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TOP SECRET NOFORN

ROUTING AND RECORD SHEET

SUBJECT: (Optional)
Economic Policy Council Meeting on US-EC Trade Relations OK

FROM:
David B. Low
National Intelligence Officer for Economics

EXTENSION

NO. NIC 03069-85

25X1

DATE 14 June 1985

TO: (Officer designation, room number, and building)	DATE RECEIVED	DATE FORWARDED	OFFICER'S INITIALS	COMMENTS (Number each comment to show from whom to whom. Draw a line across column after each comment.)
1. EXECUTIVE REGISTRY	13 JUN 1985			
2.				
3. Executive Secretary		6/14		
4.				
5. DDCI	17 JUN 1985			
6.				
7. DCI				(delivered by NIO/ECON) Not referred to USTR - waiver applies.
8.				
9.				
10.				
11.				
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14.				
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DCI EXEC REG

FORM 610 USE PREVIOUS EDITIONS

GPO : 1983 O - 411-632

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The Director of Central Intelligence

Washington, D.C. 20505

National Intelligence Council

NIC 03069-85
14 June 1985

MEMORANDUM FOR: Director of Central Intelligence
Deputy Director of Central Intelligence

FROM: David B. Low
National Intelligence Officer for Economics

SUBJECT: Economic Policy Council Meeting on US-EC Trade Relations

1. There is presently scheduled on Monday, 17 June 1985 at 10:45 a.m. a meeting of the Economic Policy Council to review US-EC trade relations and to discuss specifically a Section 301 action in response to the EC's practice of discriminating against US exports of citrus products. This meeting is scheduled to be chaired by the President.

2. A preliminary meeting was scheduled for 4:30 p.m. today but was cancelled because Treasury Secretary Baker could not attend.

3. While you have not been invited to the meeting on Monday morning, if it occurs (and this is still somewhat up in the air) I believe it is important that you attend. Accordingly, attached are materials as follows:

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David B. Low

This Memorandum Classified SECRET
When Removed from Attachments

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ATTACHMENT C

THE UNITED STATES TRADE REPRESENTATIVE
WASHINGTON
20506

May 30, 1985

MEMORANDUM FOR THE PRESIDENT

FROM: Michael B. Smith, Acting

SUBJECT: Determination Under Section 301 of the Trade Act of 1974 Regarding Discriminatory Tariff Treatment by the European Economic Community on Imports of U.S. Citrus Products

You must decide by June 20 what action, if any, to take in response to the European Community's (EC's) practice of discriminating against U.S. exports of citrus products. An international dispute settlement panel found that this practice distorts conditions of competition in the EC market with respect to trade in oranges and lemons and recommended that the EC reduce its most-favored-nation tariff rate, thus reducing the degree of discrimination. However, the EC has refused to accept the panel's finding or recommendation or to negotiate a compromise solution.

Section 301 gives you broad discretionary authority to respond to foreign practices which deny benefits to the U.S. arising under a trade agreement or which are otherwise unreasonable or discriminatory and restrict U.S. commerce. For the reasons set forth below and described more fully in the attached background document, I am recommending that you exercise this authority in a moderate way by imposing increased duties on U.S. imports of pasta products from the EC until such time as the citrus issue is resolved or the EC provides adequate compensation. This measure will restore the balance of concessions in U.S.-EC trade and will demonstrate a firm yet flexible response to unfair trade practices. The EC will react adversely to this duty increase. Moreover, because the EC has blocked acceptance of the panel's findings, our action will be taken without GATT authorization. Nevertheless, I believe action is necessary both to re-balance the level of U.S.-EC trade concessions and to meet your commitment to respond to unfair trade practices especially in the agricultural sector.

This recommendation has the support of the Departments of Agriculture, Commerce, Justice, Labor, and Treasury as well as the Office of Management and Budget and the Council of Economic Advisors. The Department of State has not taken a position on the recommendation.

ON FILE USTR RELEASE INSTRUCTIONS APPLY

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If you approve this recommendation, we will prepare a proclamation to implement your decision.

_____ Approve (Sign Memorandum at Tab A)

_____ Disapprove

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Background

Based on petitions filed in 1976 by the Florida Citrus Commission, California-Arizona Citrus League, Texas Citrus Mutual, and Texas Citrus Exchange, USTR initiated an investigation concerning the EC's tariff treatment of U.S. citrus exports. As a result of this investigation, we have found that as part of broad preferential trading agreements, the EC has, since the late 1960's, levied a lower duty on imports of citrus from the Mediterranean countries, than that levied on imports from the U.S. The level of discrimination is significant. In some cases the U.S. pays a duty five times greater than that paid by other suppliers. This discriminatory tariff treatment has impaired the ability of U.S. citrus exporters to market their fruits in the EC and, in our view, is inconsistent with the EC's obligations under international trading rules.

Nevertheless, recognizing the political importance to the EC of the EC-Mediterranean agreements, the U.S. made extensive efforts over a period of years to resolve this issue through bilateral discussion rather than mount a legal challenge to EC practices. The EC, however, rebuffed all such efforts.

The Trade Policy Committee therefore decided, in November, 1981, to challenge the EC's citrus preferences under the rules and procedures of the pertinent international trade agreement, the GATT. In January, the panel of experts appointed by the GATT to examine the U.S. complaint found unanimously that the EC practices had distorted competitive conditions with respect to two key U.S. exports, oranges and lemons. The panel recommended that the EC reduce the most-favored-nation rate of duty on these items. The EC, however, has refused to accept the findings and has effectively blocked further action on the matter in the GATT. The U.S. made further efforts to resolve the issue bilaterally: Secretary Brock personally urged Willy De Clercq, the EC Commissioner for External Relations and Commercial Policy, to seek a compromise solution, and Secretary Schultz sent letters to his counterparts in the EC Member States indicating our willingness to negotiate a reasonable solution and warning of the likelihood of unilateral action by the U.S. if no resolution is reached. The EC again rejected the U.S. overtures.

