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1 June 1987

MEMORANDUM FOR: Distribution

SUBJECT: Inter-Agency Meeting

TYPE OF MEETING	Economic Policy Council
DATE	Monday, 1 June 1987
TIME	1115
PLACE	Roosevelt Room
CHAIRED BY	Baker
ATTENDEE(S) (probable)	NIO/Econ
SUBJECT/AGENDA	Japanese Semiconductors
PAPERS EXPECTED	N/A
INFO RECEIVED	Per Cabinet Affairs, 0910

25X1

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Deane Hoffmann attended

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NATIONAL INTELLIGENCE OFFICER FOR ECONOMICS

National Intelligence Council

3 June 1987

MEMORANDUM FOR: [redacted] 25X1
D/Executive Staff

FROM: Deane Hoffmann

SUBJECT: Attached Memo for the Record

I don't think we should bother the Director with these arcane issues until his involvement becomes necessary.

Deane

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The Director of Central Intelligence

Washington, D.C. 20505

National Intelligence Council

NIC 02331-87
3 June 1987

MEMORANDUM FOR THE RECORD

SUBJECT: Economic Policy Council Meeting on 1 June

1. The Economic Policy Council (EPC) met on June 1 to review three trade issues relating to participants in the Venice Summit: (a) the semiconductor dispute with Japan, (b) possible trade retaliation against the European Community should it enact a large tax on "fats and oils," and (c) a brief tour d'horizon of the US-Canada free trade discussions.

2. Japan Semiconductors. Secretary Baker asked for a review of Japanese performance on the two main points of contention: selling prices of Japanese chips in third country markets and the US market share in Japan. It was agreed to wait until after the Venice Summit to review again the data before possibly making a recommendation to the President on lifting the penalty tariffs against Japanese exports. (This issue will not be decided on its merits. Japan cannot meet US demands and will be let off the hook only when the EPC decides Tokyo has been sufficiently punished for its sins on several trade issues.)

3. EC Fats and Oils. The arcane title belies the importance of this issue. The EPC asked the trade policy community to firm up a list of trade retaliation items for US cabinet makers to use in discussions with their counterparts at Venice to demonstrate US resolve in retaliating should the EC enact the tax. The tax would do an estimated $1.8 billion in damage against US exporters; hence, the retaliation list will be huge encompassing most EC agricultural products and, likely, some industrial items. The EC vote on the tax hinges on West Germany's decision. Italy and France want the tax, so the provisional retaliation list is tilted toward products in those countries with some German manufactured products thrown in for good measure.

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SUBJECT: Economic Policy Council Meeting on 1 June

4. Canada-US Free Trade. The US negotiator, Peter Murphy, gave a realistic rundown on the status of the negotiations and asked Cabinet members not to respond to possible Canadian requests at Venice to elevate the talks to the head-of-state level. Given the difficulties ahead, the EPC agreed to continue negotiations at the current level.

Deane E. Hoffmann
National Intelligence Officer for Economics

Attachment:
Early Draft of Fats and Oil Paper, 26 May 1987 (C)

cc: D/Exec Staff
Exec Reg (w/o att.)
C/NIC
VC/NICs
D/OGI (w/o att.)
D/EURA
D/OEA (w/o att.)

ATTACHMENT

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TPRG DISCUSSION OF FATS AND OILS TAX RETALIATION

ISSUE:

On March 4, the TPRG agreed that the U.S. would take retaliatory measures against EC imports if the European Community enacted the proposed tax on fats and oils. The TPRG also directed the TPSC to develop an action plan to dissuade EC member states from approving the tax. It now appears that the European Community will decide within the next month on an agricultural price package which may contain a fats and oils tax. The issues now before the TPRG are:

1) What guidelines should be used in drawing up a retaliation list?

2) What further messages should we convey to EC officials concerning the U.S. intent to retaliate in the event the tax is passed?

3) What common script should Cabinet members use in the event the tax is passed?

BACKGROUND:

USEC reports that one of the goals of the Belgian Presidency is to obtain passage of an agricultural price package, including a fats and oils tax, before July 1.

The member state agricultural ministers met on May 18-19 to consider a series of Belgian compromise proposals but adjourned, without reaching a decision, to accomodate the Franco-German summit scheduled for May 21-22. The group began meeting again on Sunday, May 24, but adjourned on Tuesday when it became apparent that significant differences remained among the member states. Reportedly, France is insisting that any agricultural package include a tax on fats and oils.

The agricultural council will not meet again until after the British and Italian elections on June 11 and 14. The final decision may go to the European Summit meeting of heads of state on June 29-30.

