REPRESENTATIVE
Executive Office of the President
Washington, D.C. 20506

August 22, 1985

M E M O R A N D U M

TO: Economic Policy Council

FROM: Ambassador Clayton Yeutter

SUBJECT: Section 301 Cases

Enclosed are summaries of 10 potential section 301 cases that have been developed on an interagency basis over the past couple of weeks. They are arranged in approximate priority order as we presently evaluate them at USTR though that is obviously subjective. The first two cases, in fact, are already in process, but are included here because they are ripe for acceleration by the U.S.

I will provide further background verbally on all of these when we meet next week. At that time we will wish to evaluate such factors as the flagrancy of the practice, the amount of trade involved, the longevity of the practice, the intensity and tenure of our complaints, our international competitiveness in the product involved, the strength of our case under our own law and international rules, our political and economic relationships with the country involved, etc. This may cause us to alter the priorities. We'll hone the list between now and then and when we meet I'll provide any necessary updates.

CY:bac

Enclosures

LIST OF POTENTIAL SECTION 301 CASES

legal

legal

legal - subsidies

legal

good other forum

other

leverage - retal

not doesn't want

factual error - not design failure not smelting -

leather goods

JAPAN - LEATHER AND LEATHER FOOTWEAR QUOTAS

TRADE PRACTICE

Japan maintains identical quota schemes severely restricting imports of leather and leather footwear. The U.S. has brought separate GATT actions against Japan on these issues.

In May 1984, the GATT Council adopted a panel report finding that Japan's leather import quotas are inconsistent with Article XI of the GATT. The GATT Council recommended that Japan eliminate the quotas. The illegal quotas, in combination with high tariffs, severely restrict U.S. leather exports to Japan. Since the adoption of the panel report, Japan has failed to take meaningful steps to improve the access to U.S. leather exports to Japan.

In June 1985, the United States asked the GATT Council to form a working party to consider three issues regarding the leather case: (1) how and when Japan intended to bring itself into conformity with the GATT panel's decision, (2) whether some form of compensatory adjustment is appropriate, and (3) whether the U.S. would be authorized to take compensatory measures. At the July GATT Council meeting, Japan announced that it would replace the illegal leather quota with higher tariffs pursuant to Article XXVIII of the GATT. These higher tariffs would serve to keep the Japanese market closed to U.S. exports and indeed could have an even more restrictive effect on U.S. exports. Japan therefore proposed to replace an illegal barrier to U.S. leather with a GATT-legal barrier. Japan further announced that it would enter into discussions with respect to Article XXVIII compensation after finalizing the tariff increase. Thus, while the U.S. might eventually receive compensation for the leather quota, this compensation must await further negotiations at some future point in time and with no assurance that the level of compensation would be adequate to redress the damage suffered by the U.S. industry. Meanwhile, the entry of U.S. leather exports continues to be severely restricted.

We initiated a Section 301 case against Japan on the footwear quota in December of 1982. We are about to initiate a GATT panel proceeding on the footwear quota under Article XXIII:2 and have argued that since the leather quota and leather footwear quotas are identical practices, the conclusions of the leather panel should apply to footwear. To date, Japan has taken no action to eliminate the footwear quota. We have held a series of bilateral consultations on the leather footwear quota under Articles XXII and XXIII in an effort to convince the Japanese to reduce or eliminate the quota on an MFN basis. Although the leather panel's decision was based solely on an examination of the leather quota, since the leather quota and leather footwear quotas are identical practices, we argued that in light of the leather decision the Japanese were obliged to eliminate both quota schemes. However, the Japanese have resisted this approach

and have insisted that we must go through a new Article XXIII:2 panel process on the leather footwear quota. We have agreed to the establishment of a panel and are in the process of negotiating terms of reference for the panel.

TRADE EFFECTS

The Japanese leather quota system has been found, both by the U.S. Government and by a GATT panel, to be in violation of Japan's international trade obligations. The tariff reduction on semi-finished leather imports made by Japan following the GATT panel's finding has been of very little benefit to the U.S. industry, since it affects only a miniscule portion of their exports to Japan. Indeed, it is of far greater benefit to the Japanese tanners who import semi-finished leather to manufacture finished leather which competes with U.S. exports. Additionally, the publication of the level of the quota, while useful information, has not aided U.S. leather exporters in increasing their sales. U.S. exporters remain substantially excluded from the Japanese market and this situation is not going to change in the foreseeable future. The situation will worsen if Japan follows through on its plan to raise its leather tariffs.

Although there has been no GATT panel finding with respect to the leather footwear quota, it is identical to the leather quota and it is clearly GATT inconsistent. The Japanese have taken no steps to liberalize or eliminate the footwear quota and it effectively excludes U.S. footwear exporters from the Japanese market.

EVALUATION OF THE PRACTICE

The quota system is a flagrant violation of Japan's obligations under GATT. In apparent recognition of this fact, Japan never attempted to defend the quota in GATT terms, but instead chose to argue that the quota was necessary to protect Japan's "Dowa" minority. Japan has chosen to respond to the GATT panel's finding by using the device of Article XXVIII to raise a tariff barrier against U.S. leather exports. Japan has not taken any steps to improve U.S. market access. The imposition of tariffs in this case will inhibit trade since any tariff increase will be on top of the already excessive 20 percent rate.

Congress is well aware of Japan's failure to take meaningful steps to improve U.S. market access. The Senate Finance Committee Report to the Danforth-Packwood Japan Retaliation bill (S. 1404) lists the leather quota as an example of Japanese unfair trading practices.

301 CASE - SUBSTANCE, PROCESS AND IMPLEMENTATION

Since a GATT panel has found that Japan's quota is illegal under GATT, there is no question that Japan has violated its international trade agreement obligations and that the President has the power to retaliate under section 301. The President can act immediately by retaliating unilaterally without GATT authorization.

Alternatively, the President could announce that he will seek authorization from the GATT Contracting Parties to implement retaliatory measures. To implement the retaliation, the President must act pursuant to his section 301 authority. There is a cleared Trade Policy Staff Committee (TPSC) position that the U.S. should go to the GATT Council (scheduled to meet in October) and seek authority to take counter-measures with respect to leather, pending removal of the quota and negotiation of a satisfactory compensation package. If the GATT Council fails to act within a reasonable period of time, the TPSC would recommend that the President retaliate unilaterally under section 301. With respect to footwear, however, it is unlikely that the Council would approve countermeasures at all since there has not yet been a panel finding in our favor.

With respect to the timing of retaliation, it seems clear that the U.S. has shown ample patience with the Japanese Government. The 301 case was initiated in 1977. We reached a settlement with the Japanese Government in 1979 in the expectation that market access would improve. After our expectations were not met, we followed the letter of the law by initiating and winning a GATT case.

While from a legal and procedural point of view there is reason to treat the leather and leather footwear cases separately in the GATT, they both involve the same practice which is a flagrant violation of the GATT. Therefore, if the President acts under section 301, he may want to retaliate both with respect to leather and leather footwear.

To implement this case, the President would request USTR to submit a retaliation proposal for his consideration. If he chooses not to wait for GATT authorization, he should nevertheless provide USTR 45 days to submit a proposal in order to allow adequate time for public comment.

EC - CANNED FRUITS AND RAISINS

TRADE PRACTICE

In 1978, the EC established a subsidy system to assist certain of its fruit processors. These subsidies were intended to allow higher-priced EC products to compete on an equal basis with imported items. Instead, the subsidies, combined in many instances with minimum import prices, have allowed EC products to be priced substantially below competing imports. Early efforts by the U.S. to restrain the growth of the subsidies and the number of products covered, were unsuccessful. The overall effect of the EC processing subsidy system has been to reduce or eliminate import competition. Clearly, this has occurred in canned fruits.

In October 1981, U.S. producers and processors of canned peaches, canned pears, fruit cocktail and raisins filed a Section 301 petition alleging that tariff concessions obtained from the EC on those products had been nullified and impaired by processing subsidies introduced by the EC. In July 1984, the GATT panel which considered this case found in favor of the U.S. on the canned fruits portion of the complaint, but determined that the EC subsidy scheme for raisins was essentially a continuation of an earlier Greek scheme. Although the GATT panel ruled in favor of the U.S. on canned fruits, our industry has thus far obtained no relief because attempts to negotiate a bilateral solution with the EC have been unsuccessful, and the EC has been unwilling to approve adoption of the panel report in the GATT Council. With continued EC intransigence, the only viable option for obtaining relief for U.S. fruit canners is unilateral U.S. action.

TRADE EFFECTS

The U.S. canned fruit industry is struggling to survive because of a number of factors, including the EC subsidies, the strong dollar, and competition from other countries such as Australia and South Africa. A substantial cut in EC processing subsidies would be necessary for U.S. canned fruit products to again be competitive in the European market. U.S. shipments of canned fruits to the EC market have dwindled to virtually zero over the past several years. The principle concern of the U.S. industry at this point is an EC invasion of the North American market.

EVALUATION OF THE PRACTICE

The EC processing subsidies for canned fruits have nullified or impaired concessions granted by the EC to the U.S. They have made U.S. product less competitive in the EC market and have contributed to a dramatic decrease in sales of U.S. fruit. In line with the GATT panel's recommendation, the EC should either reduce or eliminate its subsdies to restore competitive conditions or grant equivalent concessions to the U.S.

EC - CANNED FRUITS AND RAISINS

The EC subsidy system for fruit processors was intended to permit higher-priced EC products to compete on an equal basis with imported items. In practice, these subsidies--combined in many instances with minimum import prices--have allowed EC products to be priced substantially below competing imports. EC canned fruit subsidies, together with a strong dollar, have virtually eliminated U.S. product from the EC market.

301 CASE - SUBSTANCE, PROCESS AND IMPLEMENTATION

The U.S. has a meritorius claim that tariff concessions have been impaired. There is no need for further investigation; under U.S. laws the President can take action immediately to restrict EC imports into the U.S. as a means of re-balancing the level of trade concessions.

The President can implement the action by directing USTR to submit retaliation proposal for his consideration. To allow time for public comment on the proposed retaliation, USTR should be allowed 45 days to submit a proposal.

POSSIBLE EFFECTS OF 301 ACTION

There is clear domestic authority for action in this case. However, since the GATT has not adopted the panel report, the GATT has not authorized retaliation. In the citrus case, which is very similar, we decided to act under 301 without GATT authorization. However, that experience demonstrated the EC's willingness to counter-retaliate. Moreover, imposition of restrictive measures now could make it even more difficult to negotiate a final settlement of the citrus issue.

KOREA - INSURANCE

TRADE PRACTICE

Foreign firms are prohibited from writing life insurance for Korean nationals and compulsory fire insurance, which are the two most lucrative lines of insurance in Korea. American firms are eager to write these lines of insurance, and the American International Group (AIG) is prepared to file a 301 petition seeking access to both types of insurance.