As a result of the EC's unfair practices on citrus products, the level of trade concessions between the U.S. and EC is no longer in balance. Because the EC will not implement the dispute settlement panel's recommendation or otherwise provide adequate compensation, the U.S. must act to re-balance the level of trade concessions. This can be accomplished by imposing increased duties on imports of EC products equivalent to the damage our exporters incur from the EC discriminatory tariffs.

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I therefore recommend that you proclaim an increase in duty on pasta imports from the EC to a level of 40% ad valorem on pasta not containing egg and 25% ad valorem on pasta containing egg. This duty increase is a very moderate response to the EC's unfair practice. The value of concessions being withdrawn (approximately $30 million) is conservative compared with the $48 million estimated annual trade damage to the U.S. citrus industry resulting from EC preferences. Moreover, the duty increase could be rescinded at such time as the EC modifies its practice with respect to citrus or otherwise compensates the U.S. The selection of pasta for this action is appropriate because pasta was the subject of an earlier U.S.-EC trade dispute in which the EC also blocked a GATT decision favorable to the U.S. Because the EC has blocked further action in GATT, the U.S. does not have GATT authorization to take this measure. Thus we run the risk that the EC will accuse the U.S. of ignoring our own international obligations, or that the EC will retaliate by restricting imports of other U.S. products.

However, we believe we have no choice but to take that risk. We cannot credibly defer action to allow further time for negotiation, because the EC has consistently, clearly and publicly rejected the possibility of a negotiated solution. In these circumstances, failure to act will have adverse implications for both domestic and international trade policy. An essential corollary of our efforts to resist protectionist pressures is our commitment to combat unfair foreign trade practices and to seek improved international rules. While actual trade levels involved in the citrus case are relatively small, failure to act will impair the credibility of an approach dependent on international rules and could be used domestically as a symbol of our unwillingness to respond to unfair practices and will encourage those in Congress who prefer to administer trade policy through legislation. Inaction in the face of the EC's refusal to respect panel findings will also encourage other countries to flout international rules.

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Memorandum of Determination Under Section 301

of the Trade Act of 1974

Memorandum to the United States Trade Representative

Pursuant to Section 301(a) of the Trade Act of 1974, as amended (19 U.S.C. 2411(a)), I have determined that the preferential tariffs granted by the European Economic Community (EEC) on imports of lemons and oranges from certain Mediterranean countries deny benefits to the United States arising under the General Agreement on Tariffs and Trade (GATT), are unreasonable and discriminatory, and constitute a burden and restriction on U.S. commerce. I have further determined that the appropriate course of action to respond to such practices is the withdrawal of equivalent concessions with respect to imports from the EEC. I will therefore proclaim an increase in duties on pasta products classified in items 182.35 and 182.36 of the Tariff Schedules of the United States imported from the EEC. This action has been necessitated by the unwillingness of the EEC to negotiate a mutually acceptable resolution of this issue. At such time as the United States Trade Representative makes a determination that a mutually acceptable resolution has been reached, I would be prepared to rescind this measure.

Reasons for Determination

Based on petitions filed by the Florida Citrus Commission, the California-Arizona Citrus League, the Texas Citrus Mutual and

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the Texas Citrus Exchange, the United States Trade Representative initiated an investigation in November, 1976 concerning the EC's preferential tariff treatment with respect to citrus imports from certain Mediterranean countries. The petitions alleged that these discriminatory tariffs, which are granted in the context of broader trade agreements with the Mediterranean countries, are inconsistent with the most-favored-nation principle of the GATT and placed U.S. exporters at a competitive disadvantage in the EC market. Similar complaints had been filed by the U.S. industry in 1970 and 1972 under Section 252 of the Trade Expansion Act of 1962.

As a result of this investigation, we have found that since the 1960's, the EC has levied a higher duty on imports of citrus from the U.S. than that levied on imports from certain Mediterranean countries. The level of discrimination is significant. In some cases the U.S. pays a duty 5 times greater than that paid by other suppliers. This discriminatory tariff treatment has impaired the ability of U.S. citrus exporters to market their fruits in the EEC and is, in the view of the U.S., inconsistent with the EEC's obligations under the GATT.

Nevertheless, recognizing the political importance of these preferential tariffs to the EEC, the United States made extensive efforts over the course of a number of years to resolve the matter through bilateral consultations rather than mount a legal challenge against the EEC in the GATT. The U.S. also tried to resolve this issue in the context of tariff concessions granted during the Tokyo Round of Multilateral Trade Negotiations. With

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the exception of a few minor tariff reductions resulting from the Tokyo Round, these efforts were without success. Following the conclusion of the Tokyo Round, the U.S. initiated consultations under the provisions of the GATT, but the EEC again rebuffed all efforts to reach a compromise solution.

With any possibility of a negotiated settlement thus ruled out, the U.S. invoked the dispute settlement procedures of the GATT as the only alternative means of seeking a redress of our complaint. In 1983, a panel was established to review the U.S. complaint. Throughout this procedure, the U.S. has continued to demonstrate its willingness to seek a mutually acceptable solution to this problem. For example, the U.S. agreed to the unusual step of allowing the Director-General of GATT to attempt to arbitrate the dispute before pressing its request for formation of a dispute settlement panel. Unfortunately, the attempt failed. The EEC rejected all efforts at compromise.