MEMBER STATE POSITIONS:

Rumors on who will bend under pressure are rife. Although the French and Germans apparently did not reach agreement on the fats and oils tax at the May 21-22 summit meeting, rumors have been circulating for weeks that Germany could drop its opposition to the tax in return for less reform of Monetary Compensatory Amounts (MCAs) and/or grain prices. We have heard that if the Germans cave, so will the Dutch.

Other member states who have voiced opposition to the tax appear similarly shaky. Portugal and Spain have opposed the tax because it would raise olive oil prices, with inflationary effects on their consumers. However, we have heard that the Belgian presidency has proposed the inclusion of certain sweeteners for Mediterranean products in the price package, and that Spain and Portugal may drop their opposition to the tax. The Danes are also reported to be wavering, since their opposition is based on the inclusion of marine oils which now may be exempted in some way from the full impact of the tax. This leaves only the British firmly in the opposing camp.

PROPOSED ACTION PLAN:

In addition to the three issues set out below, the TPRG should discuss whether to approve the attached action plan. The TPRG should also decide when to bring this matter to the EPC. Among other things, the EPC will need to discuss a second round of retaliation, since the Community will mirror our actions no more than a few days after the announcement of our retaliation.

The goal of the proposed action plan is two-fold: to deter the member states from approving the tax by focusing their attention on the effects of such a decision and to implement the retaliation swiftly, in the event the tax is passed.

USEC advises that we maintain our low-key stance in the press while the measure is under consideration in Brussels. They recommend that discreet demarches be made in Washington at the Ambassadorial level to outline one last time the U.S. resolve to retaliate if the tax is passed. Suggestions for possible meetings between Ambassador Yeutter and member state ambassadors are contained in the action plan. Also attached is an update of actions taken to date on this issue both in Washington and overseas.

OPTIONS:

Guidelines for Retaliation

Meeting on Friday, May 22, the TPSC agreed on the following general guidelines for a retaliation:

1) Action should be taken pursuant to a Presidential determination under section 301 that the fats and oils tax is an unfair trading practice.

2) The retaliation should affect EC imports on a non-MFN basis.

3) The proposed retaliation list should cover approximately $4 billion in trade, which is twice as much as the amount of U.S. exports that would be affected by the tax; public hearings should be held to assist the TPSC in choosing appropriate items from this list.

Issues on which TPRG guidance is requested are:

A) The trade coverage for the retaliation:

1) Under one option, we would calculate the trade-weighted ad valorem equivalent of the tax on U.S. exports (which amounts to 35%), and apply this tariff to an equivalent level of EC imports.

2) Alternatively, we could apply a higher tariff to a smaller level of EC imports, based either on the estimated fall in U.S. exports or on the projected amount of revenue generated by the tax on U.S. exports. The rationale behind this option is that a higher tariff on a smaller value of imports may have a greater impact on EC trade.

The tariff level at which the U.S. retaliation begins to have a significant effect may depend in large part on the items chosen for retaliation. We recommend that the notice of public hearings on a retaliation list request suggested tariff increases on each item.

In addition, we recommend that the TPRG provide for a periodic review of the level of the U.S. retaliation, since the effect of the fats and oils tax will vary, depending upon the level at which the EC sets the tax. The TPRG may also wish to direct that the level of the U.S. tariff be revised upward to reflect any decline in the volume of U.S. exports that occurs over the next several years as a result of the tax.

B) The level of U.S. exports affected by the fats and oils tax:

1) One option is to use a base period of 1984-1986, in deference to the GATT practice of basing trade damage calculations on the most recent three-year period. U.S. exports to the EC of oilseeds, vegetable and marine oil in this period averaged $1.8 billion.

2) Alternatively, we could use a base period of 1981-1985, which is the period that the EC used in calculating the level of the fats and oils tax. U.S. exports of oilseeds, vegetable and marine oil averaged $2.2 billion in this period.

In the dispute over EC enlargement, we based our estimate of trade damage on 1984-1985, because the EC had not yet provided us with trade data for 1986.

C) Inclusion of industrial products:

In the dispute over EC enlargement, we included only agricultural items on our proposed retaliation list, since the U.S. exports at issue were all agricultural. In this case, it may be impossible to avoid including industrial items. The TPSC agreed that the following agricultural items should be excluded from the retaliation list:

1) items on which tariffs remain unbound pursuant to the enlargement settlement;

2) products subject to quotas as a result of the Portuguese oilseed consumption quota dispute;

3) products proposed for tariff reductions pursuant to the citrus agreement; and

4) products for which the U.K. is a primary supplier (e.g., Scotch and gin), since the U.K. is the only EC country that has demonstrated unwavering opposition to the tax.