AIG was given its original license in Korea immediately after the Korean war and was limited at that time to writing insurance for foreign nationals (primarily U.S. military). In the 1960's AIG sought an expanded license that would permit it to insure Korean nationals and their property. Finally, in March 1977, AIG felt that it had received a commitment from the Korean government to grant a marine insurance license within one year and to liberalize the officially sanctioned oligopoly of Korean fire insurance companies. When these commitments were not fulfilled, AIG filed a section 301 petition in 1979. USTR accepted the case and negotiated an agreement with the Government of Korea in December 1980, which required the government to issue a full marine insurance license by May 1981, to abolish the non-compulsory portion of the fire oligopoly by May 1984 and to establish an equitable retrocession arrangement during 1981. On the basis of this agreement, AIG withdrew its 301 complaint, but it made clear that its ultimate goal was to obtain access to the compulsory fire pool or to have it dismantled. Pursuant to this agreement, the Korean government granted AIG the full marine insurance license and revised the system of retrocessions. Non-compulsory fire insurance was liberalized on a de jure basis, but the government has not taken sufficient steps to prevent de facto exclusion of American firms from the oligopoly of domestic firms that controls noncompulsory fire insurance (the so-called banking pool).

During the past two years the USG has made innumerable representations to the Government of Korea: (1) to enforce its stated policy that non-compulsory fire insurance is open to foreign firms; (2) to grant American firms licenses to write compulsory fire insurance (which still is handled by an officially sanctioned oligopoly, the "fire pool") and compulsory automobile insurance; and (3) to grant American firms licenses to write life insurance for Korean nationals. During the U.S.-ROK Economic Consultations on July 1-2, the Koreans indicated that the Ministry of Finance had promised to make a proposal this year for a solution to the fire insurance problems but that implementation in any event would not begin until 1987. No commitment was made on life insurance, and we were informed that a liberalization of life insurance could be addressed only in the longer-term.

We informed the ROKG that the industry was ready to file another 301 petition unless the following two steps were taken: (1) the ROKG commits to phase-in full foreign participation in the fire pool at the rate of one city per month (there are seven cities covered by the pool), beginning in August; and (2) the ROKG agrees to provide the USG no later than January 1986 an acceptable plan for full foreign participation in the life insurance market. We have not had a response from the Korean government. AIG has revised its 301 petition to reflect the recent liberalization of auto insurance and will refile the petition if the Administration decides not to self-initiate it.

TRADE EFFECTS

Life insurance accounts for almost three-fourths of the total Korean insurance market; the value of premiums paid exceeds $3.82 billion annually, and total life insurance in force is $68.91 billion. We do not have an estimate for the value of premiums written by the Korean members of the fire pool, but the overwhelming proportion of significant buildings is reserved for those firms.

EVALUATION OF THE PRACTICE

The ROKG policy of denying American firms the right to issue compulsory fire insurance policies is a denial of national treatment and, therefore, appears to violate Article VII of the U.S.-ROK Treaty of Friendship, Commerce and Navigation (FCN). No Korean insurance company is prohibited from writing compulsory insurance, but all foreign companies are prohibited from writing compulsory insurance (except for the recently liberalized auto insurance). The Korean government also denies national treatment by not issuing licenses for American firms to write life insurance. Six Korean insurance companies are licensed to write life insurance, and no foreign firms have been granted such licenses. No new firms have been granted life insurance licenses since 1957.

301 CASE - SUBSTANCE, PROCESS AND IMPLEMENTATION

The U.S. has a meritorious claim that Korea is in violation of its FCN obligations by discriminating against U.S. insurers. Since this case involves services, the GATT is not involved. The investigation would include bilateral consultations/negotiations and would be completed in a maximum of one year (or earlier at our discretion). Our leverage to negotiate a solution lies in our willingness to restrict access for Korean goods and services in the U.S. market.

To implement this case, the President would direct USTR to self-initiate an investigation. USTR would then publish notice of its investigation in the Federal Register, solicit public comment on the issues raised in the investigation, and request consultations with the Korean Government.

BRAZIL - INFORMATICS

TRADE PRACTICE

In 1984, Brazil approved a complex new law codifying and extending past measures designed to promote a national informatics industry. The law provides broad authority to restrict imports for an eight year period and establishes a market reserve policy which sets aside for Brazilian-owned firms the exclusive right to produce and sell products within designated high-technology categories.

Brazil's informatics policy contains a wide array of restrictions limiting foreign involvement in the informatics sector. Most significantly, the market reserve policy retains for domestic firms the exclusive right to produce and sell designated product categories. The market reserve policy currently covers minicomputers, microcomputers, superminicomputers and robotics and can be extended to the entire digital processing industry.

National firms are given preference in government procurement and have access to special fiscal and financial incentives. These fiscal incentives include lower capital costs, tax incentives on capital goods and production inputs and exemptions from import duties and various national taxes. Local content and export performance requirements have been set up as conditions for establishing firms and receiving incentives. For example, a firm wishing to use foreign technology must locate production in a special export zone and produce exclusively for export. Non-national companies may also be eligible for these export incentives; however these exporters will be prohibited from selling their products domestically unless they satisfy the requirement that no "national similar" product is available. The Special Secretariat for Informatics (SEI) has the authority to intervene with foreign firm management to review and require changes in its mode of operation, approve manufacturing proposals, control the issuance of import licenses and issue regulations which restrict foreign company access to selected informatics market sectors.

A special intelligence report stated that SEI has closed Brazil's domestic market to imports of single board computer technology in an effort to promote the design and production of these products locally.

TRADE EFFECTS

The effect on U.S. firms of the informatics policy has been mixed. In general, however, the Brazilian restrictions have either totally excluded foreign firms from certain market segments or confined them to licensing their technology. Largely as a result of market reserve, U.S. multinationals operating in Brazil repeatedly have been denied approval of manufacturing proposals for new product lines. In addition, all companies in Brazil

have found it increasingly difficult to import needed inputs. SEI's strict review of import license applications--to ensure that there is no import competition for locally-manufactured goods--has forced companies to maintain inventories of parts and components substantially beyond that which would normally be required under free market conditions.

Brazilian imports of computer products fell 17 percent to $139 million in 1983 from a five year high of $166 million in 1982. Parts represented 36 percent of the 1983 total, the highest percentage during the 1978-83 period. The United States was by far the the largest supplier of computer products to the Brazilian market, accounting for $88 million or 63 percent of the 1983 import total. However, computer parts accounted for a larger share of the total, up to 41 percent in 1983, from a low of 29 percent in 1980. The value of equipment imports from the United States fell to $52 million, roughly equal to the 1980 level; this drop reflects the effect of Brazilian market restrictions. Although 1984 figures are not available from Brazil, U.S. export figures show that during the first 9 months of 1984, U.S. computer equipment exports fell 10 percent to $34 million. Parts exports increased 96 percent to $106 million and accounted for 76 percent of total U.S. computer parts and equipment exports to Brazil, the highest thus far.

EVALUATION OF THE PRACTICE

An examination of trends in U.S. exports to Brazil shows that the informatics policy has had a dampening effect on U.S. informatics industries. A comparison of the growth in U.S. trade with Brazil in computer products with the growth of the Brazilian computer market indicates that U.S. firms did not fully participate in the expansion of Brazil's computer market in recent years. During the 1980-82 period when the Brazilian market expanded rapidly, due primarily to the microcomputer segment, U.S. exports grew at only 14 percent annually while the Brazilian market increased by 30 percent.

Texas Instruments, Hewlett Packard, IBM, Burroughs, Digital Equipment Corporation and Ford/Philco have all experienced lost immediate sales and reduced long-term commercial prospects. As a result of Brazil's informatics policy, U.S. firms have been forced to maintain restricted operations in Brazil; sold or closed all or part of their Brazilian operations; and transferred technology to a Brazilian firm.

301 CASE - SUBSTANCE, PROCESS AND IMPLEMENTATION

The U.S. has a meritorious claim that Brazil's market reserve is in violation of its GATT obligations. Even if Brazil were to successfully claim an infant industry or national security defense, the U.S. could request compensation or be authorized to retaliate. Although we have had one round of GATT consultations with Brazil on its informatics policy, we would not expect to complete GATT action in less than two years.

Preferences for Brazilian firms with respect to government procurement are permitted under the GATT. Accordingly, this aspect of the Brazilian informatics policy could not be pursued in GATT. Also, it is unlikely that Brazilian domestic subsidies for computer manufacturers would be pursued successfully in the Subsidies Code, since (1) the Code's disciplines over domestic subsidies are relatively weak and (2) Article 14:7 provides a further dispensation for developing countries. We therefore might wish to limit the 301 case at this point to the market reserve issue.

The President can implement this decision by directing USTR to self-initiate a 301 investigation. USTR would then publish notice of that fact in the Federal Register, solicit public comment on the issues raised in the investigation, and request consultations with Brazil. Since we have already had consultations with Brazil under Article XXII of the GATT, we might wish to move directly to consultations under Article XXIII. This would then lay the foundation for moving directly to a GATT panel if the consultations do not lead to a resolution of the dispute.

POSSIBLE EFFECTS OF 301 ACTION

Since U.S. firms are currently operating in Brazil and could be subjected to harassment as "punishment" for the initiation of the 301 investigation, we should contact industry representatives before deciding whether to initiate to be certain we have their support.

JAPAN - TOBACCO

TRADE PRACTICE

U.S. exporters of cigarettes to Japan face three barriers:

1. a high import duty and tax-on-duty;

2. the continued monopolization of manufacturing; and

3. government restrictions on product distribution.

The principal barrier to market access remains the 18.8 percent import duty. When multiplied by the largely ad valorem domestic excise tax, the duty reaches an effective level of 37.5 percent, double the original duty. This high duty continues to be a significant impediment to American cigarette sales in Japan.

The second major barrier is the Government of Japan's monopolization of cigarette manufacturing. Because U.S. manufacturers are prohibited from establishing production facilities in Japan, there is no way to circumvent the duty or its inevitable effect on retail prices. This lack of access to local production by U.S. companies results in de facto discriminatory treatment against American cigarettes.

Restrictions on product distribution constitute a third major barrier. Although the distribution of tobacco products has technically been liberalized, the only practical means of distribution continues to be through the Tobacco Haiso, which is owned and controlled by the Japan Tobacco Inc. (JTI). The non-availability of other feasible distribution options severely limits the access that U.S. companies have to the Japanese market.

TRADE EFFECTS

The Japanese market for tobacco is estimated at $10 billion annually. Despite intense bilateral discussion over the past four years, and the expenditure of $100 million in marketing and sales efforts by U.S. manufacturers, the U.S. share of Japan's cigarette market has grown only from 1.4 percent in 1981 to 2.1 percent in mid-1985. Any objective evaluation would conclude that this is an unacceptably small market share, given U.S. competitiveness in cigarettes.

EVALUATION OF THE PRACTICE

In light of the severe and economically unjustifiable restrictions placed on American cigarette sales in Japan, it is unlikely that the situation will improve in the near future. Absent aggressive action on the part of Japan to reverse these practices, this issue will re-emerge as a major bilateral irritant.

JAPAN - TOBACCO

301 CASE - SUBSTANCE, PROCESS AND IMPLEMENTATION

The Japanese tariffs, while high, are not a violation of GATT. Furthermore, the excise tax is non-discriminatory and therefore not GATT-illegal. The manufacturing restriction is blatant; however it is not covered by GATT. Because the tobacco practices are not actionable under GATT, this case would probably be best pursued on a bilateral basis outside of GATT. In that event an investigation would be completed within one year. Our leverage to negotiate a solution would be our willingness to retaliate by restricting access for Japanese goods or services to the U.S. market.

To implement such a case, the President would direct USTR to self-initiate an investigation. USTR would then publish notice to that effect in the Federal Register, solicit public comment and request consultations with Japan.