In December, 1984, based on a voluminous record, the panel found unanimously that the EEC preferences nullified and impaired U.S. benefits arising under the GATT with respect to U.S. exports of oranges and lemons, two of the eight categories of U.S. citrus exports affected by the tariff preferences. The panel recommended that the EC reduce its MFN rate of duty on fresh oranges and lemons no later than October 15, 1985.

Although the panel did not rule on this issue, the United States continues to believe, that the EEC citrus preferences are inconsistent with the most-favored-nation principle of the GATT, and thus nullify or impair U.S. benefits with respect to exports

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of the other citrus items as well as lemons and oranges. Nevertheless, the U.S. has been willing to accept the panel's more limited recommendation for the following reasons. The sole interest of the U.S. in bringing this issue to the GATT has been to obtain the elimination or reduction of a barrier to U.S. citrus exports. While the panel's recommendation does not call for the elimination of the barriers, we believe its implementation by the EEC would significantly increase access for key U.S. citrus exports to that market. Moreover, the panel's recommendation does not require the EEC to take action inconsistent with its preferential trading arrangements; indeed it would result in lower tariffs for the preference receiving countries as well.

The EEC, however, has been unwilling to accept either the panel's findings or recommendation and has effectively prevented a resolution of this issue in the GATT. Thus, U.S. attempts to resolve this problem at the bilateral or multilateral level have not succeeded.

In light of the results of the USTR's investigation, I believe we must recognize that the level of trade concessions between the U.S. and EEC is no longer in balance. We estimate that the value of annual U.S. exports of oranges and lemons would increase by more than $48 million if the EC had implemented the panel's recommendation.

The EEC's unwillingness to implement the panel's finding or to otherwise provide adequate compensation to the U.S. requires us to re-balance the level of concessions in U.S.-EC trade. Increasing the duty on pasta imports from the EC is a reasonable and appropriate means by which to achieve this.

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ISSUE:

In accordance with the TPRG decision of March 27, and because the U.S. has been unable to resolve the citrus dispute either bilaterally or through the GATT, USTR is required, no later than May 30, 1985, to submit a recommendation to the President under Section 301. The recommendation is to call for the withdrawal of concessions on imports from the European Community equivalent to the loss in benefits to the U.S. arising from the EC's discriminatory tariff preferences until such time as a mutually acceptable resolution to this dispute is achieved. We must decide which EC products are to be subject to the withdrawal of concessions.

RECOMMENDATION:

USTR should recommend to the President that he increase the duty on the following two products as described below. The duty increase would apply only to imports of these products from the EC.

Commodity	TSUS No.	Present Duty	Proposed Duty
macaroni, not containing egg or egg products	182.35	.12¢/lb. (.5% AVE)	40% (equal to approx 10¢/lb)
macaroni, containing egg or egg products	182.36	.1¢/lb. (.25% AVE)	25% (equal to approx 10¢/lb)

RATIONALE:

Because the tariff preferences have been in existence for so long, it is difficult to quantify with precision the annual loss in orange and lemon exports caused by the preferences. We believe, however, that it is reasonable to assume we would have the same share of the EC market today that we held in the period prior to imposition of the preferences. Using a market share analysis, (See Appendix I) we estimate the trade loss at $48 million per year. In 1984 imports of pasta from the EC under the two categories above were valued at $29.4 million. (If imports from Spain and Portugal, who will soon be members of the EC are included, this number increases to nearly $29.6 million).

Duty increases of the magnitude proposed are expected to result in a sharp reduction of EC pasta exports to the U.S. However, this is not expected to have an adverse impact on U.S. consumers since imports are available form other sources and U.S. production accounts for the majority of U.S. consumption.

CLASSIFIED BY Clair F. Wilcox

DECLASSIFIED ON OADR

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While withdrawing concessions with respect to these products does not offset the total estimated lost trade, we believe it constitutes an appropriate re-balancing of concessions for several reasons.

As noted above, the $48 million figure, while a best estimate, is only an estimate. It is possible the EC could raise credible arguments for using a lower figure. We wish to avoid a situation in which the President makes a maximum withdrawal of trade concessions based on a $48 M trade loss figure and then needs to adjust the withdrawal because of an adjustment to the trade loss figure. Moreover, our objective in this action is not to be punitive. Indeed, given the political sensitivity of this issue, a conservative action by the U.S. is appropriate.

By focusing on pasta, we limit the main impact to a single EC member, i.e. Italy. This should reduce the likelihood of other EC members, not affected by the pasta duty increase, supporting a retaliatory action by the EC with all the risks attendant upon an escalation of the dispute. It is appropriate to focus on Italy because, as the major EC producer of oranges and lemons, it has been the major stumbling block to a negotiated reduction of the EC duties.

Finally, by selecting pasta rather than other products, we are providing a remedy to an industry which has suffered from EC unfair trade practices. Despite a panel ruling that EC pasta subsidies are inconsistent with the Subsidies Code, this industry has also been denied the remedy to which it was entitled because the EC blocked adoption of the panel report. Thus action to raise tariffs on EC pasta exports to the U.S. both provides a remedy to the pasta industry and signals the EC that we will take reasonable actions to enforce our rights under trade agreements, when, through an abuse of process, the dispute settlement procedures of GATT cannot work.

GATT IMPLICATIONS:

Because the dispute settlement process has been deadlocked, we do not have GATT authorization to raise the duty on pasta. Without that authorization, the U.S. action could be successfully challenged as GATT inconsistent. We have retaliated without GATT authorization on only one previous occasion (1974 Cattle War with Canada). The U.S. believes it is nevertheless justified in taking this action in part because the panel unanimously ruled in our favor. Thus, we should not be surprised if other countries, faced with a situation in which a favorable panel report is blocked, take unilateral action.