If the TPRG agrees that these items should not be included, there will be less than $1 billion in EC agricultural imports from which to choose. Although we could retaliate on less than the full trade coverage if we choose a higher tariff level, a retaliation based solely on agricultural products could leave virtually all EC agricultural imports subject to trade restrictions. Moreover, it may be beneficial to include industrial products on the retaliation list; the German industrial federation has been lobbying against the tax due to their concern that the U.S. will retaliate against industrial products. Therefore, we recommend that the TPRG approve the inclusion of industrial items on the retaliation list.

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Messages to EC Officials

Although we have made numerous representations to EC officials to communicate the strength of U.S. opposition to the tax and our intention to retaliate in the event the tax is passed, we believe there may be some question as to whether certain member states are taking this position seriously. Therefore, it may be useful to let key member state officials know that the U.S. is drafting a retaliation list. The TPRG should consider how many details of the proposed retaliation it may be useful to communicate to the EC (e.g., the trade coverage of the proposed list or items that we are considering for inclusion).

U.S. Response in the Event the Tax is Passed

In the event the EC approves the tax, TPSC members agree that it would be useful to have an agreed U.S. response prepared. Possible points for inclusion in such a response are:

-- The U.S. believes that the fats and oils tax is inconsistent with the EC's GATT obligations.

-- The tax will have an adverse effect on $1.8 of U.S. exports.

-- The U.S. plans to take action under section 301 to protect its trade rights. Hearings will be held on a proposed retaliation list covering $4 billion in EC imports. The U.S. retaliation, which will be in the form of a surcharge on EC imports, will take effect on the date of implementation of the fats and oils tax.

COUNTER-COUNTER RETALIATION:

The EC is certain to respond to any announcement of U.S. retaliation against the fats and oils tax with an announcement of its intent to counter-retaliate against U.S. exports. A likely candidate for retaliation is non-grain feed ingredients. If the EC approves the tax in late June, an announcement of EC counter-retaliation is likely to come in the middle of the conference on the trade bill. Therefore, it would be useful for the TPRG to indicate its willingness to meet on short notice to consider counter-measures to any EC counter-retaliation.

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PROPOSED ACTION PLAN FOR FATS AND OILS TAX RETALIATION

May 22:	TPSC review of guidelines for retaliation (Action: Don Phillips)
May 26-29:	Creation of a retaliation list on a non-MFN basis (Action: Doug Newkirk/Chris Marcich)
	Approval of retaliation list and talking points by the TPRG (Action: Don Phillips)
June 1-5:	Ambassador Yeutter to call in selected EC Ambassadors (including Belgium, and possibly either proponents of the tax such as France and Italy, or opponents such as the FRG, Denmark and the Netherlands) (Action: Jim Murphy/Carmen Suro-Bredie/Laura Kneale)
	Interagency approval for a U.S. Government statement in the event the tax is passed (Action: Jim Murphy/Carmen Suro-Bredie/Laura Kneale)
July 1, or whenever the tax is passed:	EPC meeting on the fats and oils tax
	Meeting with the European Economic Counselors to discuss the specific steps the U.S. Government will take (Action: Jim Murphy/Carmen Suro-Bredie/Laura Kneale)
	Presidential determination that the fats and oils tax is an unfair trading practice under section 301 (Action: Judy Bello/Chip Roh)
	Cables to Embassies describing Presidential action (Action: Jim Murphy/Carmen Suro-Bredie/Laura Kneale)
3 weeks later:	Public hearings on the retaliation list (Action: Don Phillips)
	TPRG approval of final retaliation list (Action: Don Phillips)
Prior to October 1:	Presidential Proclamation (Action: Chip Roh)

UPDATE OF FATS AND OILS TAX ACTION PLAN

May 22, 1987

Actions Taken

March 2 - USTR released a statement by Ambassador Yeutter stating U.S. opposition to the tax and our intention to "protect our trade rights."

March 4 - TPRG agreed unanimously to retaliate against the EC in the event the tax is passed.

March 10 - USEC provided USTR with statistics on EC imports of vegetable and marine oils, by country, for use in identifying potential allies.

March 12/13 - Posts in all twelve EC capitals delivered letters from Secretary Shultz to EC Foreign Ministers and from Secretary Lyng to EC Agriculture Ministers reiterating U.S. opposition to the tax.

March 18 - Ambassador Smith held a meeting with EC Economic Ministers from Washington embassies to stress the magnitude of the problem the tax would create and explain the reasons for U.S. opposition. Position papers on the U.S. position were distributed, as was a copy of the Congressional resolution opposing the tax.

