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2 February 1988

MEMORANDUM FOR: Distribution

SUBJECT: Inter-Agency Meeting

TYPE OF MEETING	Economic Policy Council
DATE	Friday, 5 February 1988
TIME	~~1100~~ ? 0915
PLACE	Rm. ~~208 OEOB~~ Roosevelt Rm
CHAIRED BY	Baker
ATTENDEE(S) (probable)	NIO/Econ
SUBJECT/AGENDA	Mexico
	Long Term Grain Agreement
PAPERS EXPECTED	Agenda by COB 3 Feb
INFO RECEIVED	Per Cabinet Affairs, 1100

25X1

Diane Hoffman

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The Director of Central Intelligence
Washington, D.C. 20505

National Intelligence Council

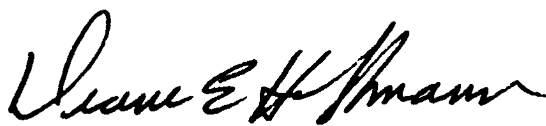
NIC 00472-88
5 February 1988

MEMORANDUM FOR THE RECORD

SUBJECT: EPC Meeting, 5 February on Mexico and the US-USSR Long-Term Grain Agreement

1. The Economic Policy Council (EPC) agreed to recommend that President Reagan suggest to President de la Madrid that the countries discuss bilateral trade initiatives (options 1A or 1B in the attachment). The EPC decided against changes in steel quotas or US tariff reductions in exchange for Mexican tariff "bindings". Secretary Herrington argued for the United States to ask Mexico to open its energy sector to foreign investment. Secretary Baker said that was not possible. Baker asked for the CIA view, and I agreed with him. NSC also agreed with Baker, and the issue was dropped.

2. The EPC agreed to seek a new Long-Term Grain Agreement with the USSR. There was no discussion of the issue.



Deane E. Hoffmann

Attachment:
Agenda and Background Material

cc:
DCI (w/o attach)
DDCI
D/DCI-DDCI Exec Staff
DD/ALA
DD/SOVA
C/OGI/SRD/EM
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THE WHITE HOUSE

WASHINGTON

February 3, 1988

MEMORANDUM FOR THE ECONOMIC POLICY COUNCIL

FROM: EUGENE J. McALLISTER EM

SUBJECT: Agenda and Papers for the February 5 Meeting

The agenda and papers for the February 5 meeting of the Economic Policy Council are attached. The meeting is scheduled for 9:15 a.m. in the Roosevelt Room.

The first agenda item will be Mexico. In the State of the Union, the President highlighted trade as one of the top items on his agenda for his talks with President de la Madrid, scheduled for February 13. The Council will consider several options for trade initiatives within the existing framework agreement. The TPRG has prepared the attached paper outlining these options.

The second agenda item will be the Long-Term Grain Agreement. The current 5-year U.S.-U.S.S.R. agreement expires September 30, 1988. The Council will discuss the possible renewal of the agreement. A paper prepared by the TPRG is attached.

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ECONOMIC POLICY COUNCIL

February 5, 1988

9:15 a.m.

The Roosevelt Room

AGENDA

1. Mexico
2. Long Term Grain Agreement with the Soviet Union

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OFFICE OF THE UNITED STATES
TRADE REPRESENTATIVE
EXECUTIVE OFFICE OF THE PRESIDENT
WASHINGTON
20506

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February 3, 1988

MEMORANDUM

TO: THE ECONOMIC POLICY COUNCIL

FROM: THE TRADE POLICY REVIEW GROUP

SUBJECT: U.S.-Mexico Trade Relations

ISSUE

President Reagan has requested an examination of the prospects for establishing a special trade and investment relationship with Mexico. He has similarly requested an examination of trade and investment issues that affect the U.S.-Mexico border. The aim is to determine possibilities for building on our currently good trade relations. On January 28, President De la Madrid called the current structural adjustment process accompanied by trade liberalization that has been initiated and implemented by his Administration the most significant achievement in the last 50 years of Mexican history. He called GATT accession and the bilateral framework agreement the two most important actions taken by Mexico during this process. He also stated that the development of a constructive working relationship with the U.S. has been one of the major achievements of his Administration.

RECOMMENDATIONS

1. That the U.S. utilize the recently signed bilateral framework agreement as the mechanism for managing the bilateral trade and investment relationship and for seeking incremental improvements in market access, foreign investment policy, and intellectual property protection. (The first round of formal consultations under the framework agreement are already scheduled for February 22-23 in Mexico.)

2. That the EPC provide guidance as to whether the U.S. should seek to negotiate any of four limited trade initiatives with Mexico (see pages 4-9).

3. That the U.S. use the February 13 meeting of the two Presidents and the February 22-23 framework agreement consultations in a coordinated manner to seek certain modest improvements in Mexican foreign investment regulation.

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4. That the EPC consider reaffirming Administration opposition to modification or elimination of U.S. tariff provisions 806.30/807.00.

BACKGROUND

-- Mexico is our fourth largest trading partner (after Canada, Japan and West Germany) and third largest export market. Total trade between the two countries in 1987 was about $35 billion. The U.S. has run a trade deficit with Mexico since 1982, with a 1987 deficit of over $6 billion. Mexico is our third largest supplier of crude oil.

-- Mexican trade policy has undergone an important evolution during the De la Madrid Administration. To move Mexico away from economic development based on import substitution and oil export earnings and towards export-led growth, the De la Madrid Administration has stimulated the process of structural adjustment through a reduction in domestic subsidies and an opening of the domestic market to import competition. With respect to trade, substantial liberalization has taken place in the level of tariffs and in the use of import licenses and official reference prices: the three tools used by Mexico in the post WWII period to control imports.

-- At the end of 1983, all of the more than 8,300 Mexican tariff categories were subject to import licensing requirements; now only 329 categories (mainly covering the auto and pharmaceutical sectors, some agricultural products, drugs, firearms, and some luxury items) are still covered. (These 329 categories represent 3.9% of the Mexican tariff schedule but covered 27.2% of total Mexican imports by value in 1987.) Official reference prices, which covered over 1,500 tariff categories two years ago, were totally eliminated at the end of 1987. Tariffs were as high as 100 percent as recently as April 1986, but have been reduced to a maximum applied rate of 20% as of December 15, 1987. The 5% general import tax, applied on top of the normal duty, was eliminated on December 15, 1987. The average weighted Mexican tariff is now 5.6%. (The comparable U.S. tariff is 3.1%.) Most of the trade liberalization has been implemented since July 1985.

-- Mexico has complemented these measures by acceding to the GATT on August 24, 1986, and by signing on November 6, 1987, with the U.S. a bilateral framework agreement for trade and investment. The significant reduction in Mexican licensing requirements and the elimination of official reference prices have fulfilled commitments made by Mexico during its GATT accession negotiation. However, the tariff reductions implemented by Mexico go well beyond Mexico's GATT commitments.

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-- The framework agreement was an important psychological step forward for Mexico. Its primary result was the establishment of a consultative mechanism which can be invoked by either side at any time to clarify respective trade policies, resolve specific disputes, or negotiate the removal or reduction of trade and investment barriers.

-- The U.S. market is, with a few important exceptions, open to imports from Mexico. Over 80% of Mexican exports to the U.S. enter at a duty rate between 0 and 5 percent. There are no section 301 measures against Mexico, while quotas on stainless steel imports are the only section 201 measures affecting Mexico. (These quotas have, in practice, not proven particularly restrictive for Mexico.) The steel and textile quotas have recently been increased, and the meat embargo is under technical review. The embargo on fresh avocados appears to be technically justified because of seed weevil infestation in Mexico. The sugar quota has had little impact since Mexico consumes almost all its sugar production domestically.

-- Mexico should benefit by the graduation of Korea, Taiwan, Hong Kong and Singapore from the U.S. GSP in January 1989. Mexico is now the fourth largest beneficiary of the U.S. GSP program, entering over $1.5 billion of products into the U.S. duty free under the program's provisions, and will become the program's leading beneficiary after the removal of the four Asian countries.

-- On the whole, the U.S. and Mexico are now enjoying good and cooperative trade relations. The substantial trade liberalization in Mexico since July 1985, much of it unilaterally implemented for Mexico's own economic development, has reduced or eliminated many of the longstanding bilateral trade irritants with respect to market access. In fact, the amount of trade liberalization has gone beyond what any observer expected.