We should also be prepared to decide whether further action by the U.S. (including possible retaliation) is needed in the event the EC retaliates against the U.S. for this action.

Despite these implications, the proposed action is appropriate. Inaction by the U.S. establishes the precedent that panel

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reports can be blocked with impunity, thus undermining the integrity of the GATT system. It also invites Congressional action to deal with barriers to U.S. exports.

BACKGROUND:

Origin of the Dispute and Efforts to Negotiate a Solution

The EC's preferential tariffs on Mediterranean citrus imports have been the subject of several complaints by the U.S. industry. The first two complaints were filed in 1970 and 1972 under Section 252 of the Trade Expansion Act of 1962. The last was filed in 1976, under Section 301, alleging that EC preferences on oranges, tangerines, lemons, grapefruit, pectin, grapefruit segments, and orange, lemon, and grapefruit juice, were inconsistent with the MFN obligation of Article I.

Although the industry sought the elimination of the preferences, the U.S. followed a strategy of seeking MFN tariff reductions as a means of narrowing the preference. Through these efforts, the U.S. obtained some temporary duty reductions in the early 1970's and permanent duty reductions were obtained in the 1974 enlargement. The U.S. obtained further minor reduction in 1979 during the Tokyo Round. Since that time nine bilateral discussions were held during which the U.S. unsuccessfully offered tariff concessions in return for citrus tariff reductions.

Our extended bilateral efforts with the EC to resolve this issue have taken place in the context of the Casey-Soames understanding, which attempted to address U.S. trade problems in citrus caused by the preferences while recognizing the importance of the preferences to the EC. Among other things, this understanding called for: 1) the EC to eliminate reverse preferences with specified LDC's; 2) the U.S. to agree not to question the Article XXIV consistency of the EC arrangements; and 3) the EC to seek solutions where the preferences caused problems for U.S. trade interests. Because of this accommodation, the U.S. for years resisted a direct GATT challenge of the preference agreements, relying instead on multilateral negotiating opportunities and bilateral discussions under the Casey-Soames understanding to resolve the problem. Indeed, the U.S. stretched the interpretation of the time limits added to Section 301 in 1979 nearly to the breaking point in order to avoid breaching Casey-Soames.

During consultations under Article XXII and XXIII, the EC rebuffed all efforts at compromise. The EC took the position that the preferences had not, in fact, caused problems. The EC Commission maintained also that it did not have, and would not seek, negotiating authority on this issue from the Member States.

Initiation of GATT Dispute Settlement Procedures

With any chance of a negotiated settlement thus ruled out, the TPC, on November 12, 1981, decided to pursue dispute settlement in

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the GATT as the only alternative. A last-ditch effort to arbitrate this dispute was made by the Director-General of GATT in August-September 1982. However, the EC rejected all offers of compromise. A panel was established in 1983 and in December, 1984 ruled unanimously that the EC preferences had nullified U.S. benefits under GATT with respect to exports of oranges and lemons.

In January 1985, prior to submission of the panel report to the GATT Council, the EC informed the U.S. that it intended to block adoption. On the fringes of the Kyoto Quadrilateral meeting, the USTR again suggested to EC Commissioner De Clercq that a solution be negotiated. De Clercq rejected the proposal.

When the GATT Council took up the citrus report on March 12 and April 30 the U.S., supported by some other CP's, proposed adoption of the panel report and recommendation. The EC and preference recipients strongly criticized the report and opposed adoption. U.S. offers to drop the report if the EC carried out the recommendation met with no response. Moreover, further diplomatic efforts to resolve the issue, including a letter from Secretary Schultz to foreign ministers of the EC member states, have been unsuccessful in convincing the EC to negotiate.

The EC's view is colored by its commitment to maintain a special trade relationship with the Mediterranean preference recipients for economic and political reasons. In the face of the erosion of the value of the current preferences by Spanish accession to the EC in 1986, the present EC members have accepted the EC reasoning that further concessions to the U.S. are impossible. The dispute settlement procedure has thus reached an impasse and cannot resolve the dispute.

TPRG ACTION:

On March 27, the TPRG considered what action to take in the citrus case. The TPRG noted that in the panel's view the EC preferences had, in effect, upset the balance of trade concessions between the U.S. and EC and that under such circumstances the U.S. would be entitled to re-balance the level of concessions by withdrawing specific concessions to the EC. The TPRG also recognized that because the EC was blocking the GATT process, the U.S. did not have specific GATT authorization to withdraw concessions and that the EC could therefore challenge the legitimacy of a U.S. withdrawal such as that proposed with respect to pasta. In such circumstances, the EC would likely receive a favorable panel finding. If so, we would link the two panel findings, not allowing one to be adopted without the other. The EC could, of course, also immediately retaliate against the U.S. without GATT authorization (in doing so, it would lack not only GATT approval but also the moral support of a favorable panel finding). Nevertheless, the TPRG believed that reasonable action to re-balance the level of concessions was appropriate to enforce U.S. rights under the GATT if the EC would not negotiate a solution. In the TPRG's view, lack of action would be detrimental to our interests because it would sig-

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nal GATT members that Panel reports can be blocked with impunity and would revive Congressional efforts to make 301 action mandatory.

Therefore, the TPRG agreed to deem dispute settlement ended (and thus trigger the 30-day statutory deadline for a recommendation to the President) at the April 30 GATT Council meeting if the EC continued to block the report. It also directed that maximum efforts be made to negotiate a solution with the EC. Finally, it directed the 301 Committee to propose withdrawals of concessions on appropriate EC products.