March 20 - Jim Murphy and Suzy Early conducted a background briefing for European press in Washington to explain the reasons the tax would adversely affect U.S. exports and violate the EC's GATT obligations. Reporters were provided with a copy of the U.S. position paper, as well as a fact sheet on the effects of the tax.

March 23 - USDA conducted a briefing for inter-agency group on the effects of the EC's oilseed supports on U.S. trade, and the projected impact of the tax on future trade patterns.

March 27 - John Baize, of the American Soybean Association, held briefing for inter-agency group on ASA's meetings with EC officials in Europe.

March 27 - USTR sent EC posts a reporting cable on Ambassador Smith's meeting with EC Economic Ministers. Cable also contained text of position paper distributed at meeting.

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March 27 - USTR sent a cable instructing USEC to share information and coordinate responses with third country representatives in Brussels.

April 10 - USDA and USTR drafted a detailed fact sheet, containing responses to arguments put forth by the Commisson and including recent trade and price data. Fact sheet was sent to U.S. posts in the EC and interested third countries for use in conversations with host government officials.

April 10 - USTR sent cable to Bonn, requesting information on groups and individuals supporting and opposing the tax in the FRG.

May 12 - USTR sent letters from Ambassador Yeutter to all EC Trade Ministers reiterating U.S. opposition to the tax.

May 12-15 - State (Assistant Secretary McMinn) called in representatives from the FRG, the Netherlands and Denmark to reiterate adverse impact that passage of the tax would have on U.S.-EC relations.

May 22 - USDA and State drafted a detailed response to Prime Minister Chirac's paper laying out France's arguments that the tax would be GATT-legal and have minimal effects on imports.

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FATS AND OILS RETALIATION LIST

First Cut

The attached list has been drawn up as a first step in identifying a retaliation package against any EC tax on fats and oils. The list is deliberately broad ($ 4.5 billion) to permit interested agencies to drop certain items before the list is made available for public hearings. The objective is to have a list covering approximately $4 billion for the public hearings which would serve as a basis for developing the final list covering 1.8 to 2.2 $ billion, depending on what base period is chosen.

The list was developed, inter alia, based on some or all of the following criteria:

1- there is evidence of significant EC12 trade;
2- the products involve "sensitive" EC exports;
3- the EC trade shows evidence of growth in recent years;
4- other sources of supply will readily make up for the EC;
5- agriculture products already on another list (XXIV.6 or citrus) were excluded;
6- an effort was made to focus the coverage on France, Italy and on the FRG, while also including the rest of the Member States;
7- agricultural products were examined first and included on the list to the extent they do not conflict with other criteria;
8- priority was given to oil or oil-based products from the EC.

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CLASSIFIED BY Donald M. Phillips
DECLASSIFIED ON OADR

ITEM	DESCRIPTION	IMPORTS, EC12 ($ 000,000)
Agricultural		
10640	Pork,frozen	92
1073525	Canned Hams,>3lbs	250
12510	Lily bulbs	3
12534	Bulbs, herbaceous perennials	18
12584	Live plants	4
12641	Flower seeds	7
13250	Potato starch	8
14165	Tomato paste	21
14166	Tomatoes, prepared	31
14192	Artichokes	14
14729	Oranges,mandarines	11
14610	Apples	9
15303	Strawberry jellies	3
15630	Chocolates,<10lbs	21
16610	Mineral water	45
16710	Champagne	253
1673030	Red wine, >$4/gl	198
16740	Vermouth	18
17629	Olive oil	46
17630	Olive oil,>40lbs	13
17633	Palm kernel oil	11
18220	Biscuits	105
18838	Gums	23
19221	Fresh cut flowers	55

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11282	Sardines,in oil	4
49312	Casein	67

Non Agricultural

25605	Wallpaper	65
33720	Woven fabrics, of silk	76
36624	Cotton towels	8
37320	Silk ties	2
37322	Silk ties,n/Orn.	33
38183	Men's wool suit coats	119
40110	Benzene	60
40174	Xylenes	25
40488	Amines	19
43782	Vitamins, synthetic	73
47470	Titanium dioxide	152
51951	Coated Abrasives	33
53487	Smokers articles	35
54620	Crystal	105
54660	Glassware	42
67434	Boring machines	135
67442	Nonmetalwkg machine tools	134
68037	Ballbearings	87
68039	Ballbearings	78
68049	Gearboxes	109
68260	Generators	275
68458	Telephone sets	34
68459	Telephonic apparatus	11

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68590	Switching equip.	424
70074	Espadrilles	6
70801	Opthalmic lenses	69
70845	Eyeglasses	55
71249	El. measuring devices	551
77251	Tires	378