U.K. RESTRICTIONS ON FIRMS SERVICING NORTH SEA OIL FIELDS

TRADE PRACTICES

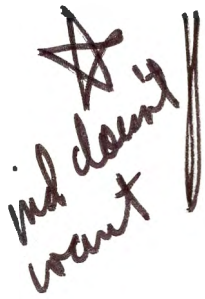
For ten years the United Kingdom has followed a policy of restricting the ability of foreign engineering and construction companies to provide engineering services and goods to offshore oil fields. This is done by conditioning the grant of leases to develop offshore oil fields to agreement to procure such goods and services from U.K. firms.

Until 1985, any firm chartered in the U.K. was considered a U.K. firm for purposes of this policy. However, in January of this year the U.K. government made this policy even more restrictive by requiring that procurement be made from firms with a majority British ownership.

TRADE EFFECTS

It is difficult to quantify the trade effects of the U.K. practice. Until January, U.S. companies could continue to do business by locating their firms in the U.K. Moreover, the impact of the new restriction may be lessened by U.S. companies forming joint ventures with U.K. partners. Nevertheless, the U.K. is the second most profitable market for U.S. oil industry engineering and contracting firms, after the U.S. market. (While joint ventures may allow U.S. firms to remain in the U.K. market, they will also reduce total profits of the U.S. firms).

EVALUATION



U.S. firms have complained to the U.S. government about the U.K. practice, but more recently have asked that the U.S. not intervene. U.S. firms appear to be ready to comply with the new British regulations by entering into joint ventures with British partners.

The U.K. government has reacted strongly to USG complaints. U.K. officials have pointed to the U.S. Jones Act as a similar discriminatory practice. The U.K. government has also used U.S. extraterritoriality policy as an excuse for cutting back reliance on U.S.-owned firms.

301 CASE - SUBSTANCE, PROCESS AND IMPLEMENTATION

The U.K. is clearly restricting the ease with which U.S. companies can offer their services in the U.K. market; however, it is not violating any international obligations in doing so. Thus the U.S. case would be based on the premise that the U.K. policy, while not illegal, is unreasonable. We therefore face the problem of articulating a standard of reasonable behavior against which to measure the U.K.'s practice. Generally, we look to the practices of other countries, including the U.S. However, since

the U.S. also restricts foreign service suppliers under the Jones Act, it becomes more difficult to label the U.K. practices as unreasonable. Moreover, if U.S. firms can continue to service North Sea oil fields through the establishment of joint ventures, it may be difficult to demonstrate the requisite burden on U.S. commerce.

Since this case does not involve the GATT, an investigation would be completed within one year. Our leverage to negotiate an end to the restrictions in the U.K. market would depend on our willingness to restrict access for U.K. goods or services into the U.S. market.

To initiate this action, the President would direct USTR to self-initiate an investigation under Sec. 301. USTR would publish a notice to that effect in the Federal Register, solicit public comment on the issues to be investigation, and request consultations with the U.K.

POSSIBLE EFFECTS OF 301 CASE

A 301 investigation could backfire if the U.S. firms it is designed to assist were to oppose our action. As noted above, U.S. firms seem willing to enter into joint ventures to circumvent the U.K. policy. They might view a 301 investigation as jeopardizing this accommodation. This suggests that we should seek industry views before making any decisions on this case.

FEDERAL REPUBLIC OF GERMANY - TRANSBORDER DATA FLOWS

TRADE PRACTICE

Telecommunications services in the Federal Republic of Germany (FRG) are controlled by the Deutsche Bundespost. The Bundespost's method of assessing charges for international leased lines is a problem for certain U.S. companies who want to send large volumes of data out of the country. These companies want to be able to lease a telephone line from the Bundespost at a "flat rate" (i.e. non-volume sensitive). However, the Bundespost will only provide an international leased line at a flat rate if the company assures the Bundespost that they are sending processed data out of Germany. If the company wants to send unprocessed data out of Germany, then they will be charged on a volume basis. The disparity between flat and volume-sensitive rates forces companies to process data in Germany.

The processing requirement applies to all companies operating in Germany, except for 15 companies who had existing flat rate international leased lines when the volume charging was introduced. These companies will be able to maintain their flat rates for unprocessed data on existing applications through 1987. For all other new applications, either by the 15 exempted companies or other companies, volume charging will be required.

A company leasing a flat rate line must assure the Bundespost of their ongoing compliance with the processing requirement. If the company does not comply, a fine is assessed and the leased line may be cut off. If the Bundespost is suspicious that the data is not processed locally, then they will install a meter and impose volume charging. If a company cannot convince the Bundespost that it is processing domestically, the leased line will be available only if the subscriber performs traffic measurement. The Bundespost may apply additional charges in addition to the volume-sensitive tariffs.

TRADE EFFECTS

U.S. industry reports a number of firms have relocated their data processing centers outside of the FRG to avoid Bundespost regulations on volume-sensitive tariffs and requirements to process data locally.

EVALUATION OF THE PRACTICE

The FRG practice imposes additional costs on those firms which must send data out of the FRG. Either they must pay for processing their data or pay the volume sensitive charges for their leased lines. If companies do not process their data locally, the Bundespost's volume charges take away any benefit the companies might have gained under a flat rate for using their lines to their maximum efficiency. The Bundespost practice is anti-

competitive and is intended to increase its revenues. The processing aspect acts as a domestic content requirement. While this practice does not violate the GATT, it clearly has the effect of restricting the free flow of data across FRG borders. This is a clear example of the type of practice we are trying to change in the course of our negotiating efforts in the services sector.

There is no published definition of "processing" as used by the Bundespost. Companies must submit all proposed applications to the Bundespost for its approval. The Bundespost states generally that processing means working on data to create new information out of the data received. It must be more than the simple collection and/or sorting of data. For example, a conversion of codes, speed format, or protocol, the addition of the time and or the date is not considered to be processing.

The Bundespost claims that the data processing requirement is necessary to prevent subscribers within the FRG from using others' leased lines to transmit data outside of the FRG, thereby bypassing the subscriber-dialed public switched networks. The Bundespost claims that the processing requirement is the only means available to prevent such by-passing. Further, the Bundespost argues these measures are designed to preserve its revenues to allow it to provide full, identical services throughout the FRG, even in areas where traffic does not generate sufficient revenue to cover costs, as required by FRG law and policy. In effect, this permits the Bundespost to maintain the equivalent revenue from international leased lines as it would receive if the same firms used the Bundespost public switched network. Even though the objective of the Bundespost regulations does not explicitly require in-country processing, they do have that effect. U.S. providers of data processing services complain that these ordinances place much greater restrictions on the use of the network than comparable U.S. regulations.

This issue is a long-standing one with the FRG. In 1982, USTR expressed its concerns through a series of letters between Ambassador Brock and FRG Economics Minister Lambsdorff. The issue has been raised on numerous occasions since then.

Progress has been slow for several reasons. (1) The FRG is not violating any international agreements. They argue that this is a domestic issue which relates to the Bundespost's legal mandate to provide and regulate high-quality telecommunications networks for all consumers throughout the FRG. (2) Although certain U.S. companies have complained that compliance with Bundespost regulations is costly, we have no information that U.S. companies are being discriminated against. (3) The Bundespost has been adamant in opposing any U.S. challenges to their practices.

The U.S. objective is to obtain the availability of flat rate tariffs (which are cost-based) for international private leased lines and remove any impediments to the free flow of information across FRG borders.

301 CASE - SUBSTANCE, PROCESS AND IMPLEMENTATION

Trade in services is not yet covered by the GATT. We could deal with the case outside of GATT, arguing that the FRG acts unreasonably in restricting the free flow of information across its borders. Our theory would be that it is unreasonable for the FRG to maintain a pricing policy for transborder data flow that has the effect of charging a higher price for unprocessed data and therefore forcing U.S. companies to process data in the FRG.

The investigation would include bilateral negotiations and would be completed within one year.

To implement this case, the President would direct USTR to self-initiate an investigation. USTR would then publish notice of this fact in the Federal Register, solicit public comment on the issues raised in the investigation, and request consultations with the FRG.

POSSIBLE EFFECTS OF 301 ACTION

Our leverage to negotiate a solution with the FRG depends on our willingness to retaliate by restricting access to the U.S. market for FRG goods and services. Retaliation in goods would likely put the U.S. in violation of its GATT obligations.

We should assume that the FRG might take action against us either unilaterally or through the GATT if we restrict FRG imports into the U.S. We should also be concerned that a confrontational approach would lead to further restrictions on U.S. firms. Therefore, we would want to consult with the affected U.S. businesses before deciding to take action. It could also make it more difficult for the FRG Economics Ministry to continue pressuring the Bundespost to liberalize.

JAPAN - ALUMINUM CARTEL

TRADE PRACTICE

Pursuant to a special law for the structural improvement of industries, Japan has designated the aluminum fabricating industry as requiring structural adjustment. While the GOJ does not concede that it has created a cartel, the industry is authorized, subject to specific MITI and Japan Fair Trade Commission (JFTC) approval, to reduce capacity and control investment.

Under the plan for the aluminum industry (which has been approved by MITI and JFTC and is in effect through 1988), the companies agree with MITI on demand and supply forecasts, joint research is permitted, mergers are officially encouraged, and joint buying and selling may be permitted (it is not known whether this latter activity is occurring now). The industry also benefits from the fact that aluminum ingots imported by Japanese smelters (many of whom are related to the aluminum fabricators) are granted duty free treatment. Such duty-free treatment is not granted to other importers.

TRADE EFFECTS

U.S. exporters currently have less than 1% share of Japan's fabricated product market. Japanese aluminum exports to the U.S. have increased significantly during the 1973-83 period.

EVALUATION OF THE PRACTICE

Japan's practices are not covered by the GATT and do not violate any international laws. Thus, a 301 case would have to be based on the premise that Japan's practices are unreasonable and a burden on U.S. commerce. We therefore face the problem of articulating a standard of reasonable behavior against which to measure Japan's practice. Section 301 provides no guidance on this point. Generally, we would look to the practice of other countries, including the U.S. With respect to burden on U.S. commerce, we lack sufficient information both as to burden and its causal link to the Japanese practices to comment on the substantive merits of the case. We know that Japanese imports of ingots have increased substantially, but do not know whether this is due to some collusive behavior. We also cannot quantify the relative burden that would remain from tariff protection if the cartel activity ceased.

301 CASE - SUBSTANCE, PROCESS AND IMPLEMENTATION

As noted above we need to develop further information before we can evaluate the merits of this case. If we did initiate an investigation, it would be handled on a bilateral basis and would be completed within one year. Our leverage to negotiate a resolution would lie in our willingness to retaliate. To implement this case, the President would direct USTR to self-initiate an investigation. USTR would publish a notice to that effect in the Federal Register, solicit public comment, and request consultations.

TAIWAN - LACK OF PATENT PROTECTION FOR CHEMICAL COMPOUNDS, INCLUDING PHARMACEUTICALS

TRADE PRACTICE

Article 4 of Taiwan's patent law expressly excludes "chemicals" from patentable subject matter. The Ministry of Economic Affairs, in 1976, issued an interpretative directive that included chemical compositions and new methods of use for chemicals in the definition of "chemicals". The latter directive was modified in 1981 to permit patenting of compositions of two or more active ingredients which produce a synergistic effect, but that does not extend to most agricultural chemicals and pharmaceuticals which involve only one active ingredient. Only new processes for manufacturing chemicals and multiple active ingredient chemical compositions, therefore, are patentable in Taiwan.