As noted above, all diplomatic efforts to resolve the issue have failed and the April 30 GATT meeting ended in a deadlock.

On May 10, USTR held a public hearing on the issue of what recommendation should be made to the President. Testimony in favor of withdrawal of concessions was given by the California-Arizona Citrus League, Sun-Diamond and the National Pork Producers' Council. The Florida Citrus Commission advocated establishment of an international commodity arrangement for citrus to deal with a wide range of citrus issues, including preferences. The Commission stated it would not oppose a withdrawal of concessions if efforts to negotiate such an agreement failed. USTR also received testimony favoring withdrawal of concessions from the American Farm Bureau Federation, the International Apple Institute, the Northwest Horticultural Council, and the National Pasta Association and the National Association of Growers and Processors for Fair Trade, the California Farm Bureau Federation, the Cling Peach Advisory Board and a number of Members of Congress.

Testimony in opposition to withdrawal of trade concessions with respect to specific products has been received from the National Association of Beverage Importers and the French Federation of Wine & Spirits Exporters (wine, spirits and beer); Mars, Incorporated, Commerce Foods Inc., the Food & Confectionery Group of the American Association of Exporters and Importers, and Peter Paul Cadbury, Inc. (candy); the International Bottled Water Association and the Perrier Group (mineral water); the Apple Group of the Association of Food Industries (apple juice); and the National Association of Specialty Food Trade (specialty food items, wines & candy). Only the last group opposed restrictions on pasta on the grounds that its members, as importers, would be adversely affected by import restrictions.

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APPENDIX I

Citrus Case: Withdrawal of Concessions

Calculation of Lost Trade

Using a market share approach as described below, the trade loss resulting from EC preferences is 17,499,000 for oranges and 30,707,500 for lemons for a total trade loss of $48,206,500.

EC Imports of Oranges

	TOTAL (Vol.) (000 MT)	U.S. Vol. (000 MT)	U.S. %	Preference Countries Vol. (000 MT)	Preference Countries %
1966-69*	2039	67	3	1,684	83
1981-83	1622	18	1	1,349	83

If U.S. had maintained 3% share of 1981-83 market, it would have sold a total of 48,700 MT's or an additional 30,700 MT's over the 18,000 actually sold. Assuming a price of $570/MT, the trade loss on these additional tons amounts to $17,499,000.

EC Imports of Lemons

	TOTAL (Vol) (000 MT)	U.S. Vol. (000 MT)	U.S. %	Preference Countries Vol. (000 MT)	Preference Countries %
1966-68	117	45	38	66	56
1981-83	267	15	6	228	85

If U.S. had maintained 38% share of the 1981-83 market, it would have sold a total of 101,500 MT or an additional 86,500 MT over the 15,000 actually sold. Assuming a price of $355/MT, the trade loss would be $30,707,500.

*1968 was excluded because it was a freeze year.

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THE WHITE HOUSE

WASHINGTON

June 14, 1985

MEMORANDUM FOR THE ECONOMIC POLICY COUNCIL

FROM: ROGER B. PORTER RBP

SUBJECT: Agenda and Papers for the June 17 Meeting

The agenda and papers for the June 14 meeting of the Economic Policy Council are attached. The meeting is scheduled for 10:30 a.m. in the Cabinet Room.

The first agenda item is an overview of U.S.-E.C. trade relations. At the June 5 meeting, the Council requested the Department of State and the Office of the U.S. Trade Representative to prepare a strategy paper for U.S.-E.C. trade relations. A copy of that paper was circulated to Council members on June 11.

The second agenda item concerns the Section 301 Citrus case. The President must decide by June 20 on what action, if any, to take in response to the European Community's practice of discriminating against U.S. exports or citrus products. A memorandum on this issue was circulated to Council members on June 3 and discussed at the June 5 meeting.

The third agenda item concerns the status of the President's steel program announced on September 18, 1984. The Office of the U.S. Trade Representative has prepared a paper on the President's Steel Program which reviews the status of steel trade negotiations, the recent pattern of imports, and the options the Administration faces on four specific issues. This paper has not yet been reviewed by other departments and agencies. It lays out the central issues and options for discussion and is not intended to serve as the basis for reaching any decisions at this meeting.

Attachments

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THE WHITE HOUSE

WASHINGTON

ECONOMIC POLICY COUNCIL

June 17, 1985

10:30 a.m.

Cabinet Room

AGENDA

1. U.S.-E.C. Trade Relations
2. Citrus Section 301 Petition
3. Status of the President's Steel Program

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June 14, 1985

President's Steel Program

Issue: The President's steel program is at a critical juncture. The Administration needs to decide what additional measures, if any, need to be taken to ensure full implementation of the program.

This paper reviews the status of steel trade negotiations the U.S. Trade Representative has held, the recent pattern of imports, and the options the Administration faces on four specific issues:

1. The substantial increase in imports of "consultation products" from the European Community (EC);

2. The greater-than-expected shipments from Canada;

3. Surges from new suppliers that have not previously been significant exporters to the U.S.;

4. Complaints about the adequacy of the semifinished steel target.

Status and Effects of Negotiations

Since September 18, 1984, the U.S. Trade Representative has held negotiations with 16 countries aimed at concluding voluntary restraint agreements. (Table 1 summarizes the status of these negotiations as of June 13, 1985.) Thus far, the U.S. has reached agreements with 14 countries, of which 12 have been formally signed and implemented.