-- The past three years have been the most active ever in the bilateral trade relationship. In addition, the bilateral subsidies understanding, Mexico's GATT accession negotiation, the GSP General Review, and the framework agreement have moved the focus of the trade relationship away from any concessionary approach by the U.S. to a mutually accepted approach of reciprocity. The recent steel/beer/wine/distilled spirits agreement and even the new textile agreement reflect this.

-- Mexican foreign investment policy and certain intellectual property issues are now the major difficulties in the bilateral trade and investment relationship.

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-- In a speech to the Mexican Importers and Exporters Association on January 28, De la Madrid stated that an FTA with the U.S. would be premature at this time due to both the current difficulties in the Mexican economy and the disparity in the levels of economic development.

POSSIBLE BILATERAL TRADE INITIATIVES

1A. Offer to increase Mexico's GSP benefits through the annual review process in return for improvements in Mexico's patent law. Specifically, offer to grant a substantial number of redesignations of product eligibility for Mexico and waivers from competitive need limits in return for the implementation within 2 or 3 years of (1) product patent protection for pharmaceuticals, chemicals and alloys and (2) process patent protection for biotechnology.

Pros

-- In effect, would reinitiate GSP General Review negotiation between U.S. and GOM. Uses part of limited U.S. negotiating leverage (GSP benefits, steel quotas and textile quota levels) to obtain concessions of commercial importance to U.S.

-- GSP waivers for Mexico might stimulate investment in Mexico.

-- If successful, would resolve one of major outstanding bilateral trade problems.

Cons

-- Difficult to promise GSP benefits which would become effective in July 1989 in return for changes in Mexican patent law which would have to be approved by Mexican Congress in fall of 1988. (Mexican Congress only convenes during September-December each year).

-- Such an agreement would commit next U.S. Administration to follow through. Perhaps too late in political life of both Administrations to pull off.

-- Could create problems with private sector or other beneficiaries if deal became public.

-- Mexican interest perhaps diminished by upcoming removal of Korea, Taiwan, Hong Kong and Singapore from U.S. GSP.

1B. Offer to increase Mexico's GSP benefits as soon as the Mexican Congress approves improvements in Mexico's patent law. Specifically, offer to grant a substantial number of

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<u>redesignations of product eligibility for Mexico and waivers from competitive need limits in return for the implementation within 2 or 3 years of (1) product patent protection for pharmaceuticals, chemicals and alloys and (2) process patent protection for biotechnology</u>.

<u>Pros</u>

-- Provides more negotiating flexibility than first option by offering to have U.S. President increase Mexico's benefits as soon as Mexican Congress acts rather than waiting until July 1989. Uses part of limited U.S. negotiating leverage (GSP, steel, and textiles) to obtain concessions of commercial importance to U.S.

-- Would make clear to everyone the special nature of the U.S.-Mexico relationship. (Such a grant of GSP benefits outside the normal annual GSP review cycle has never been done before.)

<u>Cons</u>

-- Would set a precedent that would greatly complicate the administration of GSP program, specifically the GSP Annual Review procedure that is based on a "due process" procedure. The hundreds of private sector and other beneficiary country petitioners that have relied on the predictability of the year long Annual Review process would now have clear grounds to ask for the same "special treatment".

-- Would send a clear signal to all our trading partners in the midst of the Uruguay Round that in administering the GSP program, the U.S. has no regard for our GATT obligations in how we administer the GSP. Specifically, we would be violating the principles of "non-discrimination" and "non-reciprocity" that are a central component of the GATT waiver allowing for GSP programs.

-- Would send the wrong signal to those in the GOM that deal directly with the GSP program. The GOM is notorious for submitting poorly prepared petitions that do not meet the regulations governing the submission of petitions in the GSP Annual Review.

-- Following so soon after our decision to graduate the four Asian beneficiaries, this will not send a signal that we are looking to redistribute GSP benefits to other developing countries. It will send a signal that we are interested in giving "special" treatment to Mexico. Since we cannot do the same thing for all

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other beneficiaries, this decision would potentially complicate our relations with a number of developing countries.

GSP BACKGROUND

As part of the GSP General Review exercise in 1986, the U.S. offered Mexico an increase of several hundred million dollars in GSP benefits if Mexico would make substantial improvements in its patent and trademark law. The De la Madrid Administration did submit, and the Mexican Congress did approve, comprehensive amending legislation. However, it fell short on several key points of primary interest to the U.S. In particular, the length of a patent term was only increased from 10 to 14 years, instead of the U.S. requested 17 years. Also, implementation of product patent protection for pharmaceuticals and chemicals and process patent protection for biotechnology was delayed until January 1997. The U.S. had proposed a two year phase-in (January 1989). As a result of these shortcomings the U.S. removed $200 million of GSP benefits from Mexico as of July 1987.

It should be noted that the President has, with few exceptions, broad discretionary authority in adding or deleting items or countries from the GSP program. One requirement is that he must obtain economic advice from the ITC before taking any such action.

2. Offer to negotiate additional increases in the U.S. steel quotas for Mexico in return for bound tariff reductions in Mexican steel tariffs combined with other bound tariff reductions (perhaps certain chemical, paper, canned fruit, raisin, and chocolate confectionary items) or increase in the length of the Mexican patent term.

Pros

-- Uses one of few U.S. negotiating chips (GSP benefits and steel and textile quotas) to obtain concessions of commercial importance to U.S.

Cons

-- Mexicans have insufficient capacity to increase exports of items in shortage in U.S. (semi-finished steel). Would thus need to offer increases in items where no domestic shortages reported.

-- U.S. industry accepted earlier steel deal with Mexico in order to obtain restraints on Boren amendment items, but will oppose any further increases. Industry likely to mobilize Congressional Steel Caucus in opposition to any deal.

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-- Other VRA countries accepted U.S.-Mexico steel deal in hopes of getting Boren amendment eliminated. Any additional deal will lead to demands for similar treatment.

-- The U.S. has already been generous with Mexico with respect to steel quotas. Aside from the recent increase, the VRA negotiated with Mexico contains two provisions not contained in any other arrangement. One provides for an upward adjustment to Mexico's export ceilings based on U.S. steel exports to Mexico. The other provision permits currently unrestrained imports of steel (except for one specific product) entered under TSUS item 806.30. Imports under this provision have increased significantly.

<u>BACKGROUND ON STEEL</u>

The two governments formalized an agreement under the framework agreement in late December which provided Mexico a 12.4% increase in its 1988 steel quotas in return for adding three wire products to quota restraints, elimination of the Mexican beer, wine and distilled spirits quotas, and elimination of the import licensing requirement on 38 tariff categories.

3. <u>Offer bound, U.S. tariff reductions for TSUS categories where Mexico is the principal or a substantial supplier in return for a binding of recent Mexican tariff reductions and import licensing eliminations</u>.

<u>Pros</u>

-- Provides opportunity to lock-in large part of recent Mexican trade liberalization. Could prove very important to U.S. commercial interests once Mexican economy rebounds.

-- Would provide impetus to trade credit concept in Uruguay Round.

-- Would, in effect, represent Uruguay Round tariff negotiation with fourth largest U.S. trading partner.

-- Could provide incentive to other LDCs to implement trade liberalization measures.

-- Tariff concession list could possibly be tailored to avoid giving too many other suppliers a free ride.

<u>Cons</u>

-- Negotiated concessions would require congressional approval.

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-- Could involve giving too many other countries a free ride and, thus, lose some leverage for Uruguay Round tariff exercise.

-- Preliminary analysis shows that TSUS items for which Mexico is principal or substantial supplier are heavily weighted in high duty agricultural items, high duty textile items, and petroleum. These would all be politically sensitive items.

BACKGROUND ON TRADE CREDIT OPTION

-- The idea of a "trade credit" has considerable support from the World Bank, including the Development Committee and President Barber Conable. Although there has been no detailed discussion as to the specific conditions under which these concessions would be negotiated, the concept is under study by the Uruguay Round Working Group on Developing Countries. A practical precedent exists in the U.S.-Philippine Section 124 Negotiations held in 1981. At the suggestion of the World Bank, the Philippines approached the United States asking for trade negotiations in which they would bind tariff cuts and licensing changes made as part of a structural adjustment loan in return for U.S. tariff cuts made with residual authority left over from the Tokyo Round. The negotiation was not completed before U.S. tariff authority ran out.

-- In the case of Mexico, there are two structural adjustment loans worth $1 billion that are already being disbursed. As part of the loans, Mexico pledges to remove items from their licensing list and reduce tariffs to 30% MFN on $40 million in trade. These concessions are technically only good for the life of the loan and can be easily reversed after that. To create permanent change in the trading system, Mexico would have to bind these cuts in the GATT on an MFN basis. Mexican quantitative restrictions could be removed and converted to GATT-bound tariffs as part of the negotiations.