TRADE EFFECT

Patents give an inventor the right, for a limited time, to prevent others from making, using, or selling his patented product or from using his patented process. Without patent protection for an invention which is a product, others are free to copy the product and compete directly with the inventor in the market place. Since copying generally would have little or no associated research and development costs, the copier has a competitive advantage over the inventor in marketing its product.

There generally are numerous chemical processes for producing a particular chemical so patenting a process of manufacture does not ensure the inventor of a new chemical that he will be able to exploit his invention without competition during the term of the process patent. Since Taiwan patent law practice requires very narrow claims, particularly regarding the temperature and pressure at which the process takes place, it enables local producers to "invent around" a process relatively easily. Also, in Taiwan as in the United States, infringement of a process patent exists only when the process is practiced within the borders of the country. Importation of a product does not constitute infringement.

For these reasons, U.S. agricultural chemical and pharmaceutical manufacturers frequently face competition from local producers that have copied their products merely by using different processes of manufacture. Local firms also frequently import the products from producers in countries, like Korea, where patent protection for chemical compounds is equally weak. Some Taiwan firms now export their products to third countries in the Middle East and Far East where patent protection is weak or non-existent. Local firms generally are able to price their products below those of the U.S. inventor because they have no associated research and development costs and, in some cases, can even have their products approved for marketing on the basis of pharmaco-

logical and toxicological data submitted by the U.S. firm in its application for approval to market.

EVALUATION OF THE PRACTICE

Taiwan's patent law is similar to the patent laws of most developing countries in that it does not provide protection for chemical compounds, single active ingredient compostions, and methods of use. Beginning in March of 1983, the American Institute in Taiwan with advisers from USTR, the State and Commerce Departments, including the Patent and Trademark Office has consulted with Taiwan authorities regarding intellectual property trade problems generally. In May of 1985, the Taiwan authorities told representatives of USTR and PTO that they had decided to amend their patent law to make chemical compounds and new methods of using chemicals patentable. On August 13, the Taiwan authorities reported to representatives of USTR and PTO that the first draft of the patent law amendment had been completed. The Taiwan authorities agreed that they would provide a copy of the draft to the U.S. side and would consult with the U.S. before the final version is introduced to the Legislative Yuan. Consultations are expected in October.

301 CASE - SUBSTANCE, PROCESS AND IMPLEMENTATION

The Paris Convention for the Protection of Industrial Property does not specify catagories of invention that must be protected by a country's patent law. It requires only that nationals of countries signatory to the Convention receive the same treatment as domestic parties under the law, called "assimilation." There is, therefore, no international agreement that could serve as a basis for a section 301 action. The President would have to determine, and publish a notice stating, that some act, policy or practice of the Taiwan authorities was "unreasonable" before any retaliatory step could be taken. To date, the President has not found that the mere failure to act in a particular situation is "unreasonable." An investigation would have to be completed within one year.

To initiate an investigation, the President would direct USTR to self-initiate an investigation. USTR then would publish a notice in the Federal Register indicating the nature of the investigation and asking for public comments. Consultations would be requested with the Taiwan authorities.

POSSIBLE EFFECTS OF 301 ACTION

As explained above, the Taiwan authorities have stated that they intend to amend their patent law to provide protection for chemical compounds, methods of use, and single active ingredient compounds. They have agreed to provide a copy of the draft amendment and to consult with U.S. experts before introducing the

bill into the Legislative Yuan. When the authorities consulted with U.S. experts regarding the then draft copyright law in April of 1984, they followed through by redrafting the proposal to take into account some of the U.S. concerns and introduced the bill in the Legislative Yuan, where it was enacted in June of 1985. There has been no indication of duplicity in the patent area that would lead us to believe the same process will not be followed in this case.

To date, Taiwan has made significant improvements in the protection it affords intellectual property. It has amended its trademark law to increase penalties and ensure that unregistered foreign corporations have access to the courts to enforce their rights. It has amended its copyright law extending the term of protection, expressly including protection for computer software, increasing penalties, and assuring access to the courts to unregistered foreign corporations. A draft unfair competition law will be introduced in the Legislative Yuan next month. U.S. experts will consult with the Taiwan authorities in October regarding implementation of the copyright law and regarding the draft patent law amendment.

Initiation of a section 301 investigation at this time could jeopardize the achievements that have been realized to date through ongoing consultations with the Taiwan authorities. The authorities could take the view that they will delay further movement on implementation of the copyright law, enactment of the unfair competition law and amendment of the patent law until they can determine the exact minimums acceptable to the U.S. side in each of these area. We could lose valuable time and the resulting changes in the law might be less than will be achieved through ongoing consultations. Finally, changes forced upon the authorities could be implemented less thoroughly than would changes resulting from persuasion.

Other countries with which the U.S. has been holding consultations also might delay changes in the intellectual property area until we bring similar trade actions against them, since it would appear that voluntary changes made after consultations with the U.S. will not prevent such trade actions.

EC - EXPORT SUBSIDY ON WHEAT AND BARLEY TO THE SOVIET UNION

TRADE PRACTICES

The EC subsidizes exports of wheat and barley to the U.S.S.R. The EC share of the Soviet grain market has risen from an average of 1.8 percent in the 1974-79 marketing years to 16 percent in 1984/85. This occurred in an increasing Soviet market.

TRADE EFFECTS

The U.S. market share for all grains in the Soviet Union has declined from 62.2 percent during the 1974-79 marketing years to an estimated 41 percent for the 1984/85 year. USDA estimates that the subsidized EC sales have displaced U.S. wheat and corn exports valued at $350 million annually.

EVALUATION OF THE TRADE PRACTICE

There is no question that the EC subsidizes its grain exports and that its share of the U.S.S.R. market has grown. However, the GATT only prohibits export subsidies on agricultural commodities if the subsidy results in the exporting country receiving more than equitable share of the world market or if it displaces other suppliers to the market. These rules are very imprecise; we have not been able to obtain satisfactory results in the GATT on other agricultural subsidy issues. On that basis alone it is uncertain whether we would win this case in the GATT.

Moreover, the EC may be able to make at least two strong counter arguments to the U.S. complaint. First, the EC may argue that its subsidies are not the cause of our lost market share. They can argue that the U.S. sales restrictions to the Soviets imposed in 1980 (sales were limited to 8 million tons -- in effect cancelling contracts for 13.5 million tons) negated previous market share achievements by the United States. Therefore, it may not be appropriate to use the 1974-1979 period as a basis for computing the U.S. share. The EC will also note that when the U.S. lost market share due to the 1980 sales restrictions, it was picked up principally by Canada and Argentina.

Second, the EC will argue that the U.S. is now increasing its share of the U.S.S.R. market. While the EC market share has been growing (especially in the last three years), it appears to be at the expense of the U.S. only in 1982/83 and then at the expense of Canada and Argentina in 1983/84 and 1984/85. In the latter two years the U.S. share actually increased. This coincided with the signing of a new LTA in August, 1983.

301 CASE - SUBSTANCE, PROCESS AND IMPLEMENTATION

The U.S. has less than a 50-50 chance of winning this case in the GATT. The GATT rules on agricultural subsidies are weak and the issue is complicated by the fact that the U.S. embargo of grain sales to the U.S.S.R, and the subsequent LTA have had a significant impact on U.S. trade. An investigation of this issue would involve a GATT dispute settlement case which would likely take up to two years to complete. However, because this is a subsidy issue, USTR would be required to make a recommendation no later than 7 months after the date of initiation of the investigation. At that point, the President would have to decide whether to act without GATT authority or to direct USTR to continue dispute settlement.

To implement this case the President would direct USTR to self-initiate an investigation. USTR would publish notice to that effect in the Federal Register, solicit public comment on the issue, and request consultations with the EC. If consultations are not successful in resolving the issue, we would initiate a dispute settlement panel.

Aug 14
memo to W

EPC - 8-27

301 actions
what, when?

C.Y.

- Q 1 & 2, move forward more quickly - not initiate # 2 few dollars, but matter of principle

- # 1 avenue for yes, GATT determination - Q how to bring to fruition

- △ priorities
  a. J. tobacco flagrant for years, offset to textiles since same area of US involved

  b. Korea insurance, good case, U.S. industry ready to file

  c. Brazil informatics, blatant violation, also tie in w/ footwear

  d. UK oil - U.S. industry want to hold off

  e. transborder FRG - not large, this rock at FRG?

  f. Aluminum - Japan - Alcoa already has a 301

  g. Taiwan - IP - flagrant worldwide - GOT ready to meet our demands on patents

- potential IP case w/ Korea, motion pictures - industry ready for 301 fil

- EC case - just not ready - needs perfection - not staged out - large $ item
  ⇒ huge trade war

Baker — what Π say 1st 2nd? -

CY.
- bring to fruition w/in specific time
- eg. Dec. 1 (GATT commit in Oct w/ S footwear)
- for 3, 4, 5, Π could set time table ⇒ < 1 yr

Brock
- should move, vigorously
- don't wait for ind to file anon — we should do
- pressures next few wks
  - Cong pass both footwear & textile
  - only handle bang-on those who are unfair
  - don't have to wait on GATT -
    eg. Brazil, Korea, Japan have prohibitive tariffs on footwear
  - our % all trade policy in jeopardy
- less anxious to move v. EC - hit on global subsidies for grain, not just Soviet Union

J.B. aggressively enforce trade laws?
would approve in statement

need something to hang hat on – may not be enough – past time, to act
take cases ID by appeals, valid)

CY won't satisfy Cong, but broaden spot

Whitehead (DOS)
- go – B4 Cong returns – w/ strong statements
- favor 3-4 cases, but want to exclude Brazil – debt prob – finance ministers & head of central bank resign yesterday

Brock
- disagree – information long discussed w/ Brazil – maj cause of Brazil's problems, retard own econ growth

Whitehead
- are US canners really in favor of EC 301 – w/ strong $, ship to EC – won't ship

Kelly – do you want to promise retal when odds are against us doing so?

- general discussion process - not committed strategy

Brock - 301 could ↑ negs, get access, avoid retal

Reagan - 301 seen as empty or kill

Keel - 301 attempt to gain initiative from Cong
- can't commit to retail
- IT should be cautious, take minimum # actions, & have rigorous guidelines to avoid pressure to do more eg. base on illegality vs. unreasonableness

Brock - most of cases have no constituency, need at least Aluminum
- lot of cases not even on list

Smart - do because right, not just Cong act

McFarlane - top 5 cases seen as an aggregate step - "shot across bow" - not "paper tiger" view as package not as 1st step to trade war

Baker - take close look at 8 - 5 Alum - 3, combl, alum

Baker go 1st Swiss

State - dissent Brazil
OMB - only for 1st 2

Aluminum? tell Guam

do next week - after shoes - ↑ impact

- trade policy paper
- trade & econ initiatives

Baker - decouple
- 1 sentence w/ announcement requires enforcement

301 Strategy

THE WHITE HOUSE

Office of the Press Secretary

For Immediate Release October 16, 1985

FACT SHEET

Section 301 of the Trade Act of 1974

Section 301 of the Trade Act of 1974 authorizes the President to take action against foreign trade practices that violate international trade agreements or burden or restrict U.S. commerce in an unjustifiable, unreasonable, or discriminatory fashion.