These agreements cover about 58 percent of total imports and, everything else being equal, will reduce the 1984 finished steel import level from 26 percent by about 4.6 percentage points. The EC steel arrangements cover another 22 percent of total imports. With the negotiation of strengthened provisions on pipe and tube imports, total imports from the EC should fall by about 0.7 percentage points to about 5.2 percent. It should be noted that the 100,000 ton exception for EC line pipe recently provided for the All American Pipe Line will increase imports by about 0.1 percentage points. Thus, all of the agreements should reduce imports by a maximum of about 5.3 percentage points and would likely reduce them by about 5.1-5.2 points. Such a reduction would result in imports still being about 2 percentage points above the 18.5 percent target.

The agreements are gradually having an effect on imports as shown by the following table:

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	Imports as a Percentage of Apparent Consumption	
	Including Semifinished	Excluding Semifinished
1984 - Year	26.6	25.8
1984 - Fourth quarter	28.5	27.2
1985 - January	30.9	29.6
February	27.1	26.0
March	24.5	24.1
April	23.0	n.a.

As a number of suppliers -- including Japan -- reduce exports to compensate for overshipments in the October-March period, import penetration should fall even further.

Surge of Imports

Despite the effectiveness of the agreements in reducing imports, these reductions have been partially offset by surges of imports from three major sources:

- o European Community. Imports of unlicensed "consultation products" in 1984 were 224 percent above the 1981 benchmark and further increases have occurred this year (see Table 2). This increase has added about 0.4-0.5 percentage points to the finished steel import level. The decision to aim for an 18.5 percent target assumed a 4.9 percent share for the EC. The pipe and tube arrangement would reduce the 1984 5.9 percent level to about 5.2 percent.

- o Canada. The decision not to seek a voluntary restraint agreement from Canada resulted from a combination of two factors: (1) its steel producers are not very vulnerable to antidumping and countervailing duty charges; and (2) as an exporter of numerous small overland shipments, it would be uniquely affected by any formal restraint agreement. (As the program has evolved, the licensing requirement would minimize the Customs clearance problems that concerned the Canadians.) Despite several assurances that Canada will not exploit the restraints of others, Canadian shipments continue at the 2.9-3.2 percent level, well above the historical level or the 2.4 percent level originally assumed in the program.

- o New Suppliers. There has been an explosion of new suppliers to the U.S. market in recent years, including unlikely suppliers like Thailand, Algeria, Portugal, and Zimbabwe. In some cases, the rate of increase has been dramatic with countries reaching a significant market share in a limited number of products in just one or two years. (Table 3

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summarizes some of the most dramatic examples.) The program originally assumed no or insignificant imports from new suppliers, which now account for approximately 2-2½ percent of domestic consumption.

Policy Options

Issue 1: Europe: How should the Administration address the substantial increase in imports of "consultation products" from the EC?

Secretary Baldrige has succeeded in establishing a framework for negotiation of a comprehensive solution to our steel trade dispute with the EC. The framework comprises three major elements:

1. Negotiation by July 15 of a solution to the dispute over the "consultation products" that were not specifically limited by the 1982 Arrangement.

2. Agreement by October 31 on extending the scope and duration of the Arrangement (which expires December 31, 1985) to make it consistent with the other voluntary restraint agreements under the program.

3. Immediate release of 100,000 tons of line pipe to permit the uninterrupted construction of the All American Pipe Line.

The Administration clearly prefers a negotiated settlement to a confrontation over the consultation products. However, the Administration should consider now what action, if any, to take if the U.S. and EC cannot agree by July 15 on a solution to the dispute over the consultation products. There are strong indications that a badly fragmented EC industry will stoutly resist Commission efforts to implement the burden-sharing required by any solution. Hence, the Administration may well face the decision of what action to take after July 15.

Option A: Communicate during the negotiations that if an agreement is not reached by July 15, the Administration will unilaterally enforce the provision on consultation products in the 1982 Arrangement.

Advantages

- Communicating a decision to take unilateral action as a last resort would bolster the Administration's position in the current negotiations.

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- This approach increases the prospects for success in the current negotiations, which in turn would make it more likely that the Administration will reach the 18.5 percent target. Without a reduction in the consultation product imports from their 1984 level, which was twice the 1981 benchmark for finished products and seven times the 1981 benchmark for semifinished products, it is difficult to see how the 18.5 percent target can even be approximated.

- The prospect that the Administration would take unilateral action if an agreement is not reached by July 15 increases the likelihood that the EC Commission would explore a quasi-negotiated settlement based on a U.S. unilateral action to which the EC could acquiesce.

Disadvantage

- The EC has threatened to retaliate if the U.S. takes unilateral action. However, it may acquiesce to the action if the U.S. action were sufficiently limited.

Option B: Decide now that if an agreement is not reached by July 15, the Administration will fold the issue into the broader renegotiation of the Arrangement.

Advantages

- This approach would avoid confrontation with EC at a time when there are numerous other contentious issues on the agenda (e.g., agricultural exports).

- The EC would not retaliate against the U.S.

Disadvantages

- Avoiding any action now would seriously jeopardize the Administration's credibility in negotiations across a wide range of issues since we have already conceded to allowing the conditional entry of 100,000 tons of line pipe.

- A delay in resolving this problem makes it more likely that imports of these products will continue to surge, making it more difficult for the Administration to come close to meeting the 18.5 percent target.

Issue 2: Canada: How should the Administration address the greater than expected shipments from Canada?

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After the EC, Canada is the only source that by itself could disrupt the program. Both the Canadian Government and its steel producers have repeatedly assured the U.S. Government that they want to cooperate, but on several occasions have told the U.S. steel industry that they are not obligated to do anything at all.

