DEPARTMENT OF STATE

BRIEFING MEMORANDUM

S/S

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TO: The Acting Secretary

FROM: EB - Julius L. Katz, Designate

Monthly Report
The LDCs and the MTN

All the noise in the North/South dialogue is concentrated at the moment on commodities and debt. These were the contentious issues at UNCTAD IV. They are the contentious issues that interrupted the CIEC exercise. They will continue to be troublesome now that CIEC has resumed.

By contrast, all is quiet on the trade front, or so it seems. In fact, an active negotiation is going on, removed for the time being from the glare of publicity. More than 70 LDCs are participating in the MTN. The tropical products negotiation, of special interest to LDCs, is furthest advanced of all the activities in the MTN. The moderates are in control--Brazil, Mexico, Argentina, India, Singapore, Malaysia. Although many of their views are unacceptable to us, they are serious and persistent in pressing their views and interested in negotiation rather than confrontation--at least at this time. They see real benefits for themselves and for LDCs generally from a successful negotiation. They have been willing to give the MTN a chance--notwithstanding the long delays in getting the process moving--with the result that a real dialogue is going on on substantive issues.

So far, so good. But it is becoming increasingly apparent that, even in this area, a blow-up could occur if we do not manage the negotiations well. LDC positions are diverging from ours at critical points and we will be under stress this fall and during the course of 1977 when the pace of negotiations will accelerate.

Trade is the area where, objectively, our interests should converge. Trade liberalization is, as the textbooks

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say, mutually beneficial. For the LDCs, it means opportunities for growing export earnings that can finance growing development imports and enhance their ability to borrow. It also means exposure to competition in the wider world market which can spur LDC enterprises to better performance. The fast-growing LDCs, like Korea, Taiwan, Brazil, are those that have developed an export-oriented strategy and taken advantage of opportunities in the world market. For the U.S., it means larger export markets--non-oil LDCs take more than one-fourth of our exports--and the opportunity to import goods that LDCs can produce more economically than we. At a time when we are opting for slower growth at home to avoid reigniting inflation, lower cost imports are an important counter-inflationary force.

Unlike commodity agreements which we fear LDCs will pervert from mechanisms for stabilization to mechanisms for jacking up prices, trade is pre-eminently the area where we can make offers consistent with our own economic philosophy, our narrow, as well as broad, self-interest, and further LDC welfare as well.

<u>LDC Positions in the MTN</u>

1. At the UN Special Session, we called for a fundamental structural improvement in the relationship of LDCs to the world trading system. In the earlier stages of their development they should receive special treatment, we said--preferences, favorable concessions, and exceptions which reflect their economic status. But as they progress to a higher level of development, they must gradually accept the obligations of reciprocity and be prepared to compete on more equal terms.

Following up on that principle, we have taken the lead in proposing ways in which the LDCs can enjoy preferential treatment--in the tariff area (deeper-than-formula cuts), in the subsidy area (prohibited subsidy practices might be allowed for LDC "infant" industries for a limited period), in the safeguard area (minor LDC suppliers would get preferred treatment when we restrict imports because of injury to domestic producers), etc. But our proposals are conditioned on the principle of gradual phase-out as LDCs graduate.

The LDCs reject the principle of graduation. They want <u>permanent preferential treatment</u> in all areas of the trading system, and no obligation on them to reciprocate. More specifically they want GSP to continue indefinitely with permanent preferential margins; they want to be able to subsidize their exports without facing countervailing duties; they want no limitations on their sales even when these sales cause serious injury to our domestic industries; and they believe they should not be required to reciprocate by reducing their tariffs, which in many cases run 100-200 percent, or in other appropriate ways.

It is the extreme nature of the LDC position and not the principle of "special treatment" that gives us concern. We cannot ask domestic industries that face injury to sink or swim because the injury comes from LDC competitors or to be complacent about subsidized exports because the source is a Third World country. The principle of temporary protection in the event of injury is fundamental. Furthermore, we cannot justify substantial concessions to LDCs if they are unprepared to open their markets to U.S. exports. Not all LDC enterprises are fragile "infant" industries. More fundamentally, for both political and economic reasons we want to bring the LDCs into a fuller and more responsible participation in the world trading system and not divide that system into two virtually unrelated parts.

Clearly there will have to be some give in the LDC position. In the crunch, we would expect them to back down somewhat, but only if there was enough in the total MTN package to make it worth their while.

2. The second point of stress is the strongly reiterated desire of the LDCs to limit tariff liberalization by the developed countries for products on the GSP list. They want to preserve their margins of preference or be compensated for any narrowing of the margin. We cannot agree that special treatment for LDCs should restrict the opportunities for overall liberalization. Were the industrial countries to accede to the LDC position in this--and the EC shows signs of willingness to comply--the scope of the tariff reductions in the Tokyo Round would be substantially narrowed. We would have to reduce our offers to the EC, if the EC excluded GSP items from MFN tariff cuts, in order to assure rough reciprocity. There are, moreover, a number of items on the Community's GSP list on which we would like to see the Community reduce its MFN duties. Tobacco, pineapple, and citrus are examples.