Action may be initiated by the U.S. Trade Representative (USTR) on his own initiative or at the direction of the President, or following a petition from any interested person, including business or labor. If a petition is filed, USTR has 45 days to determine if an investigation is warranted. The factors involved in initiating a section 301 investigation include, among others: the flagrancy of the foreign trade practice; the duration of the practice; the amount of trade and jobs affected; and the likelihood of resolving the issue.

Section 301 directs the USTR to consult with the foreign country involved in the dispute as part of its investigation. USTR also seeks advice from the public and from private sector groups. Most cases are resolved through negotiations with the country whose practices are questioned. If the USTR finds that unfair trade practices exist and the dispute cannot be resolved through negotiations or through dispute settlement procedures of the General Agreement on Tariffs and Trade (GATT), the USTR makes a recommendation to the President as to what action, if any, he should take.

Under section 301, the President has the authority to take all appropriate and feasible actions within his power to obtain the elimination of unfair trade practices. Specifically, he may impose duties, fees or restrictions on products and services of the offending country. These goods do not necessarily have to be related to the goods and services which are the subject of the 301 complaint. The President may also deny licenses issued by Federal regulatory agencies to foreign service suppliers. The degree and duration of these actions is up to the President.

Today's Actions

Taiwan - Cigarettes, Wine and Beer Monopoly

Taiwan maintains monopoly controls on the import and distribution of cigarettes, wine and beer through the use of high tariffs and other import limitations, such as discriminatory rules on distribution and pricing practices. These products are produced and distributed by the Taiwan Tobacco and Wine Monopoly Bureau (TTWMB). As a result of these barriers, U.S. cigarette exports accounted for less than one percent of Taiwan's $840 million market, beer imports are currently banned and U.S. wine exports amounted to only 62 metric tons in 1984.

Today, the President announced that, following consultations between the American Institute in Taiwan (AIT) and the Coordination Council for North American Affairs (CCNA), Taiwan has agreed to improve access to its market for American wine, beer and cigarettes. Under the agreement, U.S. wine, beer, and cigarettes will be permitted to be sold in all retail outlets in which the domestic products are sold. There are approximately 70,000 such outlets in Taiwan.

In addition, the TTWMB will not apply price mark-ups (including import duties, harbor tax, commodity tax, and TTWMB profit) on U.S. products at a rate higher than the overall mark-up applied to comparable domestic products. Immediate steps will be taken to begin implementing these changes. According to the CCNAA, these changes will be fully implemented within six to 12 months. The detailed implementation steps required by these changes will be discussed by AIT and CCNAA.

The President directed the USTR to report to him by December 31, 1985 on Taiwan's progress in implementing these changes.

EC - Export Subsidies on Wheat

Domestic support levels far in excess of world market prices have resulted in increasing European Community (EC) overproduction of wheat. In order to sell this gigantic surplus, the EC provides direct export subsidies. These subsidies have increased the EC's share of the $14.5 billion world wheat export market from less than eight percent in the early 1970s to more than 16 percent in the past crop year. The EC's practice has also depressed world prices. U.S. farmers suffer doubly: lower prices and reduced export volume.

International rules do not prohibit export subsidies on farm products, but they do prohibit using such subsidies to obtain "more than an equitable share" of world trade.

Today, the President directed the United States Trade Representative to initiate a GATT Subsidies Code case against EC wheat export subsidies. Dispute settlement under the Subsidies Code includes three phases: bilateral consultations, conciliation, and establishment of a dispute settlement panel.

Korea - Intellectual Property Rights

Korea's laws appear to deny effective protection for U.S. intellectual property. Korea's patent law does not cover foodstuffs, or chemical compounds and compositions. Protection for chemicals and pharmaceuticals is limited to process patents. Works of U.S. authors are not protected under Korea's copyright law.

It is difficult to quantify the effects of these policies, especially where the effect is simply a decision not to invest in Korea. However, in the copyright area alone, U.S. industry estimates losses of over $170 million annually. The U.S. has consulted with Korea on this issue over the last two years. While the Government of Korea has indicated an intent to change its laws to protect the intellectual property rights of other nations, no legislative changes have yet been made.

Today, the President directed the U.S. Trade Representative to initiate section 301 proceedings against Korea's unfair trade practices in intellectual property rights.

* * *

GATT Subsidies Code Process

Bilateral Consultations: USTR will first request bilateral consultations with the EC. If those consultations do not lead to a resolution of the problem within 30 days of the request, the U.S. may request conciliation.

Conciliation: Under conciliation, which also lasts 30 days, the signatories to the Subsidies code will hear the U.S. complaint and try to assist the U.S. and EC in resolving the issue.

Dispute Settlement Panel: After 30 days of conciliation, the U.S. may request establishment of a dispute settlement panel to review its complaints and issue findings and recommendations which will then be reviewed by the committee of signatory nations to the Subsidies Code.

The Subsidies Code Committee will consider the panel report as soon as possible and make recommendations to the parties to the dispute. If the Committee's recommendations are not followed, countermeasures may be authorized.

# # #

J must in T & export to US

Taiwan's Use of Trade-Related Performance Requirements

Taiwan Trade Practice

On February 23, 1986, Taiwan authorities approved an investment application for Toyota which contained some performance requirements. Under the plan, Toyota will purchase 22 percent of a Taiwan manufacturer of heavy trucks. By 1992, production is scheduled to reach 40,000 units with an export requirement of 12.5 percent or 4,800 units of output. After 1992, export requirements will be based on production levels and could reach 50 percent should Toyota increase capacity further.

Taiwan has designated auto manufacturing as a strategic industry and has implemented a wide range of policies to stimulate this sector. Targets for auto exports include the entire North American market. It will likely follow the Korean Hyundai strategy, exporting first to Canada as an entry point to the much larger U.S. market. Besides Toyota, Taiwan is also discussing additional automotive projects with two other Japanese companies. These projects, if approved, are also expected to contain significant export requirements. We are concerned that the United States is likely to be the recipient of significant amounts of automotive exports as a result of performance requirements placed by Taiwan on third country investors. Moreover, we are concerned that Taiwan plans to continue to use performance requirements as a matter of policy.

Trade Effects

The Japanese are actively seeking equity participation in Taiwan's auto industry to soften the effects of the strengthening yen, to circumvent restrictions on Japanese autos, and to concentrate domestic production on the higher margin luxury market. US auto manufacturers are also actively researching equity participation in Taiwan's auto industry. Should Taiwan succeed in becoming a major auto exporter, the US-Taiwan trade gap-already a $13 billion surplus in Taiwan's favor-likely will widen.

Prior to Toyota's cutting this deal with Taiwan, the company raised the possibility of producing 300,000 units in Taiwan; such an action could significantly raise the level of exports to the U.S. market, especially if these units are produced under a 50 percent export requirement. Furthermore, two additional Japanese firms may begin producing under similar requirements in Taiwan. (The Toyota deal represents the first time Taiwan officials agreed to set requirements based on output rather than on the size of the investment.)

CLASSIFIED BY Donald M. Phillips
DECLASSIFIED ON OADR

Legal Analysis

We are concerned that Taiwan is continuing to use performance requirements such as export and equity requirements as a matter of policy. The President's 1983 investment policy statement sets out the USG's opposition to the use of performance requirements. Furthermore, such requirements are actionable under U.S. trade legislation, particularly Section 301 of the 1974 Act and Section 307 of the 1984 Act. Under Section 307, the USTR is authorized to seek through consultation and negotiation the elimination or reduction of foreign export requirements that adversely affect U.S. economic interests. The use of Section 307 may be more appropriate than Section 301 because Section 307 provides an opportunity to address a prospective problem with regard to Taiwan's use of performance requirements before the issue becomes confrontational a la Section 301. The Taiwanese may be receptive to a Section 307 request to consult over the concerns such requirements could have on our trade relationship. This case ~~also~~ provides a highly unusual opportunity to initiate the USG's first Section 307 action because U.S. economic interests may be affected not by requirements placed on U.S. investment overseas, but by requirements placed on investors of a third country. Thus, a Section 307 could be taken to protect U.S. economic interests without necessarily damaging the position of U.S. investors overseas, e.g., Ford has some operations in Taiwan.

Consensus — EPC

~~CONFIDENTIAL~~ self initiated 301

DEPUTY UNITED STATES TRADE REPRESENTATIVE
EXECUTIVE OFFICE OF THE PRESIDENT
WASHINGTON, D.C. 20506
202-395-5114

March 13, 1986

MEMORANDUM

To: Trade Policy Review Group

From: Ambassador Smith

Subject: Section 301 Self-Initiation Candidates

An EPC meeting is scheduled for Thursday, March 20, to discuss possible 301 self-initiation candidates. Accordingly, a second TPRG meeting is scheduled for Monday, March 17, at 8:30 a.m. in Room 203 at USTR. Attached are revised papers on the candidates previously considered. Please note that we have dropped the Soviet Union from the nitrogen fertilizer paper.

Attachments

✓ Tab 1 Canada--Alcoholic Beverages
✓ Tab 2 Canada--Forced Divestiture
~~Tab 3~~ Canada--Patent Law
~~Tab 4~~ EC--Meat Issues 305 on 3d count
~~Tab 5~~ EC--Oilseeds and Grains (TPRG tomorrow)
~~Tab 6~~ GDR & Romania--Import of Nitrogen Fertilizer Products
✓ Tab 7 India--Almonds
~~Tab 8~~ Indonesia--Intellectual Property
~~Tab 9~~ Japan--Financial Assistance to Small and Medium-Size Export Firms

✓ (to EPC)

~~CONFIDENTIAL~~

~~CONFIDENTIAL~~

CANADA -- ALCOHOLIC BEVERAGES

CANADIAN TRADE PRACTICES

Retail sales of alcoholic beverages in Canada are conducted almost exclusively through provincial liquor boards or marketing agencies. U.S. suppliers experience difficulty marketing their products in Canada because of the following practices:

1. Arbitrary and discriminatory listing and sales quota requirements in each province preclude the sale of many American beers and wines.

2. Discriminatory and often high mark-ups on imported products effectively price them out of the market. Most provinces have different mark-ups for local, other provincial, and foreign products. For example, Ontario's mark-up is 58 percent on Ontario wine, 105 percent on other Canadian wine, and 123 percent on foreign wine.

3. Restrictive and discriminatory marketing practices limit the stores and outlets from which U.S. wine and beer can be sold. For example, 95 percent of the beer sold in Ontario is through Brewers Retail outlets, while U.S. beer can only be sold through provincial liquor stores, which are primarily wine and spirit outlets.

4. Canada has high import tariffs on beer.

On March 13-14, we will consult in Ottawa with federal officials as well as provincial officials from Ontario, Quebec, BC, Alberta and Manitoba. We will seek immediate resolution of U.S. concerns over implementation of the 1979 MTN Understanding, and a firm commitment to include the provincial liquor board practices affecting all alcoholic beverages in the upcoming comprehensive negotiations.