The nature of U.S.-Canada trade is complex, with significant tonnage traded between steel producers on both sides of the border. Even accounting for such trade though, Canadian shipments of such products as pipe, wire products, and cold finished bar appear to have increased substantially.

Option A: Seek to negotiate a voluntary restraint agreement with Canada at the 1981-1983 level (2.4 percent) or higher.

Advantages

- This option would treat Canada on the same basis as other major steel exporters to the U.S., including some countries which can also claim to not dump or subsidize exports.
- A formal restraint would be more effective than the status quo in reducing overall imports by as much as 0.8 percentage points.

Disadvantages

- The political fallout from the U.S. pressuring Canada for a voluntary restraint agreement could be considerable.
- Canada would likely object that it should be excluded from the program because its producers trade fairly.
- Canada would argue that a formal restraint presents unique customs clearance problems for small, overland Canadian shipments.
- This restraint could disrupt certain intracompany trade across the border.
- The U.S. will have little leverage to encourage Canada to agree to voluntary restraint because of their relative invulnerability to unfair trade complaints.

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Option B: Continue to express concern over the level of current shipments especially in sensitive products and seek to enhance customs cooperation to minimize transshipments and fraudalent practices by third countries.

Advantages

- This option would avoid the political fallout that would result from the U.S. pressuring Canada for a voluntary restraint agreement.
- This option avoids substantially complicating trade between steel producers across the U.S.-Canadian border.

Disadvantages

- This option is unlikely to reduce Canadian steel imports significantly.
- Continuing to exempt Canada from the program maintains resentment by other "fair traders" which have had to sign formal restraint agreements.

Issue 3: New Suppliers: How should the Administration address the surge in imports from new suppliers?

Certain domestic steel brokers have sought to stay one step ahead of the program by finding new suppliers as other suppliers cut back their exports. It is difficult to control the inflow of a new supplier because our negotiating leverage over it is visible only after it has exported a significant quantity of dumped or subsidized steel. An importer is able to attract new suppliers by moving large quantities of steel rapidly into the market, with the expectation that the worst outcome would be a voluntary restraint agreement guaranteeing the exporter a market share it never had before.

The result may be that for the forseeable future, the Administration will have to pursue new suppliers one by one using recently filed cases as leverage. Ultimately, there will have to be many agreements, instead of the few initially expected. Moreover, these new suppliers can force the Administration to retreat from the overall 18.5 percent target because the market share guaranteed by each new agreement must be added to the market share already guaranteed to suppliers under the original program.

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Option A: While imports from new suppliers are at relatively low levels, aggressively pressure new suppliers to agree to restrain shipments and/or self-initiate unfair trade actions against them (including Section 301 petitions).

Advantages

- Only by addressing the imports from new suppliers at low levels can the Administration hope to come close to the 18.5 percent target.
- Some steel producers, led by Bethlehem, prefer this approach in which surges could be controlled before they rise to high levels.

Disadvantages

- It may be difficult to persuade new suppliers to agree to restrain shipments at the current levels at which they are exporting to the U.S.
- Some steel producers, particularly wire rod producers, generally oppose further voluntary restraint agreements, preferring remedies under the unfair trade statutes. These producers believe they are cost competitive with any producer and have been pressured to drop their current cases (20 or more) as part of the agreements reached to date.

  In most of these rod cases, remedy under an unfair trade statute would have severely curtailed imports. In the case of Argentina, this remedy has totally eliminated its rod exports to the U.S. for an entire year.

Option B: Continue to rely on the leverage generated by domestic industry unfair trade cases and wait for foreign governments to request negotiations to settle them.

Advantages

- Given the likely reluctance of new suppliers to agree to restrain shipments, this may be the only realistic approach.
- This approach focuses the Administration's response to this surge in imports on unfairly traded steel.

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Disadvantages

- o This approach is likely to result in eventually negotiating voluntary restraint agreements with new suppliers only after they have attained a significant market share, with dozens of restraint agreements and total imports significantly above the 18.5 percent target.

- o This approach runs the risk that otherwise acceptable agreements with foreign countries could be blocked by some domestic producers refusing to withdraw their unfair trade cases.

Issue 4: Semifinished Steel: How should the Administration address the apparent inadequacy of the semifinished steel target?

At the insistence of the major integrated producers, the Administration agreed to a target of 1.7 million tons of semifinished steel: ingots, billets, blooms, and slabs, all of which are subsequently rolled into intermediate or final shapes. While that target would represent a record level of imports, it is viewed by some producers as inadequate given the needs of the industry over the next 5 years.

Estimates of demand for semifinished imports run as high as 5 million tons with the next 2-3 years. Reports suggest that if semifinished imports are limited to the 1.7 million ton target, a number of domestic producers will be forced to curtail operations they otherwise would have had running.

Semifinished steel is imported for several reasons:

- o For competitive reasons, no producer wants to rely for its raw material supply on a direct domestic competitor.

- o Continuously cast slabs and certain types of billets will not be readily available in the U.S. until considerable additional investment has taken place.

- o Where steelmaking and finishing facilities are not balanced, semifinished imports permit the fuller utilization of rolling mills, helping to drive down unit costs.

- o During start-up or modernization, individual mills need external sources of semifinished steel to stay in business.

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A number of U.S. producers are heavily dependent on imported semifinished steel, for example, California Steel, Tuscaloosa Steel, Cyclops, and Raritan River. Other producers, including Bethlehem and LTV, import at least some semifinished steel and are reported as having approached Brazilian, Venezuelan, and EC producers for more. Even U.S. Steel is reported to have discussed importing semifinished steel from South Korea.

