BRIEFING PAPER ON TRADE & TOURISM

ISSUES FOR NATIONAL CONFERENCE

OF LIEUTENANT GOVERNORS 1988

(Committee Meeting)

CONTENTS

Bureau of Planning
1988

PERSPECTIVES ON TRADE & TOURISM

DEPARTMENT OF COMMERCE
GOVERNMENT OF GUAM
AGANA, GUAM 96910

June 15, 1988

MEMORANDUM (Second Submission)

To: The Lieutenant Governor
From: Director, Department of Commerce
Subject: National Conference of Lieutenant Governors
Committee on International Trade and Tourism

In response to your memorandum regarding the above subject, dated May 24, 1988, I am submitting the following list of pertinent topics and issues for your consideration as discussion items for the upcoming meeting:

TRADE
- Protectionism
- Competition in the Production of Agricultural Commodities
- Product Quality
- The Devaluation of the Dollar
- The "Buying of America"
- Cabotage

Tourism
- Promotions
- Cabotage
- Information Standardization and Dissemination
- Aircraft Safety

For your convenience, I have had a member of my staff prepare a synopsis of the issues involved in the above topics (attached). Should you require additional information regarding any or all of these items, please do not hesitate to contact me at your earliest convenience.

Peter R. Barcinas
Acting

Attachment

TRADE AND TOURISM ISSUES

The following is a series of trade and tourism issues confronting the United States in the latter half of the 1980s. While these issues do not all specifically affect Guam in a direct manner, they are nevertheless important to the economic performance of the nation, both domestically and in the international arena.

TRADE

Protectionism: Over the past five to ten years there has been a rising tide of protectionism throughout the world, which is most often exhibited in the form of import tariffs and quotas along with export subsidies and, in some cases, restraints; boycotts and embargoes also play a role, but are more frequently used for political rather than (perceived) economic purposes. In fact, the perceived gains for a nation from applying protectionist measures are short-lived, if such gains accrue at all, and the ultimate effect of protectionism is to cause economic damage to both partners in a trade relationship: trade exists to take advantage of economic efficiencies (comparative advantage), and protectionism interferes with the realization of those efficiencies. Also, protectionism in the extreme has been the root cause of many (if not most) international conflicts over the past century, including but not limited to wars.

The only two categories of protectionism that are rationally justifiable are those that are designed to foster the growth and perpetuation of "infant industries" until they can stand alone in competition with foreign producers, and those designed to maintain industries that produce the primary resources and finished products necessary to the defense of the integrity of a nation's borders during times of war, when these products might not be available because of embargo or blockade. In the former case, the measures applied should be for a short term only, and for industries that are likely to eventually be viable; in the latter, the products should be absolutely essential to a nation's war effort, and not replaceable with close substitutes even during periods of national catastrophe.

For the two justifiable categories of protectionism, the measures should be in the form of tariffs, quotas, or a combination of the two (which have effectively the same impact upon the forces of supply and demand, but differ in their effects upon government revenues and private profits); however, in the case of technology with potential military applications, restraints (export controls) may also be necessary and appropriate. Export subsidies may be applied in retaliation against perceived "dumping" (selling products below manufacturing cost in the international market), setting lower prices for the particular commodity in world trade, but promoting economic inefficiency in its production and transferring income from the tax paying public as a group to the product's producers.

In general, with the exception of the two rationally justified reasons for protectionism, the practice is an unfortunate but sometimes necessary evil in the trade relations between nations.

Competition in the Production of Agricultural Commodities: For nearly the first two hundred years of its existence, the United States was a net exporter; from the humble beginning of being an exporter of raw materials (primary resources), the country gradually became the major source of manufactured products in world trade. However, the mainstay of America's exports has always been food.