-- It's important to note that Mexico has now gone substantially beyond the conditions attached to the World Bank loans. The U.S. would aim for bindings at the new lower tariff levels (maximum Mexican tariff is now 20 percent).

-- There are 147 TSUS items which are not GSP-eligible and for which Mexico is the principal or a substantial supplier. 40 of the items are in the 0-5 percent duty range, 47 in the 5-10 percent, 43 in the 10-20 percent, and 17 over 20 percent. Total value of imports from Mexico under the 147 TSUS items is $4.2 billion, or 29.5 percent of total U.S. imports of those items. Of the $4.2 billion in imports from Mexico, $3.2 billion enters under the 0-5 percent duty range, $414

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million in the 5-10 percent range, $409 million in the 10-20 percent range, and $83 million over 20 percent.

-- If GSP eligible items are added to the list of possibilities, there are 395 TSUS items for which Mexico is the principal or a substantial supplier. Of that 395, 158 are in the 0-5 range, 134 in the 5-10 range, 75 in the 10-20 range, and 28 over 20 percent. Total imports from Mexico in the 395 items is $8.5 billion, or 29.5 percent of total imports of those items. Of those imports, $5.9 billion enters in the 0-5 percent duty range, $1.8 billion in the 5-10 percent range, $626 million in the 10-20 percent range, and $156 million over 20 percent.

4. Negotiate a U.S.-Mexico Auto Pact.

A small TPRG sub-group has reviewed this option and found such a sectoral trade arrangement to be premature. Further study of the implications for U.S. employment and production and the relation to the U.S.-Canada Auto Pact is needed. In addition, sectoral arrangements are GATT incompatible and would require a GATT waiver.

IMPROVEMENTS IN MEXICAN INVESTMENT REGIME

During the February 13 meeting in Mazatlan, the President and U.S. cabinet officers could point to the benefits to Mexico should conditions for foreign investors be eased. While recognizing the difficulty in obtaining major legislative changes in the Mexican Foreign Investment Law at this late stage of the De la Madrid Administration, U.S. reps could point to certain small improvements which could help Mexico and improve the bilateral investment climate. Suggested improvements could include an increase in the threshold (currently $8 million) which defines small and medium size companies which are allowed to have 100 percent foreign ownership without Foreign Investment Commission approval. Other improvements could be a standstill on the use of export performance requirements, or a lowering of the 55 percent tax on dividends. It could then be suggested that details be worked out during the formal framework agreement consultations on February 22-23 in Mexico.

BACKGROUND ON INVESTMENT

-- The U.S. is by far the largest source of foreign investment in Mexico. Total U.S. direct investment in Mexico is $5.9 billion (1986 estimate), or 68.2% (1985) of all foreign investment in Mexico. This $5.9 billion represents only 2.5% of total U.S. foreign investment, with Mexico ranked 12th among countries receiving U.S. foreign investment (but 2nd among LDCs).

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-- In most cases foreign investment is limited to 49% of equity, although majority ownership can be negotiated with the Foreign Investment Commission. In those latter cases, majority ownership is authorized only in return for commitments on local content, export performance, location, and R&D requirements. In addition to these general rules regarding foreign investment, Mexico has developed sectoral programs in automobiles, electronics and pharmaceuticals. In each case, all investment approvals are dependent upon commitments for local content, technology transfers, export performance and net foreign exchange earnings.

-- These restraints on foreign investors are now, in light of the significant progress made in the last two years on market access issues, the single largest area of disagreement in our bilateral trade and investment relations. We believe these obstacles to investment are not just irritants to the U.S., but counterproductive to Mexico's own economic development.

BACKGROUND ON 806.30/807.00 RECOMMENDATION

-- At the request of the House Ways and Means Committee, the ITC conducted a study on the economic effects of TSUS items 806.30 and 807.00. These duty classification numbers cover products which have been exported from the United States for processing abroad. Upon their re-entry into the United States, the importer pays duty only on the value-added abroad.

-- The study, released on January 26, found that plant relocation outside of the U.S. is not being spurred by 806.30/807.00 tariff concessions, but by lower labor costs abroad, especially in Mexico. In addition, Mexico has additional factors making it attractive - the maquila program, quality workers, low transportation costs and ease of communications. As such, the ITC concluded that the elimination of preferential duty treatment will not result in the return of assembly jobs to the United States. The ITC also concluded that items 806.30 and 807.00 "appear" to have improved the competitiveness of U.S. firms vis-a-vis foreign manufacturers of products containing no U.S. components.

-- The House Ways and Means Trade Subcommittee recently requested public comment on a bill introduced by Cong. LaFalce to eliminate 806.30 and 807.00. The administration opposed similar legislation in 1986.

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-- Consideration of the issue in 1987 was put on hold pending the outcome of the ITC report. U.S. private sector groups along the U.S.-Mexico border have called for assurances from the Administration that it will continue to oppose changes in these tariff provisions.

TRADE OPTIONS FOR MEETING OF THE PRESIDENTS

-- President Reagan could acknowledge the substantial progress made by President De la Madrid in liberalizing trade and eliminating or reducing subsidies.

-- Particular attention could be drawn to the framework agreement which was signed by Mexico and the U.S. in November 1987. The signing of the framework agreement fulfilled the Presidents' August 1986 pledge to dedicate their administrations to strengthening trade and investment ties between the two countries. To reinforce the commitment of both nations to continuing progress in that regard, the Presidents could express their continuing commitment to progressively reduce barriers to bilateral trade and investment, using the framework agreement and the GATT process as mechanisms for achieving this. Particular attention could be drawn to possible improvements in the investment area which could be discussed during upcoming framework agreement talks.

-- President Reagan could point out the benefits to Mexico of his decision to remove four Asian countries from the U.S. GSP.

-- President Reagan could reaffirm his opposition to a protectionist trade bill and to oil import fees.

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U.S.-USSR LONG TERM AGREEMENT

Issue

The United States currently has a five-year grain trade agreement with the Soviets (Attachment A) which will expire September 30, 1988. Secretary Shultz and Soviet Minister of Foreign Affairs Shevardnardze agreed last fall that we would explore the merits of renewing the agreement early in 1988. At a January 5 meeting in London, the Soviets suggested that the U.S. should extend an invitation to the USSR to begin such talks.

Recommendation

The Trade Policy Review Group reviewed this issue on January 26. The Group's unanimous recommendation was that the U.S. should attempt to negotiate a new agreement.

The EPC should accept the TPRG recommendation.

Background

1. TPRG Discussion

The TPRG discussed a number of issues relating to the agreement. The principal issue was whether a formal arrangement on grain trade with the Soviets should be pursued to replace/extend the present agreement. The TPRG unanimously favored the continuation of an arrangement. With regard to whether this should be the negotiation of a new agreement or simple extension of the current agreement, the TPRG concluded that our primary objective should be the negotiation of a new agreement. However, the group expressed the sense that an extension of the current agreement could be an acceptable fall-back position if efforts to renegotiate are not productive.

The TPRG addressed a number of additional issues but agreed that these should be decided by the U.S. negotiating team or resubmitted for policy guidance as the negotiations proceed. Those issues include:

a. The time frame covered by the agreement.

- o The Soviets have indicated that they would prefer a period shorter than 5 years to bring the agreement into conformity with the USSR five-year plan.

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b. The price provisions to be included in the agreement.

- The present agreement states that sales will be made at prevailing market prices. This could be interpreted as prevailing U.S. or world market prices.

  In recent years, world prices have been significantly below U.S. prices.

c. Products covered by the agreement.

- There is considerable interest among U.S. commodity groups in bringing more products into the agreement.

d. What quantities should be included, and should trade-offs between commodities be permitted in determining compliance with the minimum purchase provisions?

- The Soviets have suggested that they would like lower minimum purchase requirements and total flexibility in shifting between products.

e. Role of non-agricultural issues in the negotiations.

- The Soviets may want to bring shipping issues or non-agricultural trade matters into the agreement.

USTR will lead the negotiations for the new agreement, in close coordination with the Departments of Agriculture and State. This is an economic agreement, but cannot be considered outside the scope of the overall bilateral relationship. Therefore, throughout the negotiations USTR will seek appropriate guidance from interested departments and agencies on foreign policy and national security considerations.