Some observers may find hypocritical the pressures by integrated producers to keep the 1.7 million ton semifinished target while importing such products themselves. When pressed, senior management of integrated producers will declare that they would cease all semifinished imports if necessary, although their purchasing managers continue to explore the possibility of increasing imports.

Thus far, USTR has allocated about 1.5 million tons to the countries with voluntary restraint agreements. Imports from the EC (666,000 tons annual rate) and Sweden (300,000 tons annual rate) continue to be strong. But imports from Canada, the only other unrestrained foreign supplier, have declined sharply to about 70,000 tons per year. However, without a sharp reduction in the EC level of at least 50 percent, it will in all likelihood not be possible to keep close to the target of 1.7 million tons.

Option A: Attempt to maintain the 1.7 million ton target through a combination of voluntary restraint agreements and the filing of unfair trade cases.

Advantages

- Maintains commitment the Administration made to industry leaders in September.
- Such a restriction would help producers (e.g., Bethlehem) investing in new steelmaking equipment.

Disadvantages

- Such a restriction would severely curtail operations of smaller producers who want to increase finished steel production with the aid of semifinished imports.
- Maintaining this target would make it harder to reach agreement with the EC given the rate at which it has thus far exported semifinished steel to the U.S.
- It would also pose a problem for Brazil whose minimum contractual commitments already exceed the 700,000 ton limit agreed to in December.

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- This limit places the U.S. Government in the awkward position of having to allocate semifinished imports among domestic companies and thus determining which particular firm will be able to operate at desired levels.

Option B: Raise the limits negotiated to a level closer to predicted peaks.

Advantages

- Such an increase in limits would enable some domestic producers to continue to produce finished steel.
- An increase in the semifinished target would provide the Administration additional leverage with countries wishing to export finished steel to the U.S.

Disadvantages

- Some integrated producers may object that the Administration has reneged on its commitment to the 1.7 million ton target.

Option C: Impose a tariff on all semifinished imports.

Advantages

- Although the price of semifinished imports would be higher than it otherwise would be, domestic producers would at least be able to import any quantity they need to meet demand.
- A tariff system would obviate the need for the U.S. Government to allocate shares of semifinished imports among domestic companies.

Disadvantages

- Some integrated producers would likely object that the Administration has reneged on its commitment to the 1.7 million ton target.
- If the tariff is not at a high enough level, large semifinished imports would jeopardize the modernization efforts of a number of integrated producers.

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Option D: Impose a tariff-rate quota on all semifinished imports, with tariff-free quantities based on the voluntary restraint agreements already negotiated and on historical levels for other suppliers (principally Canada, Sweden, and the EC).

Option D would have the same advantages and disadvantages as Option C except the following.

Advantages

- A tariff-rate quota would permit importers to enjoy some benefit from the limits they have already negotiated.

Disadvantages

- Unlike a simple tariff, the Administration would be forced to take action against specific countries, in particular Canada and Sweden, which have thus far expressed no interest in negotiating voluntary restraint agreements.

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TABLE 1

STATUS OF VRA TALKS

	Implemented	Pending Signature	Under Negotiation	Import 1984	Penetration VRA
Japan	X			7.05	5.80
Korea	X			2.48	1.90
Brazil	X			1.42	.80
Spain	X			1.45	.67
S. Africa	X			.59	.42
Mexico	X			.83	.36
Finland	X			.30	.22
Venezuela	X			.51	.20
Australia	X			.20	.18
Romania	X			.28	.16
E. Germany		X		.29	.11-12
Poland		X		.14	.10
Czechoslovakia	X			.07	.04
Hungary	X			.04	.04
Austria			X	.34	--
Argentina			X	.31	--

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TABLE 2

IMPORTS OF CONSULTATION PRODUCTS FROM THE EUROPEAN COMMUNITY (000 OF NET TONS)

	Benchmark (1981)	1984	1985*
Finished	331	632	888
Semifinished	112	809	848
TOTAL	443	1,441	1,736

* Three months, annualized.

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TABLE 3

ILLUSTRATIVE SURGES FROM NEW SUPPLIERS
(000'S OF TONS)

	1983	1984	1985 (annualized)
Romania**	9	272	693
Sweden	214	639	615
Venezuela**	154	491	562
Austria*	35	326	498
E.Germany**	13	274	296
Taiwan	177	160	234
Portugal	0	55	135
Norway	2	61	81
Trinidad-Tobago	66	67	75
Israel	2	9	31
India	8	10	20
Chile	0	8	15
Singapore	0	1	14
Thailand	0	0	4
TOTAL	680	2,373	3,273
% CHANGE	---	+249	+38

* Negotiations under way
** Restraint agreement concluded

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14 June 1985 OK

TALKING POINTS: ECONOMIC POLICY COUNCIL

Deficiencies:

-- Issues are too specific for principals only Cabinet-level meetings, compared with review of overall strategy. Should be refined by more staff work.

-- Staff work preceding the meetings is too narrow--it excludes the traditional IG process and it excludes the entire national security community (NSC, CIA, DOD).

-- Meetings exclude CIA.

-- The meetings mix domestic and international issues--this is a waste of time. The agendas should separate these issues, or subgroups should be established to consider domestic and international issues.

-- Agenda formulation is unclear--for example, why have the very serious issues relating to Argentina/Peru debt problems not been considered in the last two weeks? (Possible answer: Treasury keeping this to itself.)

-- Relationship of the EPC to the NSC undefined.

Requirements:

EPC must broaden participation (CIA, NSC, DOD) and take steps to meet each of these problems. The present approach is untenable.

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