



Prime Minister

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MR POWELL (10 Downing Street)

TOKYO ECONOMIC SUMMIT: US/EUROPEAN COMMUNITY TRADE DISPUTE

I attach a note describing what the current US/Community trade dispute over US exports of grain to Spain and of grain and soya products to Portugal is about. The dates for action are 1 May (deferred) for Portugal and 1 July for Spain. The most important points are -

(1) Spain and Portugal are transiting over 7 years from their current import arrangements to those of the Community. By the end of the period

- Spain and Portugal will be applying the Community's full variable levies on imports of cereals. At least in respect of Spain the prospects for US exports of cereals will get worse.

If this were agreed, it would be an element in the GATT Article XXIV.6 negotiation. The situation is less clear for Portugal (current imports controlled by a monopoly) but the United States objects to a transitional arrangement under which Portugal would buy 15.5 per cent of its cereal imports from the Community.

- Spain and Portugal will be applying the Community's import arrangements for soya and soya products. Most US supplies to the EEC come in as soya beans. The Community has no tariff and no levy and gives completely free entry for soya beans. The US complaint is about transitional arrangements which the Community believes to be no more restrictive than those applied by Spain and Portugal in a recent period.

- Spain and Portugal have substantial industrial protection which is being phased out as they move to the Community's low industrial tariffs.

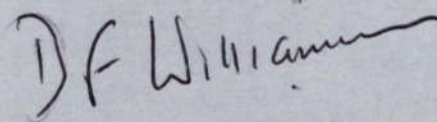
- The Commission estimates the ratio of advantages to disadvantages for all US exports to Spain and Portugal as a result of accession at 5 to 1.

- Community has agreed its mandate for GATT Article XXIV.6 discussions with the United States which will cover the global effect on trade of the accession of Spain and Portugal and is keen to get on with them.

In our view the most likely sequence of events is that before the Tokyo Economic Summit the United States will put quotas on certain Community exports at levels which have no trading effect. The Community will respond equivalently. We shall have to find in the period before 1 July some way of keeping down the temperature (eg by acknowledging the US "credit" on cereals exports) while maintaining that the final balance sheet and settlement must cover all trade, both agriculture and industry.

--- Recent Spanish and Portugese import figures on cereals and oilseeds are attached.

I am sending copies to Tony Galsworthy (FCO), Rachel Lomax (Treasury), John Mogg (DTI) and Sir Robert Armstrong.



D F WILLIAMSON

1 May 1986

US exports to Spain

	1982	1983	1984	1985
<u>Cereals</u>				
Milliontonnes	5.87	3.24	2.45	about 2.45
Ø million	750	467	364	n.a.

US exports to Portugal

	1984
<u>Soya oil</u>	33,000
(for consumption)	

tonnes quota

1985
40,000

1986
50,000

<u>Cereals</u>	
milliontonnes	2.8
Ømillion	4.75

DISPUTE BETWEEN THE EC AND THE US OVER ENLARGEMENT TERMS

The most serious of a series of current trade disputes between the EC and the US concerns the terms of accession for Spain and Portugal in certain agricultural products of interest to the US, namely grain and oilseeds. The US has threatened retaliation within a month against Portuguese measures, and retaliation in July/August against the new Spanish cereals regime.

The Problem

2 On grain, Spain and Portugal, which are both in deficit for feed grain, were previously free to import cereals from any source on the best available terms, including some 3 million tonnes each from the USA of various grains. On oilseeds the Accession Treaty recognises the concern of the Community to maintain the existing price ratio between olive oil and competing vegetable oils pending adjustment of the edible oils acquis.

3 The arrangements which apply for Spain and Portugal therefore are as follows:

Portugal - for cereals the state monopoly of imports will be progressively liberalised by 20% a year from March 1, 1986 to 1991. Customs duties will be abolished and a levy system introduced, applicable equally to imports from Community and third countries, but subject to a margin of price preference for Community cereals, plus an obligation on Portugal to buy 15.5% of its total annual cereals imports from the EC11 from March 1, 1986.

- for oilseeds, import restrictions (which were abolished at the end of 1984) will be reintroduced at a level based on trade in 1980-83. For oilcake contingency provision has been made for restrictions of imports from third countries till December 31, 1992.

Spain - for cereals, full import levies (adjusted by any differences between Spanish and EC10 intervention prices) whose effect will be inter alia to double the cost of US maize.

US Action

4 On 2 April the US, which had protested vigorously but belatedly against these elements in the accession arrangements, on the grounds that they could entail a loss of trade to the US of \$1 billion, announced that public hearings will be held on April 21. Following this retaliatory measures will be introduced on or about May 1, 1986 (July 1 in the case of the Spanish cereals levies) under Section 301 of the Trade Act of 1974. The US argues, in essence, that (i) negotiations for compensation under Article XXIV:6 of the GATT should have been completed in the case of the Spanish cereals levies before the levies were introduced; and (ii) the new Portuguese import quotas and the Community preference on cereals are illegal under GATT.

5 The proposed US retaliation takes the form of a dollar value quota for Community white wine, equivalent to the alleged adverse impact on the US of the Portuguese restrictions on oilseeds; increased duties on a number of products including fruit, fruit juices, biscuits, cakes etc., to match the Portuguese restrictions on grain imports; and increased duties to offset the Spanish levies on grains on a number of products including certain meats, and cheeses, chamois leather, white wine and spirits including whisky.