2. <u>Status of Current Agreement:</u>

The current agreement provides that the Soviet Union will buy a minimum of nine million tons of grain during each agreement year. Of this amount, at least four million tons must be wheat and at least four million tons must be corn. The remaining million tons may be corn or wheat or may be soybeans/soybean meal. Soybeans and soybean meal are counted at a 2:1 ratio (1/2 ton of soybeans is the equivalent of 1 ton of grain for the purposes of this agreement.)

The present agreement has not operated smoothly. We have had a running disagreement with the Soviets about the pricing provisions, which simply state that the grain must be purchased at market prices. When U.S. prices were above those of our competitors,

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subsidies were made available under the Export Enhancement Program for four million tons of wheat during the 1986-87 agreement year and for even greater amounts of wheat during the current year. Attachment B shows the status of U.S. sales under the present agreement.

The USSR also has ongoing supply agreements with Argentina for corn and soybeans; with Canada for wheat, and with France for wheat (and possibly barley).

3. Economic Benefits of an Agreement:

The concrete economic benefits of an agreement are difficult to measure. What benefits do accrue to the U.S. are concentrated in the wheat sector where there are large surpluses in world markets and we face strong competition from other suppliers. The competition in corn and soybeans is more limited; we are by far the major supplier to world markets.

4. Private Sector Views:

The USSR is the world's largest importer of grains, and despite its stated goal of achieving self-sufficiency, the Soviets are likely to remain major grain importers for the foreseeable future. Despite the troubled history of U.S.-USSR grain trade, the agreement does play an important facilitative role. For that reason, the agreement enjoys strong and widespread support in the U.S. agricultural sector. It is generally believed that the Soviets will buy more U.S. grain when an agreement is in effect than absent a long-term agreement. This is especially true in the case of wheat.

5. USSR Interest:

The Soviets had indicated earlier that they might not be interested in an agreement after the present pact expires. They recently rejected an Australian approach regarding a grains supply agreement. During the summit visit, Mr. Gorbachev, in response to a question from a representative of the Bunge Corporation, was negative on a new/extended agreement with the U.S. However, during a meeting with the Soviets on January 5 in London, the USSR delegation expressed an interest in a new grains agreement with the U.S., and suggested that the U.S. should send a negotiating invitation to the USSR.

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ATTACHMENT A

APPENDIX

Agreement Between The Government of the United States of America and The Government of the Union of Soviet Socialist Republics on the Supply of Grain

The Government of the United States of America ("USA") and the Government of the Union of Soviet Socialist Republics ("USSR"),

Recalling the "Basic Principles of Relations between the United States of America and the Union of Soviet Socialist Republics" of May 29, 1972 and other relevant agreements between them;

Desiring to strengthen long-term cooperation between the two countries on the basis of mutual benefit and equality;

Mindful of the importance which the production of food, particularly grain, has for the peoples of both countries;

Recognizing the need to stabilize trade in grain between the two countries; and

Affirming their conviction that cooperation in the field of trade will contribute to overall improvement of relations between the two countries;

Have agreed as follows:

Article I

The Government of the USA and the Government of the USSR hereby enter into an agreement for the purchase and sale of wheat and corn for supply to the USSR. To this end, during the period that this Agreement is in force, except as otherwise agreed by the Parties, the Soviet foreign trade organizations shall purchase from private commercial sources, for shipment in each twelve-month period beginning October 1, 1983, nine million metric tons of wheat and corn grown in the USA; in doing so, the Soviet foreign trade organizations, if interested, may purchase, on account of the said quantity, soybeans and/or soybean meal produced in the USA, in the proportion of one ton of soybeans and/or soybean meal for two tons of grain. In any case, the minimum annual quantities of wheat and corn shall be no less than four million metric tons each.

The Soviet foreign trade organizations may increase the nine million metric ton quantity mentioned above without consultations by as much as three million metric tons of wheat and/or corn for shipment in each twelve-month period beginning October 1, 1983.

The Government of the USA shall employ its good offices to facilitate and encourage such sales by private commercial sources. Purchases/sales of commodities under this Agreement will be made at the market price prevailing for these products at the time of purchase/sale and in accordance with normal commercial terms.

Article II

During the term of this Agreement, except as otherwise agreed by the Parties, the Government of the USA shall not exercise any discretionary authority available to it under United States law to control exports of commodities purchased for supply to the USSR in accordance with Article I.

Article III

In carrying out their obligations under this Agreement, the Soviet foreign trade organizations shall endeavor to space their purchases in the USA and shipments to the USSR as evenly as possible over each twelve-month period.

Article IV

The Government of the USSR shall assure that, except as the Parties may otherwise agree, all commodities grown in the USA and purchased by Soviet foreign trade organizations under this Agreement shall be supplied for consumption in the USSR.

Article V

Whenever the Government of the USSR wishes the Soviet foreign trade organizations to be able to purchase more wheat or corn grown in the USA than the amounts specified in Article I, it shall notify the Government of the USA.

Whenever the Government of the USA wishes private commercial sources to be able to sell to the USSR more wheat or corn grown in the USA than the amounts specified in Article I, it shall notify the Government of the USSR.

In both instances, the Parties will consult as soon as possible in order to reach agreement on possible quantities of grain to be supplied to the USSR prior to purchase/sale or conclusion of contracts for the purchase/sale of grain in amounts above those specified in Article I.

Article VI

The Government of the USA is prepared to use its good offices, as appropriate and within the laws in force in the USA, to be of assistance on questions of the appropriate quality of the grain to be supplied from the USA to the USSR.

Article VII

It is understood that the shipment of commodities from the USA to the USSR under this Agreement shall be in accord with the provisions of the American-Soviet Agreement on Maritime Matters which is in force during the period of shipments hereunder.

Article VIII

The Parties shall hold consultations concerning the implementation of this Agreement and related matters at intervals of six months, and at any other time at the request of either Party.

Article IX

This Agreement shall enter into force on execution and shall remain in force until September 30, 1988, unless extended by the Parties for a mutually agreed period.

DONE at Moscow this twenty-fifth day of August, 1983, in duplicate, each in the English and Russian languages, both texts being equally authentic.

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STATUS OF U.S. SALES TO THE USSR UNDER CURRENT LTA
REPORTED AS OF 1/14/88
(1,000 Metric Tons)

	ACTUAL SHIPMENTS				TOTAL SALES	SHIPMENTS TO DATE
AGREEMENT YEAR (Oct/Sep)	83/84	84/85	85/86	86/87	87/88	
Wheat	7,593	2,887	153	4,081	4,812	944
Corn	6,476	15,750	6,808	4,102	1,764	1,666
TOTAL - Grains	14,069	18,637	6,961	8,183	6,576	2,610
Soybeans	416	-	1,519	68	800	212
Soybean Cake & Meal	-	-	-	-	1,303	291
AGREEMENT MINIMUM	9,000	9,000	9,000	9,000	9,000	

Source: USDA/FAS - U.S. Export Sales

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TRANSMITTAL SLIP | **DATE** 4 FEB 19..

TO: D/DCI-DDCI Exec Staff

ROOM NO. | **BUILDING**

5:10 pm

REMARKS:

FROM: NIO/ECON

ROOM NO. 7E48 | **BUILDING** HQS | **EXTENSION**

FORM NO. 241 1 FEB 55 — REPLACES FORM 36-8 WHICH MAY BE USED. (47)

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SECRET

The Director of Central Intelligence

Washington, D.C. 20505

National Intelligence Council

NIC 00460-88
4 February 1988

MEMORANDUM FOR: Director of Central Intelligence

FROM: Deane E. Hoffmann
National Intelligence Officer for Economics

SUBJECT: Economic Policy Council Meeting, Friday, 5 February

1. Action: Possible attendance at an Economic Policy Council Meeting, Friday, 5 February from 9:15 to 10:15 in the Roosevelt Room at the White House.

2. The Economic Policy Council will meet tomorrow to discuss a series of policy initiatives on Mexico. It will also decide on whether to negotiate a renewal of the long-tern grain agreement with the Soviet Union. The initiatives taken toward Mexico will be modest and non-controversial. The CIA will have no role in the discussion. The renewal of the grain agreement is largely a political issue. The Intelligence Directorate did a background paper on the grain agreement, and you could have talking points on this issue.

3. Because both issues are more broad guage than the normal trade trivia covered by the Council, you might like to make an appearance to see the Council operate and, perhaps say a few words on Soviet grain.