TRADE EFFECTS

Changes in the Canadian practices would allow U.S. companies to market their products in a region that, but for the international boundry line, is literally in their own backyards. (Stroh's breweries are located in Allentown, Pennsylvania, and St. Paul, Minnesota; Heilmann's breweries are in LaCrosse, Wisconsin, and Frankemuth, Michigan; and Schmidt's has a brewery in Philadelphia.)

Canada is the largest U.S. export market for wines, but the trade barriers make bottled wine a much smaller export item compared to bulk wine. If discriminatory price mark-ups were eliminated and the products could be made as available as local products, the

U.S. industry believes U.S. table wine sales in Canada would greatly increase.

Although projections as to the effect of a reduction or elimination of trade barriers are imprecise, U.S. brewers and vintners predict they would sell considerably greater volume if granted ready access. There is ample evidence already of a demand for U.S. beers when available on a nondiscriminatory basis. Budweiser and Miller High Life, both brewed in Canada under licensing agreements, have captured approximately 5 and 10 percent of the market, respectively. In addition, Canadians readily consumed U.S. beer when it was made available during the recent Canadian brewery strike.

LEGAL ANALYSIS

As part of the MTN, Canada agreed to a standstill on differentials in price mark-ups for alcoholic beverages and to nondiscrimination between foreign suppliers with respect to listing applications. We contend that some current practices violate these trade agreements, and on that basis are actionable under Section 301.

With regard to wine, we have informed the Canadian Government that we expect full implementation of the MTN agreement by April 1, 1986, and that the remaining discriminatory practices should be addressed in our bilateral free trade talks. The Congress and the U.S. industry have indicated they expect self-initiation of a Section 301 investigation if the practices are not adequately reduced or eliminated.

Aside from Canada's MTN agreements, Canadian provincial practices in many cases clearly discriminate against imports or products from other provinces, and deny them national treatment as required by the GATT. However, Article XXIV:12 of the GATT requires each Contracting Party only to "take such reasonable measures as may be available to it to ensure observance of the provisions of this Agreement by the regional and local governments and authorities within its territory." While the Canadian Government apparently has not taken any such measures to bring provincial alcoholic beverage practices into compliance with GATT rules, it could satisfy this GATT requirement easily without effecting any meaningful relief for U.S. interests.

The EC initiated a GATT case against Canadian wine practices last spring. A dispute settlement panel is being formed following the failure of bilateral consultations to resolve the problem.

CANADA -- FORCED DIVESTITURE

CANADIAN TRADE PRACTICES

Under Investment Canada, the GOC reserves the right to review foreign investment in "culturally sensitive" sectors. In July 1985, Canada announced its policy for the first "culturally sensitive" sector, book publishing and distribution. Under this policy, Canada prohibits new foreign investment (including acquisitions) unless investors agree to majority Canadian control over a specified time period. The most restrictive aspect is forced divestiture (within two years) of existing foreign investments, in cases of indirect acquisitions. These acquisitions involve no extension of foreign investment in Canada, but merely the transfer of ownership of a Canadian subsidiary between two foreign parent companies; e.g., Gulf and Western's acquisition of Prentice Hall. The United States is also concerned about Canada's current use of forced divestiture as a general policy tool in other sectors such as in the National Energy Program ("back-in" provisions) and its potential future use in other "culturally sensitive" sectors.

TRADE EFFECTS

The trade effects of Canada's investment review policy are difficult to measure but may prove to be substantial. The prospect of government review necessarily has a chilling effect on new U.S. investment in the Canadian cultural sector. Likewise, the forced divestiture of existing subsidiaries is likely to lower the selling price to the U.S. parent and discourage new U.S. investment in the Canadian cultural sector.

GOC's policy of mandatorily increasing Canadian ownership of cultural sector enterprises could have at least two kinds of trade effects: it could hinder the ability of U.S. firms to use the distribution and retail channels of Canadian subsidiaries to facilitate marketing of U.S. exports; and it might tend to alter the input sourcing decisions of Canadian cultural firms in favor of Canadian suppliers. The magnitude of these trade effects will depend on the corporate structure of affected companies and on whether and how vigorously the policy is implemented.

The recent and mutually satisfactory settlement of the Prentice Hall dispute is an encouraging sign that Canada intends to implement the policy in a flexible and pragmatic manner. However, it should be emphasized that the terms of that settlement involved a "grandfathering" of Prentice Hall as an exception to the policy; it did not involve a retraction of the policy. Though

existing investment is likely to remain untouched in Canada, the GOC's review policy will remain a disincentive to new U.S. investment and, therefore, to the acquisition of new marketing outlets for U.S. exports.

The GOC appears to remain firmly wedded to its announced program of establishing over time, as new foreign investment and acquisitions take place, Canadian control of the book publishing industry. The GOC estimates that foreign ownership in book publishing is over 80 percent (with U.S. firms controlling a large share of this market). U.S. industry sources point out that Canadian firms are investing actively and acquiring book publishing interests in the United States without significant restrictions. The loss of U.S. control of book publishing firms in Canada could shift the level of book publishing trade with Canada. A forced divestiture and/or investment review policy in other sectors could similarly damage U.S. trade opportunities.

LEGAL ANALYSIS

Canada's investment review policy clearly discriminates by treating non-Canadian (including U.S.) firms less favorably than Canadian firms with regard to particular investment opportunities. Under Section 301, "discriminatory" expressly involves any "act, policy, or practice which denies national or most-favored-nation treatment to United States goods, services, or investment."

The Canadian policy is likely to prove burdensome on U.S. commerce, defined to include "foreign direct investment by United States persons with implications for trade in goods or services," for the reasons discussed above. However, the magnitude of the burden is difficult to assess at present because implementation of the policy is largely prospective, and because the chilling effect of the review policy is largely invisible.

Finally, Section 301 authorizes the President to take "all appropriate and feasible action <u>within his power</u>" in stated circumstances (emphasis added). Section 301 does not itself authorize restriction of foreign direct investment in the United States. Therefore, if we were to retaliate against Canada, we would need to find an independent legal basis for any retaliation involving reciprocal restrictions on Canadian investment in the U.S. Alternatively the United States could take trade retaliatory measures authorized by Section 301.

~~CONFIDENTIAL~~

CANADA -- PATENT LAW

CANADIAN TRADE PRACTICES

In recent years there have been repeated indications that Canada would reform its patent laws. To date no changes have been implemented.

Currently substances obtained from chemical processes are not patentable if those substances are intended for use in food or medicine. While Canadian law permits patenting a process of manufacture, a specific product can be made through various processes. Thus, if a medicine or foodstuff patent holder wants effective protection, he often must obtain several process patents.

Canadian patent law allows for compulsory licensing of pharmaceutical patents, and requires payment of only a nominal four percent royalty. This provision of the patent law was enacted in 1969, to limit what were thought to be inordinately high profits reaped by multinational pharmaceutical companies.

The Canadian Government has in recent years indicated a willingness to try to change the compulsory licensing rules for pharmaceuticals. Most recently the Eastman Commission proposed increasing royalties from 4 to 14 percent, and providing a four-year period of exclusive use before licensing would compelled.

We have consulted with Canadian officials over a number of years--most recently, during Ambassador Yeutter's December 17 visit to Canada. At that time, senior Canadian Government officials agreed to decide by February 1 whether to introduce modifying legislation, and the form of those changes. Foreign Minister Clark recently assured Secretary Shultz that a bill will be introduced by March 27, and that a Pfizer product, feldipe, will "be taken care of." USTR and Treasury staff are reviewing the draft bill.

U.S. proprietary manufacturers that are members of the Pharmaceutical Manufacturers' Association of Canada find the proposed bill (including an exclusivity period of 8-10 years) satisfactory. PMA would like to have the U.S. Government avoid doing anything that would jeopardize the legislation or make the terms public "prematurely."

Canadian drug manufacturers oppose the changes because they fear a diminution in their competitiveness. Perhaps more importantly, provincial and consumer interests are intensely opposed. Provincial governments fear that changes in the law would engender higher prices for medicines, which would in turn bankrupt their budgets for health care.

TRADE EFFECTS

It is hard to quantify the actual economic effects of these policies. The greatest losses are likely to result from unreasonably low royalties on products subject to compulsory licensing and investment in Canada foregone because of inadequate protection.

LEGAL ANALYSIS

The basis under section 301 for most allegations of insufficient patent protection must be judged by the standard of unreasonableness, since patent practices seldom violate any international agreement or discriminate. Therefore, a section 301 case against Canadian compulsory licensing of pharmaceutical patents must be on this ground. We also need to show a burden or restriction on U.S. commerce, which would require evidence that pharmaceutical compulsory licenses have hindered U.S. exports to Canada of goods or services or adversely affected U.S. direct investment in Canada with implications for trade in goods or services. Some compulsory licenses have been granted to U.S. generic drug producers, so their exports would have to be factored into our assessment of the effect on U.S. commerce.

~~CONFIDENTIAL~~

EC -- MEAT ISSUES

EUROPEAN TRADE PRACTICES

The EC recently proposed two changes in its meat import policies. If implemented as currently planned, either one could.effectively eliminate imports of U.S. meats and meat products. In 1985, U.S. exports of these products to the EC had a value of about $125 million.

Hormones: In late December, the EC Council approved a proposed directive that will ban the use of all hormones in livestock production, except for therapeutic purposes. This ban would also apply to meats and meat products imported from countries, such as the United States, that permit the use of the outlawed hormones. These new restrictions on imports take effect on January 1, 1988.

The U.S. strongly maintains that there is no scientific evidence that the outlawed substances are harmful to human or animal health when used properly and in appropriate circumstances. We have appealed to the EC to agree to establish a residue testing system that will permit trade to continue.

Third Country Meat Directive: The Directive for fresh meat establishes the rules under which non-member countries can export to the EC. Following recent reviews by EC veterinarians of approximately 400 U.S. meatpacking plants, the Community notified USDA that none of the plants surveyed currently meets the minimum requirements of the Directive. The EC has informed us that it will publish a regulation June 1 that will permit meat imports not in compliance with the Directive to continue only through December 31, 1986.

TRADE EFFECTS

Implementation of the hormone ban would immediately cut off U.S. exports of about $100 million in meats and meat products. The use of growth promoting hormones is permitted in the U.S., and such substances are used extensively in commercial cattle feeding operations. U.S. production practices make it economically impractical to identify and segregate products from animals which have not received hormones. However, hormones are not used in horses, and significant sales of horse meat to the EC could likely be preserved.

Implementation of the Third Country Directive will either eliminate our exports of meats and meat products to the EC ($125 million in 1985) or force costly and unnecessary changes in U.S. plants. The EC recently indicated that it might have some flexibility in implementing its Directive, but has yet to demonstrate the extent of that flexibility.

There is no scientific basis for the implementation of either of these meat import policy changes. Since a major consideration appears to be the EC's massive surplus of domestically produced beef, the policy changes can be described accurately as nontariff trade barriers.

Ambassador Yeutter has advised EC officials that implementation of either of these actions would undoubtedly lead to U.S. restrictions on imports of EC meats and meat products. To demonstrate how seriously we take these threats, the President would:

1. Instruct the U.S. Trade Representative to investigate whether the EC ban on hormones and/or implementation of the EC Third Country Meat Directive would be unjustifiable, unreasonable, or discriminatory, and a burden or restriction on U.S. commerce within the meaning of Section 301.

2. Direct the U.S. Trade Representative to conclude his investigation and report by November 1 or some other appropriate date. (The Directive is currently scheduled to become effective for the U.S. on January 1, 1987. The hormone ban will become effective January 1, 1988.)