Since the end of World War II, the industrialized nations, through organization of the United Nations, have made strong and successful efforts to assist the less-developed developing countries (LDCs) to become self sufficient in the production of foodstuffs. This provides an excellent example of the altruistic motive coming back to haunt us: we were (and are) so appalled by the specter of starvation among humanity that we have gone to great lengths to implement a remedy, yet the cure has cost us dearly, as the LDCs have turned from being substantial importers of grain and other foods to being quite effective producers and exporters in their own right. With its vast and fertile heartland, the United States had long had both a comparative and absolute advantage in the production of foodstuffs. and the enormous efforts to advance farm technology in the 1930s kept the nation at the forefront of world food markets through the 1960s; the surge of competition from the LDCs, though, has seriously hurt the U.S. as a world trade leader. This, combined with the industrialization of the Asian-Pacific Rim countries, has reversed the role of the United States from that of a net exporter and international creditor to that of a net importer (on a grand scale) and debtor to such nations as Japan and the Republic of China. The collapse of our international agricultural markets has had extremely potent political impacts domestically because of the much-publicized effect upon the economy of the farm belt in the Midwest. In addition, the problem is very costly to the nation because of the long-standing policy of categorizing food as an essential strategic product, leading to subsidization of the industry by way of crop price supports and other methods of interference with market forces.

Competition in the production of agricultural commodities has brought many of the LDCs into the mainstream of the world economy at the same time that it has pushed the United States down a few notches, and it is not likely that the nation will reemerge from this posture soon: because wage scales and standards of living in the U.S. are still well ahead of those in most other countries, we will not be able to compete effectively in this arena until the world's economies are somewhat realigned. What is likely is that the nation's farm economy will be depressed for many more years, even decades, but the mere fact that the U.S. has such wide tracts of highly fertile land will eventually reverse this situation.

Product_Quality: Perhaps the greatest problem that the United States faces today in its export markets for manufactures is the widespread perception (accurate or otherwise) that the progress made toward efficient mass production has come at the cost of quality. Again, the wage scales and standard of living in the U.S. place the nation at a comparative disadvantage, but in this case for two reasons: first, of course, is that the cost of labor in the manufacturing process forces up the prices of U.S.-made goods; the second, somewhat less obvious reason is that the motivation, the "work ethic" of the American labor force has deteriorated due to the leisure and security that high incomes generate. Another aspect of the decline in the perceived quality of U.S. goods is that there was so little international competition in the manufacture of goods relying on advanced technology for so long that American management practices have become inefficient and moderately disorganized. A prime example of this malady was the inability of the U.S. automobile industry to adapt to higher fuel prices in the mid-1970s by manufacturing smaller, more economical cars: in fact, Chrysler Corporation discontinued production of the Plymouth Valiant, the last midsized "economy car" in the country, just one year before the first oil crisis, and effectively refused to put it back into production even when the energy crunch went into full swing. This was one of the elements that cost the U.S. its preeminence in world markets.

As the international sector of the U.S. economy remains depressed, the forces causing the nation's exports to lag will gradually be diminished. Although there have been real improvements in the quality of U.S. goods over the last decade and efforts are being made to impress this fact upon the rest of the world, it will nevertheless take several more years for the perception of America's manufactures to turn around. In the meantime, efforts to improve the efficiency and effectiveness of corporate management could do a great deal to advance the nation's competitive posture, as will continued improvements in the engineering and design of new products with an eye not just toward the satisfaction of the U.S. consumer, but toward the wants of our newly-prosperous neighbors, as well.

The Devaluation of the Dollar: In 1985, the U.S. struck an accord with Japan, its second largest trading partner (behind Canada), to realign the value of the dollar vis-a-vis the yen. Since that time, the yen has far surpassed its target value of 185 to the dollar, settling for an unexpected period of time at the much higher exchange rate of around 125 to the dollar. The reason for this accord was that Japan had been running large and recurring surpluses in its trade with the U.S., and protectionist pressures were heating up in the States (particularly in the Midwest); the dollar's devaluation was an attempt (a successful one) to head off what could only have been damaging trade wars. The anticipated effect of the devaluation, that it would make U.S. goods more price-competitive and reverse the balance of trade, has not yet been fully realized. The main reason for this is that markets take time to adjust to changing conditions, but there are other, non-market barriers to the widespread consumption of U.S. goods in Japan, as well. In addition to the ingrained quality consciousness of the typical Japanese buyer, there is also present a degree of what could be characterized as nationalistic pride that automatically grants preferences to Japanese-made products in Japan; a similar attitude holds sway in virtually every country, and even within individual communities, worldwide.