4. Attached is a list of attendees from a past EPC meeting.

Deane E. Hoffmann

DCI EXEC REG

Attachment:
As stated

CL BY SIGNER
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January 14, 1988

PARTICIPANTS

Secretary Baker, Chairman Pro Tempore

Secretary Lyng
Secretary Verity
Secretary Burnley
Director Miller
Chairman Sprinkel
Deputy Attorney General Burns
(Representing Attorney General Meese)
Deputy Secretary Martin
(Representing Secretary Herrington)
Under Secretary Wallis
(Representing Secretary Shultz)
Ambassador Holmer
(Representing Ambassador Yeutter)

T. Kenneth Cribb, Jr., Assistant to the President for Domestic Affairs
Nancy J. Risque, Assistant to the President and Cabinet Secretary
Eugene McAllister, Executive Secretary

For Presentation

James C. Fletcher, Administrator, NASA
Dale Myers, Deputy Administrator, NASA
Robert H. Brumley, Acting General Counsel, Department of Commerce

Additional Invitees

James W. Dyer, Deputy Assistant to the President for Legislative Affairs
Dan L. Crippen, Deputy Assistant to the President
Rebecca Range, Deputy Assistant to the President and Director of the Office of Public Liaison
Jay Stephens, Deputy Counsel to the President
B. Jay Cooper, Special Assistant to the President and Deputy Press Secretary
Stephen I. Danzansky, Special Assistant to the President and Senior Director for International Economic Affairs, NSC
Michael Driggs, Special Assistant for Policy Development
William Graham, Science Advisor to the President and Director of the Office of Science and Technology Policy
C. Boyden Gray, Counsellor to the Vice President

Deane Hoffman, National Intelligence Officer for Economics, CIA

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ROUTING SLIP

TO:

		ACTION	INFO	DATE	INITIAL
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2	DDCI				
3	EXDIR				
4	D/ICS				
5	DDI				
6	DDA				
7	DDO				
8	DDS&T				
9	Chm/NIC				
10	GC				
11	IG				
12	Compt				
13	D/OCA				
14	D/PAO				
15	D/PERS				
16	D/Ex Staff		X	04 FEB 1988	
17	NIO/ECON		X		
18					
19					
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21					
22					
	SUSPENSE		Date		

Remarks

Executive Secretary

4 Feb '88

Date

3637 (10-81)

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Executive Registry
88-0383X

THE WHITE HOUSE
WASHINGTON

CABINET AFFAIRS STAFFING MEMORANDUM

Date: Feb. 3, 1988 **Number:** 490,726 **Due By:** -----

Subject: Economic Policy Council Meeting -- Friday, February 5, 1988
Roosevelt Room -- 9:15 a.m.

	Action	FYI
ALL CABINET MEMBERS	☐	☐
Vice President	☑	☐
State	☑	☐
Treasury	☑	☐
Defense	☑	☐
Justice	☑	☐
Interior	☐	☐
Agriculture	☑	☐
Commerce	☑	☐
Labor	☑	☐
HHS	☐	☐
HUD	☐	☐
Transportation	☑	☐
Energy	☑	☐
Education	☐	☐
Chief of Staff	☑	☐
OMB	☑	☐
UN	☐	☐
USTR	☑	☐
CEA	☑	☐
CIA	☑	☐
EPA	☐	☐
GSA	☐	☐
NASA	☐	☐
OPM	☐	☐
SBA	☐	☐
VA	☐	☐

	Action	FYI
CEQ	☐	☐
OSTP	☐	☐
Powell	☑	☐
Cribb	☑	☐
Bauer	☑	☐
Dawson *(For WH Staffing)*	☑	☐
Executive Secretary for:		
DPC	☐	☑
EPC	☑	☐
AID	☑	☐

REMARKS:

The Economic Policy Council will meet on Friday, February 5, 1988, at 9:15 a.m. in the Roosevelt Room. The agenda and background materials are attached for your review.

RETURN TO:

☑ Nancy J. Risque
Cabinet Secretary
456-2823
(Ground Floor, West Wing)

☐ Associate Director
Office of Cabinet Affairs
456-2800
(Room 235, OEOB)

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THE WHITE HOUSE

WASHINGTON

February 3, 1988

MEMORANDUM FOR THE ECONOMIC POLICY COUNCIL

FROM: EUGENE J. McALLISTER EH

SUBJECT: Agenda and Papers for the February 5 Meeting

The agenda and papers for the February 5 meeting of the Economic Policy Council are attached. The meeting is scheduled for 9:15 a.m. in the Roosevelt Room.

The first agenda item will be Mexico. In the State of the Union, the President highlighted trade as one of the top items on his agenda for his talks with President de la Madrid, scheduled for February 13. The Council will consider several options for trade initiatives within the existing framework agreement. The TPRG has prepared the attached paper outlining these options.

The second agenda item will be the Long-Term Grain Agreement. The current 5-year U.S.-U.S.S.R. agreement expires September 30, 1988. The Council will discuss the possible renewal of the agreement. A paper prepared by the TPRG is attached.

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ECONOMIC POLICY COUNCIL

February 5, 1988

9:15 a.m.

The Roosevelt Room

AGENDA

1. Mexico
2. Long Term Grain Agreement with the Soviet Union

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OFFICE OF THE UNITED STATES
TRADE REPRESENTATIVE
EXECUTIVE OFFICE OF THE PRESIDENT
WASHINGTON
20506

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February 3, 1988

MEMORANDUM

TO: THE ECONOMIC POLICY COUNCIL

FROM: THE TRADE POLICY REVIEW GROUP

SUBJECT: U.S.-Mexico Trade Relations

ISSUE

President Reagan has requested an examination of the prospects for establishing a special trade and investment relationship with Mexico. He has similarly requested an examination of trade and investment issues that affect the U.S.-Mexico border. The aim is to determine possibilities for building on our currently good trade relations. On January 28, President De la Madrid called the current structural adjustment process accompanied by trade liberalization that has been initiated and implemented by his Administration the most significant achievement in the last 50 years of Mexican history. He called GATT accession and the bilateral framework agreement the two most important actions taken by Mexico during this process. He also stated that the development of a constructive working relationship with the U.S. has been one of the major achievements of his Administration.

RECOMMENDATIONS

1. That the U.S. utilize the recently signed bilateral framework agreement as the mechanism for managing the bilateral trade and investment relationship and for seeking incremental improvements in market access, foreign investment policy, and intellectual property protection. (The first round of formal consultations under the framework agreement are already scheduled for February 22-23 in Mexico.)

2. That the EPC provide guidance as to whether the U.S. should seek to negotiate any of four limited trade initiatives with Mexico (see pages 4-9).

3. That the U.S. use the February 13 meeting of the two Presidents and the February 22-23 framework agreement consultations in a coordinated manner to seek certain modest improvements in Mexican foreign investment regulation.

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4. That the EPC consider reaffirming Administration opposition to modification or elimination of U.S. tariff provisions 806.30/807.00.

BACKGROUND

-- Mexico is our fourth largest trading partner (after Canada, Japan and West Germany) and third largest export market. Total trade between the two countries in 1987 was about $35 billion. The U.S. has run a trade deficit with Mexico since 1982, with a 1987 deficit of over $6 billion. Mexico is our third largest supplier of crude oil.

-- Mexican trade policy has undergone an important evolution during the De la Madrid Administration. To move Mexico away from economic development based on import substitution and oil export earnings and towards export-led growth, the De la Madrid Administration has stimulated the process of structural adjustment through a reduction in domestic subsidies and an opening of the domestic market to import competition. With respect to trade, substantial liberalization has taken place in the level of tariffs and in the use of import licenses and official reference prices: the three tools used by Mexico in the post WWII period to control imports.

-- At the end of 1983, all of the more than 8,300 Mexican tariff categories were subject to import licensing requirements; now only 329 categories (mainly covering the auto and pharmaceutical sectors, some agricultural products, drugs, firearms, and some luxury items) are still covered. (These 329 categories represent 3.9% of the Mexican tariff schedule but covered 27.2% of total Mexican imports by value in 1987.) Official reference prices, which covered over 1,500 tariff categories two years ago, were totally eliminated at the end of 1987. Tariffs were as high as 100 percent as recently as April 1986, but have been reduced to a maximum applied rate of 20% as of December 15, 1987. The 5% general import tax, applied on top of the normal duty, was eliminated on December 15, 1987. The average weighted Mexican tariff is now 5.6%. (The comparable U.S. tariff is 3.1%.) Most of the trade liberalization has been implemented since July 1985.

-- Mexico has complemented these measures by acceding to the GATT on August 24, 1986, and by signing on November 6, 1987, with the U.S. a bilateral framework agreement for trade and investment. The significant reduction in Mexican licensing requirements and the elimination of official reference prices have fulfilled commitments made by Mexico during its GATT accession negotiation. However, the tariff reductions implemented by Mexico go well beyond Mexico's GATT commitments.