3. Proclaim a tariff increase on imports of EC meats, effective immediately after the EC measures are implemented, if the practices are found actionable under Section 301.

LEGAL ANALYSIS

Both measures appear actionable under Section 301 because: (1) the lack of a scientific basis for them renders them unreasonable and (2) they would clearly burden or restrict U.S. commerce once they are effective. Consequently, we could conduct a Section 301 investigation, and take action once the EC measures are applied.

EC--OILSEEDS AND GRAINS

EUROPEAN TRADE PRACTICES

The Treaties for the Accession of Spain and Portugal to the European Community required Spain and Portugal to implement certain trade restrictive measures on March 1, 1986. These measures include the following:

-- Implementation of import quotas for oilseeds and vegetable oils in Portugal, together with a restriction on the amounts of vegetable oils that can be marketed domestically.

-- Establishment of a minimum access requirement for EC grains in Portugal.

-- Withdrawal of tariff bindings on corn and sorghum in Spain.

The implementation of the oilseed quotas has been delayed one month; however, they are likely to be retroactive to March 1 once implemented.

TRADE EFFECTS

The 1981-83 average value of U.S. trade in the potentially affected products exceeded $1 billion. Because of large Spanish crops, 1984 value had declined to about $900 million, with growth in oilseed sales to Portugal partially offsetting declines in grain sales to both Spain and Portugal.

The levels of quotas on oilseed imports are unclear. The treaty states that they would be based on 1980-83 consumption levels. For soybeans this would be only about 60 percent of estimated 1985 consumption levels, and would restrict total imports to a level well below the level of 1985 imports from the U.S. alone. However, there has been some indication that the EC may consider a higher quota level if it will help forestall U.S. retaliatory actions. Nevertheless, Portuguese soybean crushers believe that the domestic oil marketing restrictions may be even more of a threat than the import quotas themselves since crushing beans is commercially viable only if the crusher can sell both meal and oil. Other oilseeds could also be adversely affected.

Since the U.S. has been virtually the sole supplier of grains to Portugal, the minimum access requirement for EC grains is expected to displace U.S. exports directly.

U.S. grain exports to Spain are expected to drop drastically as a result of the application of the variable levy system. Trade sources estimate that the market could decline 50 percent next year and to 25-30 percent of current levels by the end of five

years. Other sources believe the market may disappear completely in as little as two years.

If we do not take meaningful action, we will not only suffer immediate trade damage, but we will leave the door open for the extension of these "temporary" quotas to other products and to the rest of the Community. Furthermore, we should not allow the EC to set the precedent of withdrawing concessions before compensation is negotiated.

LEGAL ANALYSIS

Implementation of these measures is inconsistent with the EC's GATT obligations and impairs U.S. GATT rights. The Portuguese import quotas on oilseeds will both violate Article XI and impair a tariff binding. The oil consumption quota could be construed as a violation of Article III:5 regarding restrictions of use. The reserve of a 16 percent market share for EC suppliers in the Portuguese grain market is contrary to Article XI (since the U.S. and other suppliers would be restricted to 84 percent of Portugal's grain imports). The withdrawal of the Spanish tariff bindings, for which compensation should be negotiated under Article XXIV:6, took place long before it will be possible to enter into such negotiations.

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GERMAN DEMOCRATIC REPUBLIC AND ROMANIA --
IMPORTS OF NITROGEN FERTILIZER PRODUCTS

GDR AND ROMANIAN TRADE PRACTICES

Domestic nitrogen fertilizer producers claim that these nonmarket economy countries (as well as the USSR) have invested heavily in facilities to produce nitrogen fertilizer products, particularly urea, for reasons not consistent with commercial considerations. According to U.S. producers, these countries are exporting increasing quantities of a fungible commodity at uncommercially low prices resulting in significant price depression in the U.S. market.

The commercial viability and market-responsiveness of nonmarket economy (NME) enterprise is, of course, always questionable. However, in this case the industry also alleges that NME prices for fertilizer products bear no relation to world market prices for the energy resources on which the products are based. They claim that netback analysis shows the price of the processed fertilizer products to be well below raw material prices. This underlines the noncommercial nature of the NME trade.

Two distinct but related issues are raised: the treatment of NMEs under U.S. trade law and the "natural resource" issue. Concerning the NME issue, the preferred avenues for import relief from unfair trade practices are effectively unavailable for NME imports. Commerce does not apply the countervailing duty law to NMEs, and the current dumping law does not work with respect to them. To date we have been unable to agree on the details of a predictable pricing test to replace the antidumping and countervailing duty laws. Moreover, U.S. producers feel they should not be relegated to injury-based trade relief only, particularly given section 406's notable nonapplication. (Ammonia producers have had two successive losses under section 406 -- first at the Presidential level, then at the ITC.) They also anticipate the Administration's reluctance to provide relief under section 201 except in meritorious adjustment circumstances.

Because NME prices do not appear to reflect raw material costs, this problem is seen as part of the natural resource issue. U.S. nitrogen fertilizer producers are foremost among the supporters of Gibbons' natural resource subsidy amendment to the countervailing duty law. The Administration opposes the Gibbons bill in its present form. Yet we still have not clearly taken a position on the natural resources issue. Increased imports into the U.S. of downstream products made from or using arbitrarily priced cheap natural resource inputs are perceived as a problem, which many (including Gibbons) believe involve an unfair trade practice.

The NME fertilizer imports may fall within this category, although the home market prices and costs of NME fertilizers are unknown and almost meaningless.

The U.S. industry claims that absent government intervention, nitrogen fertilizer products would be manufactured close to their intended destination because of high transport costs. They maintain that the production of such downstream products elsewhere results from governmental intervention and leads to distortion of trade patterns. In the case of NMEs, the distortion is: (1) the failure of NMEs and NME producers to act on a commercial basis and to respond to marketplace developments, and (2) the artificial relationship between processed product and raw material prices.

Self-initiating a 301 investigation is one of the options for an Administration response to the natural resources issue. Self-initiating a section 301 investigation would not, in itself, eliminate the U.S. ammonia industry's support for legislative changes that we oppose. Yet it could be presented as indicative of the Administration's willingness to deal with the natural resource problem, and might, therefore, reduce support for legislative change pending the outcome of the 301 case. It also would send a signal to those now supporting legislative change because they believe the Administration will do nothing.

TRADE EFFECTS

Imports of urea from Romania rose from 136,094 short tons in 1983 to 311,655 short tons in 1985, or 4.49 percent of the U.S. market. Imports from East Germany have risen from 12,127 short tons in 1982 to 41,473 short tons in 1985, or 0.60 percent of the market in 1985. Imports from the Soviet Union, of which the U.S. industry also complains, rose from 96,969 short tons in 1982 to 396,814 short tons in 1985, or 5.72 percent of the U.S. market.

More importantly, conditions are deteriorating rapidly. Urea imports from these countries in December were the highest ever, at about $82 a short ton, while the industry says it must sell at $105 to recover even its cash costs.

LEGAL ANALYSIS

The U.S. ammonia industry informally has presented arguments about the unfairness of the practices concerned, and the burden or restriction they cause to U.S. commerce. We are still evaluating the arguments pertaining to the GATT and bilateral agreements. However, we think it likely that a reasonable argument can be crafted that the artificial relationship between NME fertilizer product prices and world raw material prices distorts trade to the disadvantage of U.S. producers, and that GDR and Romanian investment in and production of nitrogen fertilizers has been unreasonable, since their increased activities have occurred in times of declining prices and thus declining investment and

production by competitors in market economy countries. Burden or restriction should be relatively easy to demonstrate if it is true, as the industry maintains, that imports skyrocketed in December at prices falling through the floor.

INDIA -- ALMONDS

INDIAN TRADE PRACTICES

India's dried fruits and nuts import policies have been an irritant in our bilateral trade relations since 1981. These products then were moved from open general licensing (where they had been placed in 1977) to the restricted list, as India restricted imports of nonessential goods for balance of payments reasons.

In 1983 India abolished discriminatory valuation practices that favored Afghan imports over U.S. imports. Yet at the same time it reduced the availability of import licenses from 50 to 25 percent of the importer's best year of dried fruits and nuts imports in the last decade. In FY 1984/85, it started a policy of specific duty rates per kilogram, moving toward conformity with the Customs Valuation Code. However, after two years of reasonable progress in liberalizing tariff and other import practices on almonds, in April 1985 the GOI again tightened import licensing procedures, despite high level U.S. representations for further liberalization.

Currently duty rates are 15 rupees per kilogram on hardshell almonds, equivalent to some 58 percent ad valorem, 28 rupees per kilogram on softshell almonds, equivalent to some 121 percent ad valorem, and 56 rupees per kilogram on kernels, equivalent to some 219 percent ad valorem. However, import licenses are restricted to 20 percent of the CIF value of the importer's purchases of dried fruits and nuts during any of the Indian fiscal years from 1972/73 to 1984/85, and the minimum importable amount has been reduced from 20,000 to 5,000 rupees, thus increasing transaction costs.

Indian authorities have assured us since the 1978 Tropical Products negotiations that they would liberalize the import regime on almonds. Partly for that reason, we have delayed Section 301 and GATT Article XXII action twice over the years. We have made representations regularly and at all levels (including Secretary Block to Rajiv Gandhi in June 1985). Although we were always promised sympathetic consideration, the regime was made more restrictive rather than liberalized. Ambassador Dean has recently raised the issue at the highest levels again. We have asked for a resolution at the March 17-18 Indo-U.S. Economic and Commercial Subcommission meetings.

TRADE EFFECTS

U.S. exporters' primary interest, represented through the California Almond Growers Exchange, is in almond exports, particularly shelled almonds. U.S. almond exports to India have fluctuated from $4.5 million in 1981 to $6.9 million in 1982, $3.5 million in 1983 and 1984, and $6.2 million in January-November 1985, without any clear linkage to changes in India's import policy. The almond industry's main concern is that import restrictions

are preventing it from using the full potential of the Indian market. It estimates that exports would grow by $15-20 million if open general licensing were reinstated. USDA experts feel this amount is overstated.

The United States does not export much in other nuts and dried fruits to India. Our raisin shipments were $58,000 in 1980, then disappeared until 1985 when they rose to $118,000 in the first 11 months. We have not received any industry complaints in this area.

LEGAL ANALYSIS

While Article XI of the GATT prohibits restrictions on imports through import licenses, Articles XII and XVIII generally permit such restrictions if imposed for balance of payments reasons. In 1981 India's balance of payments was negative $3.1 billion, and presumably India could have justified its action.

India's balance of payments reached positive $55 million in FY 1984/85. Therefore, we could argue that it should begin liberalizing those restrictions. However, if we pursue the issue under GATT (as we should), we can hope for a recommendation for only moderate improvement, since India's balance of payments is expected to deteriorate again. India's trade deficit in FY 1984/85 was $4.4 billion. Due to increased imports, the trade deficit for the first quarter of FY 1985/86 reached $1.7 billion, up 80 percent from the same period in FY 1984/85.

If we retaliated under Section 301, India would likely take us to the GATT, where we would be on weak grounds. Or it might counter-retaliate against our high tech exports to India for which export license approvals reached $1.3 billion, up 158 percent since the signing of the technology transfer MOU. If we initiate a 301, we should consider requesting consultations under Article XXII of the GATT.