If we can persuade the industrial countries to join us in rejecting extreme LDC positions, many LDCs might prefer to see the MTN fail since maintaining preference margins for GSP items might be judged more beneficial than limited MFN cuts. However, some LDCs such as Mexico, Brazil, Hong Kong, Taiwan, and India, which have not benefited fully from GSP because they are competitive on a number of products and excluded thereby from enjoying preference on those products, are interested in seeing MFN rates reduced in the expectation that they could increase their sales thereby. In the crunch, the LDC united front on this issue might break. But the LDCs could all join in seeking compensation for erosion of preference margins.

3. The third and critical area is the desire of LDCs for deep tariff cuts on items not on the GSP list. This is an entirely legitimate desire and one we should try to accommodate. It involves two sticky problems, however. The first is the fact that the key items excluded from the GSP list are those that are in the main import-sensitive items such as textiles, shoes, and other leather goods, consumer electronics, and raw and processed agricultural items, all of which are difficult, although not impossible, for us to liberalize. The second sticky problem is our desire to have reciprocity which the LDCs reject in principle. We are facing that problem in the tropical products negotiation where we have made specific tariff offers subject to concessions by the LDCs to which the offers have been made. We accept the principle that requests for reciprocity from LDCs should be consistent with their individual development, financial, and trade needs. We believe that reduction of their excessive tariffs, burdensome customs procedures, and licensing requirements, which we are seeking in specific cases, would in fact benefit the efficiency of the economy of the LDCs concerned.

We can probably make satisfactory offers on some items that were excluded from the GSP list not because the Trade Act required their exclusion but because the reduction in duties from their present level to zero without any phasing would have been too deep and too sudden for the domestic industries to tolerate. We might also be able to reduce the tariff on textiles which is a major LDC export item (almost $3 billion in sales to us in 1975 or 15 percent of their total non-oil sales to us in that year) because the Multifiber Agreement protects us from a flood of imports. To do anything in textiles, however, will require a heroic effort. We could certainly make MFN reductions on items on the GSP list and bind those

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reductions to the benefit of "competitive" LDCs, but this, as noted above, is a controversial matter.

4. The last important area is the desire of the LDCs to reform the GATT by legalizing permanent preferential status for all LDCs. Brazil has proposed the formation of a new negotiating group in the MTN to undertake this task.

Potential for Confrontation

We have always been aware of the potential for confrontation with the LDCs when the MTN nears its close. It has been the slow pace of the negotiation and its technical nature that has thus far kept the negotiation from exploding.

Two issues will come to a head in October. One is the formation of a new negotiating group to reform the GATT. We want to avoid a blow-up on this issue in October and will, therefore, agree to the creation of such a group. We will, of course, have trouble in moderating the extreme LDC position in this group, but we may be able to keep the discussions going beyond the termination of the MTN negotiations themselves. Reform of the legal framework of the GATT is not a necessary part of the MTN negotiations. Offers can be exchanged and the balance struck on these offers without changing the GATT charter.

The second issue in October is the meeting of the Tropical Products group. Our offers are on the table and we are waiting for LDC concessions. The LDCs maintain they should not be required to say what their concessions will be, if any, until the end of the negotiations.

The next point of potential confrontation will be in the early Spring of 1977 when we will be discussing the tariff formula (our formula is liberal) and the critical question of exceptions. Here the issue is twofold: (i) willwe be prepared to bind the LDC preference margins (we will not); and (ii) more important, what will we be prepared to offer in the way of significant MFN tariff cuts on non-GSP items.

Later in the year we will face the issue of non-tariff barriers, and in particular, the issue of subsidies. Our problems here are not solely with the LDCs. We must come out of the negotiations with a reasonable subsidies code to which our major trading partners agree if we are to get congressional support for the MTN results. And we must come out with a tolerable grains agreement that has some liberalizing, as well as stabilizing, features. On the assumption that we will be successful, as we must, on both counts, we have the lesser but real problem to deal with of preferential treatment for LDCs in the subsidies code.

Confrontation with the LDCs, if it comes, will come near the end of the negotiations. Until then, we can keep talking. At that time, in all likelihood the LDCs will tote up the gains to them from significant DC offers and the costs as they see them, in particular the erosion of preference margins, the requirement of reciprocity, and the unwillingness of the industrial countries to accept the principle of permanent preferential treatment for LDCs across the board. Their choices at that time will be to take the gains--if the gains are large--or to walk out of the MTN and take their case to the UN General Assembly. Our objective will be to present a package of gains that the major LDC traders will wish to take.

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