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-- The framework agreement was an important psychological step forward for Mexico. Its primary result was the establishment of a consultative mechanism which can be invoked by either side at any time to clarify respective trade policies, resolve specific disputes, or negotiate the removal or reduction of trade and investment barriers.

-- The U.S. market is, with a few important exceptions, open to imports from Mexico. Over 80% of Mexican exports to the U.S. enter at a duty rate between 0 and 5 percent. There are no section 301 measures against Mexico, while quotas on stainless steel imports are the only section 201 measures affecting Mexico. (These quotas have, in practice, not proven particularly restrictive for Mexico.) The steel and textile quotas have recently been increased, and the meat embargo is under technical review. The embargo on fresh avocados appears to be technically justified because of seed weevil infestation in Mexico. The sugar quota has had little impact since Mexico consumes almost all its sugar production domestically.

-- Mexico should benefit by the graduation of Korea, Taiwan, Hong Kong and Singapore from the U.S. GSP in January 1989. Mexico is now the fourth largest beneficiary of the U.S. GSP program, entering over $1.5 billion of products into the U.S. duty free under the program's provisions, and will become the program's leading beneficiary after the removal of the four Asian countries.

-- On the whole, the U.S. and Mexico are now enjoying good and cooperative trade relations. The substantial trade liberalization in Mexico since July 1985, much of it unilaterally implemented for Mexico's own economic development, has reduced or eliminated many of the longstanding bilateral trade irritants with respect to market access. In fact, the amount of trade liberalization has gone beyond what any observer expected.

-- The past three years have been the most active ever in the bilateral trade relationship. In addition, the bilateral subsidies understanding, Mexico's GATT accession negotiation, the GSP General Review, and the framework agreement have moved the focus of the trade relationship away from any concessionary approach by the U.S. to a mutually accepted approach of reciprocity. The recent steel/beer/wine/distilled spirits agreement and even the new textile agreement reflect this.

-- Mexican foreign investment policy and certain intellectual property issues are now the major difficulties in the bilateral trade and investment relationship.

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-- In a speech to the Mexican Importers and Exporters Association on January 28, De la Madrid stated that an FTA with the U.S. would be premature at this time due to both the current difficulties in the Mexican economy and the disparity in the levels of economic development.

POSSIBLE BILATERAL TRADE INITIATIVES

1A. Offer to increase Mexico's GSP benefits through the annual review process in return for improvements in Mexico's patent law. Specifically, offer to grant a substantial number of redesignations of product eligibility for Mexico and waivers from competitive need limits in return for the implementation within 2 or 3 years of (1) product patent protection for pharmaceuticals, chemicals and alloys and (2) process patent protection for biotechnology.

Pros

-- In effect, would reinitiate GSP General Review negotiation between U.S. and GOM. Uses part of limited U.S. negotiating leverage (GSP benefits, steel quotas and textile quota levels) to obtain concessions of commercial importance to U.S.

-- GSP waivers for Mexico might stimulate investment in Mexico.

-- If successful, would resolve one of major outstanding bilateral trade problems.

Cons

-- Difficult to promise GSP benefits which would become effective in July 1989 in return for changes in Mexican patent law which would have to be approved by Mexican Congress in fall of 1988. (Mexican Congress only convenes during September-December each year).

-- Such an agreement would commit next U.S. Administration to follow through. Perhaps too late in political life of both Administrations to pull off.

-- Could create problems with private sector or other beneficiaries if deal became public.

-- Mexican interest perhaps diminished by upcoming removal of Korea, Taiwan, Hong Kong and Singapore from U.S. GSP.

1B. Offer to increase Mexico's GSP benefits as soon as the Mexican Congress approves improvements in Mexico's patent law. Specifically, offer to grant a substantial number of

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<u>redesignations of product eligibility for Mexico and waivers from competitive need limits in return for the implementation within 2 or 3 years of (1) product patent protection for pharmaceuticals, chemicals and alloys and (2) process patent protection for biotechnology</u>.

<u>Pros</u>

-- Provides more negotiating flexibility than first option by offering to have U.S. President increase Mexico's benefits as soon as Mexican Congress acts rather than waiting until July 1989. Uses part of limited U.S. negotiating leverage (GSP, steel, and textiles) to obtain concessions of commercial importance to U.S.

-- Would make clear to everyone the special nature of the U.S.-Mexico relationship. (Such a grant of GSP benefits outside the normal annual GSP review cycle has never been done before.)

<u>Cons</u>

-- Would set a precedent that would greatly complicate the administration of GSP program, specifically the GSP Annual Review procedure that is based on a "due process" procedure. The hundreds of private sector and other beneficiary country petitioners that have relied on the predictability of the year long Annual Review process would now have clear grounds to ask for the same "special treatment".

-- Would send a clear signal to all our trading partners in the midst of the Uruguay Round that in administering the GSP program, the U.S. has no regard for our GATT obligations in how we administer the GSP. Specifically, we would be violating the principles of "non-discrimination" and "non-reciprocity" that are a central component of the GATT waiver allowing for GSP programs.

-- Would send the wrong signal to those in the GOM that deal directly with the GSP program. The GOM is notorious for submitting poorly prepared petitions that do not meet the regulations governing the submission of petitions in the GSP Annual Review.

-- Following so soon after our decision to graduate the four Asian beneficiaries, this will not send a signal that we are looking to redistribute GSP benefits to other developing countries. It will send a signal that we are interested in giving "special" treatment to Mexico. Since we cannot do the same thing for all

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other beneficiaries, this decision would potentially complicate our relations with a number of developing countries.

GSP BACKGROUND

As part of the GSP General Review exercise in 1986, the U.S. offered Mexico an increase of several hundred million dollars in GSP benefits if Mexico would make substantial improvements in its patent and trademark law. The De la Madrid Administration did submit, and the Mexican Congress did approve, comprehensive amending legislation. However, it fell short on several key points of primary interest to the U.S. In particular, the length of a patent term was only increased from 10 to 14 years, instead of the U.S. requested 17 years. Also, implementation of product patent protection for pharmaceuticals and chemicals and process patent protection for biotechnology was delayed until January 1997. The U.S. had proposed a two year phase-in (January 1989). As a result of these shortcomings the U.S. removed $200 million of GSP benefits from Mexico as of July 1987.

It should be noted that the President has, with few exceptions, broad discretionary authority in adding or deleting items or countries from the GSP program. One requirement is that he must obtain economic advice from the ITC before taking any such action.

2. Offer to negotiate additional increases in the U.S. steel quotas for Mexico in return for bound tariff reductions in Mexican steel tariffs combined with other bound tariff reductions (perhaps certain chemical, paper, canned fruit, raisin, and chocolate confectionary items) or increase in the length of the Mexican patent term.

Pros

-- Uses one of few U.S. negotiating chips (GSP benefits and steel and textile quotas) to obtain concessions of commercial importance to U.S.

Cons

-- Mexicans have insufficient capacity to increase exports of items in shortage in U.S. (semi-finished steel). Would thus need to offer increases in items where no domestic shortages reported.

-- U.S. industry accepted earlier steel deal with Mexico in order to obtain restraints on Boren amendment items, but will oppose any further increases. Industry likely to mobilize Congressional Steel Caucus in opposition to any deal.

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-- Other VRA countries accepted U.S.-Mexico steel deal in hopes of getting Boren amendment eliminated. Any additional deal will lead to demands for similar treatment.

-- The U.S. has already been generous with Mexico with respect to steel quotas. Aside from the recent increase, the VRA negotiated with Mexico contains two provisions not contained in any other arrangement. One provides for an upward adjustment to Mexico's export ceilings based on U.S. steel exports to Mexico. The other provision permits currently unrestrained imports of steel (except for one specific product) entered under TSUS item 806.30. Imports under this provision have increased significantly.

BACKGROUND ON STEEL

The two governments formalized an agreement under the framework agreement in late December which provided Mexico a 12.4% increase in its 1988 steel quotas in return for adding three wire products to quota restraints, elimination of the Mexican beer, wine and distilled spirits quotas, and elimination of the import licensing requirement on 38 tariff categories.

3. Offer bound, U.S. tariff reductions for TSUS categories where Mexico is the principal or a substantial supplier in return for a binding of recent Mexican tariff reductions and import licensing eliminations.

Pros

-- Provides opportunity to lock-in large part of recent Mexican trade liberalization. Could prove very important to U.S. commercial interests once Mexican economy rebounds.