We can also consult about the almond issue during the GSP annual review. The total 1984 value of imports from India which could be affected by a competitiveness finding is $101 million, although the average duty rate on these products would be only 4 percent ad valorem.

INDONESIA -- INTELLECTUAL PROPERTY

INDONESIAN TRADE PRACTICES

Indonesian copyright law protects only works first published in Indonesia. It does not protect sound recordings at all. The country does not adhere to any international copyright convention, and has no bilateral copyright agreement with the United States. Recent evidence confirms that Indonesians are exporting pirated sound recordings in substantial quantities to the U.S., Europe and the Middle East, and that they may be exporting pirated video-cassettes as well.

Indonesia has only a draft patent law. In addition, the draft law excludes from patentability certain chemical and pharmaceutical compounds.

The U.S. sporadically has expressed concern about the shortcomings in Indonesia's intellectual property protection, but to date the GOI has not reacted concretely. A team of U.S. intellectual property experts traveled to Jakarta in mid-February to present a seminar on intellectual property protection and to consult with GOI officials. In response to U.S. inquiries, GOI officials expressed some interest in exploring a bilateral copyright agreement, which would extend protection to U.S. authors and works. U.S. trade officials consulted with the GOI the next week and again raised U.S. concerns on the lack of protection for U.S. intellectual property rights in the country.

TRADE EFFECTS

In 1983, the International Intellectual Property Alliance estimated that 40 million unauthorized cassette tapes valued at about $75 million were produced in Indonesia. Thus, unauthorized copying in Indonesia for U.S. copyrighted works is an especially serious problem for the U.S. sound recording industry. However, other works and inventions may be affected as Indonesia becomes more technologically advanced.

If Indonesia fails to respond to U.S. concerns, a Section 301 case against Indonesia on its lack of intellectual property protection for foreign works would complement our efforts to control counterfeiting activities in Asia. It the present situation is allowed to continue, Indonesia could become a haven for counterfeiters relocating from elsewhere in Asia where enforcement measures and penalties for such activity have been tightened. Moreover, other leverage with Indonesia is limited. For example, it does not participate significantly in the GSP program.

Representatives of the Recording Industry Association of America, Inc. (RIAA) have contacted USTR recently to discuss the possibility

of a 301 petition against Indonesia. They recently conducted a sting operation in New York, where an Indonesian national and the Commercial Counselor at the Consulate offered for sale counterfeit cassettes, allegedly transported to the U.S. through the diplomatic pouch. The Indonesian national is being prosecuted for customs fraud. RIAA is considering either a narrow case on sound recordings alone, or a broader case possibly in cooperation with the International Intellectual Property Alliance.

LEGAL ANALYSIS

A complaint under 301 against Indonesia because of the lack of intellectual property protection for U.S. works must be judged by the standard of unreasonableness. The lack of protection burdens U.S. commerce, especially the U.S. sound recording industry. We would need to document the extent of the burden and to determine the degree to which other U.S. works protected by intellectual property laws are currently affected.

JAPAN -- FINANCIAL ASSISTANCE TO SMALL AND MEDIUM-SIZE EXPORT FIRMS

JAPANESE TRADE PRACTICES

On December 2, 1985, the GOJ started offering concessionary loans for smaller exporters hit by the rise in the yen. The JFY 86 budget approved by the Cabinet on Dec. 28 provided additional lending authority and subsidy funds for this program. Also, a law with more high-yen relief measures was recently passed by the Diet and came into effect Feb. 25.

1. The loans are to "small and medium businesses", from four specialized government financial institutions set up to lend to such businesses. These institutions receive their capital from the GOJ's "investment budget", the Fiscal Investment and Loan Plan, at 6.8 percent, and on-lend the funds at 5.5 percent.

The lending authority for such concessionary loans, through March 1987, is 300 billion yen ($1.67 billion). The JFY 86 budget provides ¥1.1 billion ($6.1 million) for the interest-rate buy-down.

MITI officials have told us that there are two categories of loans under this authority:

(1) Equipment loans for "small business conversion", for industries and firms designated under the 1976 Small Enterprise Business Conversion Temporary Measures Law ("1976 law"), the 1979 Industrial Areas Small Business Temporary Measures Law, or the new law below; 15 years with a 2-year grade period.

(2 Operating loans for firms facing serious difficulty from yen appreciation, as judged by sales decline and export ratio; maximum repayment period six years, three years grace period.

2. In addition, the MITI-drafted "Designated Small Enterprise Business Conversion Temporary Measures Law" was promulgated Feb. 25; the cabinet order implementing the law was approved Feb. 21. The new law:

(1) Extends for seven years the 1976 law (benefits include loan guarantees as well as eligibility for the loans above);

(2) Provides, for two years, emergency relief measures for yen appreciation, including: expanded loan guarantees; 3-year extension on payback of previous government loans for equipment purchase; refund of past taxes paid.

MITI Minister Watanabe's statement of Feb. 21 on this law asserted: "Its overall objective is to encourage export industries to shift their focus from the foreign to the domestic market. It contains absolutely no export-promoting intent." The new law, and the loan program, are politically important to PM Nakasone and the Liberal Democratic Party, which faces elections in June. Initial USG criticism raised a storm of protest in Japan. This sensitivity and the stake the LDP has in the program make it highly unlikely the GOJ will abolish it. Nevertheless, there are very good reasons to object to it.

At the Economic Sub-Cabinet on Feb. 28 in Tokyo, the U.S. side raised our concerns that this program undercuts the G-5 agreement and could subsidize exports. This week, MITI will finish drafting the implementing regulations for the law; MITI will send officials from Tokyo to explain the law as soon as possible thereafter.

TRADE EFFECTS

128 industrial sectors have been designated for program benefits, accounting for 7.4 percent of total Japanese exports. Designated sectors include many that are import-sensitive in the U.S.: 28 textile sectors (yarn, fabric and apparel), footwear, leather goods, electric-furnace steel, pipe and tube, copper products, flatware, hand tools, fasteners, and cold-finished steel bars. In many of these the ITC has in the past found material injury or serious injury from imports. The designated sectors also include areas where the U.S. has sought to increase our penetration of the Japanese market: plywood, lumber, sporting equipment. Some sectors designated have no hope of converting away from export--orientation: Christmas decorations, sporting arms.

Under Japanese law, a "small and medium business" in manufacturing is any business with capitalization up to ¥100 million ($556,000) or up to 300 employees. Such businesses can include significant competitors (as seen in the designated sectors list here).

MITI states that the average operating funds loan is only ¥25 million, but this can be quite significant in relation to the asset size of these businesses. The loans are being given because the alternative would be bankruptcy, which would remove these firms as competitors in the international marketplace.

This program undercuts the G-5 agreement of last September. It is inappropriate for a wealthy country like Japan with a massive global trade and current-account surplus.

LEGAL STATUS:

1. Article 9 of the GATT Subsidies Code prohibits developed countries from granting export subsidies on industrial products or minerals. Item (k) of the Code's Illustrative List of Export Subsidies defines prohibited export financing subsidies:

> The grant by governments (or special institutions controlled by and/or acting under the authority of governments) of export credits at rates below those which they actually have to pay for the funds so employed...or the payment by them of all or part of the costs incurred by exporters or financial institutions in obtaining credits, in so far as they are used to secure a material advantage in the field of export credit terms.

In this case, the 5.5 percent lending rate is well below the rate which the three government financial institutions concerned have to pay FILP for the funds they use. The 5.5 percent rate is also below the GOJ's cost of comparable funds (the 5-year government bond rate).

Thus, the legal status of this program depends on whether benefits are tied to exporting. We need more information on conditions for eligibility under the 1976 and 1979 laws above and the new law.

2. If they are contingent on export performance, the tax benefits in the draft law are also a prohibited export subsidy (item (f) of the Illustrative List); the same goes for extension on repayment of government loans (item (k) or item (l)).

3. It can also be argued that Japanese relief measures for yen appreciation nullify and impair tariff bindings, as the United States has a right to expect that Japan not frustrate the benefits we would get from a strong yen.

On February 27, the USG cross-notified this program under Article 7:3 of the Subsidies Code, requesting that Japan notify it as a subsidy under Article XVI:1 of the GATT. On March 7, Japan did so. In its XVI:1 notification, the GOJ denied that the program actually is a subsidy in the sense of GATT Art. XVI:1. However, this denial amounts to an assertion, consistent with prior GOJ statements, that the program does not operate directly or indirectly to increase exports or decrease imports. Our information so far on trade effects apperas to contradict this assertion.

IPRG

March 17, 1986

301 Cases

- List to EPC on Thursday

1. Canada -- Alcoholic Bev

- talks
  1) comply w/ 79 understand: only prov w/ any new Ontario - some Δ's in mkup o/ prov back Bf 4/1
  2) deal w/ o/ in FTT: feds OK

- use 301 consid as leverage in talks

[gen approv, but no act til after 4/1]

2. Canada -- Fused Wrist

- Emb assess of GW/PH: clear rule applies to any M/A post July 85

- Q mirror legis? Smith - want EPC guide - policy of auto 301's / mirror legis?

- [to EPC generically, incld energy, guide on what do]

3. Canada - Patent Law

- Clark → Shultz - Can intro legis by 3/27-28 to address US problem

[droop, not time to act]

4. EC - Meat

- Amstutz - not time for 301 - expect good chance of US/EC belated on hormones - still talking on 3d country dir
  - -- hormones: U.S. ind not adverse impact for 1yr
  - -- 3d country: tho time short, still hope to resolve this Summer

- Holmes - §305 allows investig w/o signal that mtrl is set (305 purely fact-finding) no neg for determinatio

- Amstutz - 305 unlikely to help - may not hurt

[rec 305 on 3d country dir only]

5. EC - Enlargement
(IPAG - 2nd time)

6. GDR - Romania - Nitrogen Products

- Amstutz - opposed - increase US cost farming
- not proved subsidy

- McMinn - why self init? but ind come in - avoid int'l pol prob - opposed

[drop - DOC reck econ & AD/CVD #'s]

7. India - Almonds

- McMinn - good case, but Indians in town, give to EPC for consideration

- Amstutz - negotiable if better case cause large similar issue of almost every LDC/NIC key Q - ability of LDC/NIC to import non essential item w/ Bal Pay ↑ ?

[to EPC]

8. Indonesia - Intellectual Property

- Smart, McMinn - not ripe for 301 - try bilateral talks first
- Smith - real prob w/ enforce, esp w/ Inds got can't enforce

[drop]

9. Japan - Assist small firms

- Pease - still not started, little demand, not 301
- Wood - §305? public warning

[drop - Dec St mission - Holmer raise w/ GATT subsidies panel for further investigation]

Japan Trade Policy

- to EPC, 3/24

- Key macro Q - Δ meantime exp for savings / invest

- Smart - must also consider
  -- exports to US
  -- competit in 3rd co mkts
  -- invest here, there, 3rd co
  -- structural issues

- Mathias - need time to react to this paper - Q of this as intragvt paper or USTR paper

- McAllister - no discussion of constraints apart under
  - looking for policy for '86

1. both constraints both J & US op under (both views)
2. timetable, how deal w/ problem
   a. w/ NAK visit
   b. rest of year

[comments in - redraft by Tues COB]