Effect on UK of US list

6 The level and form of US action (quota, increased tariff...) has yet to be specified, but of the products listed, several are highly sensitive (notably whisky - £270m exports, gin, cakes - £9½m, confectionary - £44m and chamois leather). In most of these, the UK is a dominant supplier. The overall structure of US retaliation seems disproportionately detrimental to UK exporters (\$580m worth of exports are vulnerable, compared to \$530m for France and much lower amounts for other Member States).

Community View

7 The Community takes the view that the terms of the accession arrangements are legal in GATT, both because Portugal had no bound tariffs for the products in question and because the Community is prepared to negotiate compensation for the levies on Spanish cereals imports as part of the overall negotiation under GATT article XXIV:6 following enlargement. In the Community's view there is no requirement or precedent for compensation negotiations under Article XXIV:6 to be completed before a free trade area is created or enlarged, and the US is in the wrong in insisting that this should be so. Further, the Community considers that in accordance with the strict terms of Article XXIV:6 the consequences of enlargement (losses and gains to trading partners) should be looked at as a whole (the US stands to gain substantially from many Spanish and Portuguese duty reductions though not till later in the transitional period). The US disputes this view also. Within the Community, FRG UK and others have underlined the shakiness of the GATT defence for a minimum import requirement laid on Portugal. But the GATT legality of this and other aspects of the Act of Accession would fall to be addressed, if the US chose, in a separate Article XXIII panel.

8 The Article 113 Committee (full members) discussed the issue on 11 April. They concluded that:

- i) there was no possibility of reopening the terms of the Accession Treaty;
- ii) the Community must insist on a global approach to the XXIV:6 negotiations, taking into account both losses and gains to the US;
- iii) a mandate for the negotiations must be agreed as quickly as possible;

- iv) all possible steps must be taken to prevent the US from introducing the threatened retaliatory measures on May 1;
- v) the most urgent problem was the measures threatened on 1 May in respect of Portugal;
- vi) indicative lists of products for retaliation against the US must be agreed as quickly as possible;
- vii) individual Member States in their bilateral contacts with the US must lend every possible weight in support of the Community position;
- viii) some delegations continued to argue for additional "gestures" designed to conciliate the US, but this approach is regarded with deep suspicion by the Commission and by a majority of Member States.

Impact in UK of Community Retaliation

9 The Community's indicative lists are designed above all to focus on products that are sensitive to US Lobbies. But this objective is not easy to reconcile with UK importing interests. The inclusion of some products used by UK industries whose exports are themselves on the US List risks penalising the same sector twice over: for example, British bakers risk losing US supplies of dried fruit and almonds at the same time as losing access to the US market. And up to half of EC imports of some other items (wine and tinned corn) are bought by British consumers.

Other Current Problems

10 Most of the other various disputes between the Community and the US (e.g. on steel semis, citrus, VAT on government contracts) are likely to prove containable and capable of being resolved either severally or as part of a wider agreement. The Manufacturing Clause, with the strong US printing lobby defending a long-standing piece of protectionist law, is an exception. But the enlargement issue is different from all of these, partly because it involves agricultural products which are particularly sensitive for the US and partly because it entails some basic disagreements as to the meaning of the GATT. It is common ground that everything possible must be done to head off the threatened US measures; but this may not be possible. Although the US appears almost wholly in the wrong, this will not help the atmosphere for the run-up to the new GATT Round, nor the common front which the developed countries need to present on a number of key issues.

11 It is not even clear how much trade the US will lose from the Community enlargement provisions, since the likelihood is that quotas/where they apply) will be set at levels which will hardly reduce US exports to Spain/Portugal compared with the reference periods.

Conclusions

12 If the present dispute goes on escalating, the implications for UK trade, both in the US retaliation lists and in the draft indicative retaliation lists which the Commission have proposed, are considerable. The implications are that:

- a) the Community should be ready to retaliate quickly if the US introduces the threatened measures;
- b) EC retaliation should be concentrated on sensitive products ;
- c) the Community must defend the principle of a global negotiation in GATT that respects the Acts of Accession;
- d) ways to de-escalate the dispute must still be sought.

This points to the following approaches:

A Line to Take with US:

1. A bilateral squabble now could have very serious consequences for the forthcoming OECD, Summit and GATT meetings.
2. The principle of a global GATT negotiation about the consequences of enlargement is a political sticking-point for the Community. So, too, is the status of the enlargement treaties which represent a series of delicate compromises.
3. The Community has committed itself to speedy Article XXIV.6 negotiations. US should take up this offer, and press for early assessment of level of "debit" on Spanish cereals.
4. [If US emphasise that they are concerned at breaches of GATT law as well as trade effects]. If this is the worry then US must have recourse to Article XXIII procedures : our aim in GATT is to strengthen dispute settlement procedures, not ignore them.
5. On practical trade impact of Portuguese oils regime, US should pin Commission down to continuing consultations. 1986 regime will be unrestrictive.
6. Same is true for Portuguese grains. Need to consult if there is a problem once 1986 results are known.

B Line to Take in Community:

1. Must stand firm on principle of a global negotiation. Must therefore finalise mandate and make an early start on talks.

Now done

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2. Should offer early assessment of XXIV. 6 consequences of change in Spanish cereals regime. This will demonstrate good faith and put an end to excessive US estimates.
3. On Portuguese regimes, must be prepared for pragmatic bilateral discussions and must give all possible assurances on likely levels of trade in coming year or so.
4. Must emphasise out ultimate objective to return to EC(10) levels of tariff.

DTI/ITP
14 April 1986

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