-- Would provide impetus to trade credit concept in Uruguay Round.

-- Would, in effect, represent Uruguay Round tariff negotiation with fourth largest U.S. trading partner.

-- Could provide incentive to other LDCs to implement trade liberalization measures.

-- Tariff concession list could possibly be tailored to avoid giving too many other suppliers a free ride.

Cons

-- Negotiated concessions would require congressional approval.

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-- Could involve giving too many other countries a free ride and, thus, lose some leverage for Uruguay Round tariff exercise.

-- Preliminary analysis shows that TSUS items for which Mexico is principal or substantial supplier are heavily weighted in high duty agricultural items, high duty textile items, and petroleum. These would all be politically sensitive items.

BACKGROUND ON TRADE CREDIT OPTION

-- The idea of a "trade credit" has considerable support from the World Bank, including the Development Committee and President Barber Conable. Although there has been no detailed discussion as to the specific conditions under which these concessions would be negotiated, the concept is under study by the Uruguay Round Working Group on Developing Countries. A practical precedent exists in the U.S.-Philippine Section 124 Negotiations held in 1981. At the suggestion of the World Bank, the Philippines approached the United States asking for trade negotiations in which they would bind tariff cuts and licensing changes made as part of a structural adjustment loan in return for U.S. tariff cuts made with residual authority left over from the Tokyo Round. The negotiation was not completed before U.S. tariff authority ran out.

-- In the case of Mexico, there are two structural adjustment loans worth $1 billion that are already being disbursed. As part of the loans, Mexico pledges to remove items from their licensing list and reduce tariffs to 30% MFN on $40 million in trade. These concessions are technically only good for the life of the loan and can be easily reversed after that. To create permanent change in the trading system, Mexico would have to bind these cuts in the GATT on an MFN basis. Mexican quantitative restrictions could be removed and converted to GATT-bound tariffs as part of the negotiations.

-- It's important to note that Mexico has now gone substantially beyond the conditions attached to the World Bank loans. The U.S. would aim for bindings at the new lower tariff levels (maximum Mexican tariff is now 20 percent).

-- There are 147 TSUS items which are not GSP-eligible and for which Mexico is the principal or a substantial supplier. 40 of the items are in the 0-5 percent duty range, 47 in the 5-10 percent, 43 in the 10-20 percent, and 17 over 20 percent. Total value of imports from Mexico under the 147 TSUS items is $4.2 billion, or 29.5 percent of total U.S. imports of those items. Of the $4.2 billion in imports from Mexico, $3.2 billion enters under the 0-5 percent duty range, $414

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million in the 5-10 percent range, $409 million in the 10-20 percent range, and $83 million over 20 percent.

-- If GSP eligible items are added to the list of possibilities, there are 395 TSUS items for which Mexico is the principal or a substantial supplier. Of that 395, 158 are in the 0-5 range, 134 in the 5-10 range, 75 in the 10-20 range, and 28 over 20 percent. Total imports from Mexico in the 395 items is $8.5 billion, or 29.5 percent of total imports of those items. Of those imports, $5.9 billion enters in the 0-5 percent duty range, $1.8 billion in the 5-10 percent range, $626 million in the 10-20 percent range, and $156 million over 20 percent.

4. Negotiate a U.S.-Mexico Auto Pact.

A small TPRG sub-group has reviewed this option and found such a sectoral trade arrangement to be premature. Further study of the implications for U.S. employment and production and the relation to the U.S.-Canada Auto Pact is needed. In addition, sectoral arrangements are GATT incompatible and would require a GATT waiver.

IMPROVEMENTS IN MEXICAN INVESTMENT REGIME

During the February 13 meeting in Mazatlan, the President and U.S. cabinet officers could point to the benefits to Mexico should conditions for foreign investors be eased. While recognizing the difficulty in obtaining major legislative changes in the Mexican Foreign Investment Law at this late stage of the De la Madrid Administration, U.S. reps could point to certain small improvements which could help Mexico and improve the bilateral investment climate. Suggested improvements could include an increase in the threshold (currently $8 million) which defines small and medium size companies which are allowed to have 100 percent foreign ownership without Foreign Investment Commission approval. Other improvements could be a standstill on the use of export performance requirements, or a lowering of the 55 percent tax on dividends. It could then be suggested that details be worked out during the formal framework agreement consultations on February 22-23 in Mexico.

BACKGROUND ON INVESTMENT

-- The U.S. is by far the largest source of foreign investment in Mexico. Total U.S. direct investment in Mexico is $5.9 billion (1986 estimate), or 68.2% (1985) of all foreign investment in Mexico. This $5.9 billion represents only 2.5% of total U.S. foreign investment, with Mexico ranked 12th among countries receiving U.S. foreign investment (but 2nd among LDCs).

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-- In most cases foreign investment is limited to 49% of equity, although majority ownership can be negotiated with the Foreign Investment Commission. In those latter cases, majority ownership is authorized only in return for commitments on local content, export performance, location, and R&D requirements. In addition to these general rules regarding foreign investment, Mexico has developed sectoral programs in automobiles, electronics and pharmaceuticals. In each case, all investment approvals are dependent upon commitments for local content, technology transfers, export performance and net foreign exchange earnings.

-- These restraints on foreign investors are now, in light of the significant progress made in the last two years on market access issues, the single largest area of disagreement in our bilateral trade and investment relations. We believe these obstacles to investment are not just irritants to the U.S., but counterproductive to Mexico's own economic development.

BACKGROUND ON 806.30/807.00 RECOMMENDATION

-- At the request of the House Ways and Means Committee, the ITC conducted a study on the economic effects of TSUS items 806.30 and 807.00. These duty classification numbers cover products which have been exported from the United States for processing abroad. Upon their re-entry into the United States, the importer pays duty only on the value-added abroad.

-- The study, released on January 26, found that plant relocation outside of the U.S. is not being spurred by 806.30/807.00 tariff concessions, but by lower labor costs abroad, especially in Mexico. In addition, Mexico has additional factors making it attractive - the maquila program, quality workers, low transportation costs and ease of communications. As such, the ITC concluded that the elimination of preferential duty treatment will not result in the return of assembly jobs to the United States. The ITC also concluded that items 806.30 and 807.00 "appear" to have improved the competitiveness of U.S. firms vis-a-vis foreign manufacturers of products containing no U.S. components.

-- The House Ways and Means Trade Subcommittee recently requested public comment on a bill introduced by Cong. LaFalce to eliminate 806.30 and 807.00. The administration opposed similar legislation in 1986.

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-- Consideration of the issue in 1987 was put on hold pending the outcome of the ITC report. U.S. private sector groups along the U.S.-Mexico border have called for assurances from the Administration that it will continue to oppose changes in these tariff provisions.

TRADE OPTIONS FOR MEETING OF THE PRESIDENTS

-- President Reagan could acknowledge the substantial progress made by President De la Madrid in liberalizing trade and eliminating or reducing subsidies.

-- Particular attention could be drawn to the framework agreement which was signed by Mexico and the U.S. in November 1987. The signing of the framework agreement fulfilled the Presidents' August 1986 pledge to dedicate their administrations to strengthening trade and investment ties between the two countries. To reinforce the commitment of both nations to continuing progress in that regard, the Presidents could express their continuing commitment to progressively reduce barriers to bilateral trade and investment, using the framework agreement and the GATT process as mechanisms for achieving this. Particular attention could be drawn to possible improvements in the investment area which could be discussed during upcoming framework agreement talks.

-- President Reagan could point out the benefits to Mexico of his decision to remove four Asian countries from the U.S. GSP.

-- President Reagan could reaffirm his opposition to a protectionist trade bill and to oil import fees.

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U.S.-USSR LONG TERM AGREEMENT

Issue

The United States currently has a five-year grain trade agreement with the Soviets (Attachment A) which will expire September 30, 1988. Secretary Shultz and Soviet Minister of Foreign Affairs Shevardnardze agreed last fall that we would explore the merits of renewing the agreement early in 1988. At a January 5 meeting in London, the Soviets suggested that the U.S. should extend an invitation to the USSR to begin such talks.

Recommendation

The Trade Policy Review Group reviewed this issue on January 26. The Group's unanimous recommendation was that the U.S. should attempt to negotiate a new agreement.

The EPC should accept the TPRG recommendation.

Background

1. TPRG Discussion

The TPRG discussed a number of issues relating to the agreement. The principal issue was whether a formal arrangement on grain trade with the Soviets should be pursued to replace/extend the present agreement. The TPRG unanimously favored the continuation of an arrangement. With regard to whether this should be the negotiation of a new agreement or simple extension of the current agreement, the TPRG concluded that our primary objective should be the negotiation of a new agreement. However, the group expressed the sense that an extension of the current agreement could be an acceptable fall-back position if efforts to renegotiate are not productive.

The TPRG addressed a number of additional issues but agreed that these should be decided by the U.S. negotiating team or resubmitted for policy guidance as the negotiations proceed. Those issues include:

a. The time frame covered by the agreement.

- The Soviets have indicated that they would prefer a period shorter than 5 years to bring the agreement into conformity with the USSR five-year plan.

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b. The price provisions to be included in the agreement.

- o The present agreement states that sales will be made at prevailing market prices. This could be interpreted as prevailing U.S. or world market prices.

  In recent years, world prices have been significantly below U.S. prices.

c. Products covered by the agreement.

- o There is considerable interest among U.S. commodity groups in bringing more products into the agreement.

d. What quantities should be included, and should trade-offs between commodities be permitted in determining compliance with the minimum purchase provisions?

- o The Soviets have suggested that they would like lower minimum purchase requirements and total flexibility in shifting between products.

e. Role of non-agricultural issues in the negotiations.

- o The Soviets may want to bring shipping issues or non-agricultural trade matters into the agreement.

USTR will lead the negotiations for the new agreement, in close coordination with the Departments of Agriculture and State. This is an economic agreement, but cannot be considered outside the scope of the overall bilateral relationship. Therefore, throughout the negotiations USTR will seek appropriate guidance from interested departments and agencies on foreign policy and national security considerations.

2. <u>Status of Current Agreement:</u>

The current agreement provides that the Soviet Union will buy a minimum of nine million tons of grain during each agreement year. Of this amount, at least four million tons must be wheat and at least four million tons must be corn. The remaining million tons may be corn or wheat or may be soybeans/soybean meal. Soybeans and soybean meal are counted at a 2:1 ratio (1/2 ton of soybeans is the equivalent of 1 ton of grain for the purposes of this agreement.)

The present agreement has not operated smoothly. We have had a running disagreement with the Soviets about the pricing provisions, which simply state that the grain must be purchased at market prices. When U.S. prices were above those of our competitors,

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subsidies were made available under the Export Enhancement Program for four million tons of wheat during the 1986-87 agreement year and for even greater amounts of wheat during the current year. Attachment B shows the status of U.S. sales under the present agreement.

The USSR also has ongoing supply agreements with Argentina for corn and soybeans; with Canada for wheat, and with France for wheat (and possibly barley).

3. Economic Benefits of an Agreement:

The concrete economic benefits of an agreement are difficult to measure. What benefits do accrue to the U.S. are concentrated in the wheat sector where there are large surpluses in world markets and we face strong competition from other suppliers. The competition in corn and soybeans is more limited; we are by far the major supplier to world markets.

4. Private Sector Views:

The USSR is the world's largest importer of grains, and despite its stated goal of achieving self-sufficiency, the Soviets are likely to remain major grain importers for the foreseeable future. Despite the troubled history of U.S.-USSR grain trade, the agreement does play an important facilitative role. For that reason, the agreement enjoys strong and widespread support in the U.S. agricultural sector. It is generally believed that the Soviets will buy more U.S. grain when an agreement is in effect than absent a long-term agreement. This is especially true in the case of wheat.

5. USSR Interest:

The Soviets had indicated earlier that they might not be interested in an agreement after the present pact expires. They recently rejected an Australian approach regarding a grains supply agreement. During the summit visit, Mr. Gorbachev, in response to a question from a representative of the Bunge Corporation, was negative on a new/extended agreement with the U.S. However, during a meeting with the Soviets on January 5 in London, the USSR delegation expressed an interest in a new grains agreement with the U.S., and suggested that the U.S. should send a negotiating invitation to the USSR.

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ATTACHMENT A

APPENDIX

Agreement Between The Government of the United States of America and The Government of the Union of Soviet Socialist Republics on the Supply of Grain

The Government of the United States of America ("USA") and the Government of the Union of Soviet Socialist Republics ("USSR"),

Recalling the "Basic Principles of Relations between the United States of America and the Union of Soviet Socialist Republics" of May 29, 1972 and other relevant agreements between them;

Desiring to strengthen long-term cooperation between the two countries on the basis of mutual benefit and equality;

Mindful of the importance which the production of food, particularly grain, has for the peoples of both countries;

Recognizing the need to stabilize trade in grain between the two countries; and

Affirming their conviction that cooperation in the field of trade will contribute to overall improvement of relations between the two countries;

Have agreed as follows:

Article I

The Government of the USA and the Government of the USSR hereby enter into an agreement for the purchase and sale of wheat and corn for supply to the USSR. To this end, during the period that this Agreement is in force, except as otherwise agreed by the Parties, the Soviet foreign trade organizations shall purchase from private commercial sources, for shipment in each twelve-month period beginning October 1, 1983, nine million metric tons of wheat and corn grown in the USA; in doing so, the Soviet foreign trade organizations, if interested, may purchase, on account of the said quantity, soybeans and/or soybean meal produced in the USA, in the proportion of one ton of soybeans and/or soybean meal for two tons of grain. In any case, the minimum annual quantities of wheat and corn shall be no less than four million metric tons each.

The Soviet foreign trade organizations may increase the nine million metric ton quantity mentioned above without consultations by as much as three million metric tons of wheat and/or corn for shipment in each twelve-month period beginning October 1, 1983.

The Government of the USA shall employ its good offices to facilitate and encourage such sales by private commercial sources. Purchases/sales of commodities under this Agreement will be made at the market price prevailing for these products at the time of purchase/sale and in accordance with normal commercial terms.

Article II

During the term of this Agreement, except as otherwise agreed by the Parties, the Government of the USA shall not exercise any discretionary authority available to it under United States law to control exports of commodities purchased for supply to the USSR in accordance with Article I.

Article III

In carrying out their obligations under this Agreement, the Soviet foreign trade organizations shall endeavor to space their purchases in the USA and shipments to the USSR as evenly as possible over each twelve-month period.

Article IV

The Government of the USSR shall assure that, except as the Parties may otherwise agree, all commodities grown in the USA and purchased by Soviet foreign trade organizations under this Agreement shall be supplied for consumption in the USSR.

Article V

Whenever the Government of the USSR wishes the Soviet foreign trade organizations to be able to purchase more wheat or corn grown in the USA than the amounts specified in Article I, it shall notify the Government of the USA.

Whenever the Government of the USA wishes private commercial sources to be able to sell to the USSR more wheat or corn grown in the USA than the amounts specified in Article I, it shall notify the Government of the USSR.

In both instances, the Parties will consult as soon as possible in order to reach agreement on possible quantities of grain to be supplied to the USSR prior to purchase/sale or conclusion of contracts for the purchase/sale of grain in amounts above those specified in Article I.

Article VI

The Government of the USA is prepared to use its good offices, as appropriate and within the laws in force in the USA, to be of assistance on questions of the appropriate quality of the grain to be supplied from the USA to the USSR.

Article VII

It is understood that the shipment of commodities from the USA to the USSR under this Agreement shall be in accord with the provisions of the American-Soviet Agreement on Maritime Matters which is in force during the period of shipments hereunder.

Article VIII

The Parties shall hold consultations concerning the implementation of this Agreement and related matters at intervals of six months, and at any other time at the request of either Party.

Article IX

This Agreement shall enter into force on execution and shall remain in force until September 30, 1988, unless extended by the Parties for a mutually agreed period.

DONE at Moscow this twenty-fifth day of August, 1983, in duplicate, each in the English and Russian languages, both texts being equally authentic.

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ATTACHMENT B

STATUS OF U.S. SALES TO THE USSR UNDER CURRENT LTA
REPORTED AS OF 1/14/88
(1,000 Metric Tons)

	ACTUAL SHIPMENTS				TOTAL SALES	SHIPMENTS TO DATE
AGREEMENT YEAR (Oct/Sep)	83/84	84/85	85/86	86/87	87/88	
Wheat	7,593	2,887	153	4,081	4,812	944
Corn	6,476	15,750	6,808	4,102	1,764	1,666
TOTAL - Grains	14,069	18,637	6,961	8,183	6,576	2,610
Soybeans	416	-	1,519	68	800	212
Soybean Cake & Meal	-	-	-	-	1,303	291
AGREEMENT MINIMUM	9,000	9,000	9,000	9,000	9,000	

Source: USDA/FAS - U.S. Export Sales

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