Another aspect of the remarkable success that Japan has had in international trade since the late 1960s is that the yen has been competing more and more with the dollar as the currency of preference in the world marketplace. Although this has been something of a blow to the pride of our national government and has become a topic of conversation in trade and financial circles, it is actually of very little true importance. The reason that the yen has gained this status is that the price level in Japan has remained surprisingly stable throughout recurrent business cycles; thus, the yen has a stable value, and traders who use it have correspondingly lower risks because of the reduced probability of exchange rate losses in transactions. In general, though, it really makes very little difference which nation's currency dominates international trade, so long as the value of that currency is relatively stable and the currency itself is available in quantities adequate to support the level of world trade activity.

The "Buying of America": As the trade position of the United States has deteriorated over the past twenty or so years, other nations, most notably Japan and the Republic of China, have built up enormous surpluses of international exchange in the form of U.S. dollars and other claims enumerated in dollars. While the devaluation of the dollar has hurt these countries in real terms, the nationals of these foreign nations have taken a rational approach to protecting their wealth: they have been buying assets within the U.S., where the stability of the value of their assets in real terms remains relatively constant and not subject to the damages that would have otherwise been caused during the 1985 devaluation. We are experiencing this phenomenon on Guam, with the Japanese almost indiscriminately buying land and other assets at wildly inflated prices and nationals of both the Republic of South Korea and the Republic of China preparing to spring into a similar type of action at any moment; Hawaii has been experiencing much the same thing, as have California and the other States, albeit to a lesser extent. This situation has led to the not-altogether unreasonable concern within the United States that the nation may lose a large degree of control over its own economy, and ultimately its political system.

While the "buying" of America could be likened to a type of economic warfare, whether it presents a real problem is more a matter of political philosophy than of anything else. Although our sense of national pride becomes infuriated at each new account of the sale of a portion of our country's wealth, this is dampened by the realization that the nation as a whole is founded upon numerous diverse ethnic and geopolitical backgrounds, and that it is exactly this eclecticism that has made the United States the dynamic and prosperous world power that it has become in the brief span of two centuries; perhaps an infusion of "new blood" is precisely what is needed to bring the country up to its potential once again.

Cabotage: The restriction of the right to transport cargo and passengers in coastwise trade is a specific category of protectionism that may have outlived its useful purpose. This set of laws and regulations was designed to protect the U.S. shipbuilding and maritime industries, yet the United States is not the flag of preference for vessel registry on the high seas: over the years, the country has imposed so many constraints upon its shipping companies that they can not operate as efficiently, in economic terms, as their foreign counterparts; this means that the manufacturers that produce for export may be paying more for transport than is necessary, making their products less competitive on world markets, and that the consuming public is paying more for goods that are traded internationally. Although Guam is intimately familiar with this issue (which we normally refer to as the Jones Act), it is a policy that affects the nation as a whole. The protection of shipbuilding used to be justified on a national security basis, to ensure that the country had sufficient capacity to build adequate numbers of vessels during times of war, but the Navy seems to be doing quite well in creating enough demand in that area at present; in addition, the use of ships in warfare is no longer as critical to the overall war effort as it was in the distant past. The protection of the maritime industry from foreign competition is also no longer as critical as it used to be. Opening the coastwise trade to foreign-registered vessels could even improve the trade position of the United States simply by putting the country in a more friendly posture in terms of trade relations.

TOURISM

Promotions: It appears that one of the major constraints to the further development of the U.S. as a destination for foreign tourists is that there is very little coordination of promotional efforts at the national level, and that the task of tourism promotion is disjointed because it has been relegated to the States. From our own experience, it is clear that enormous gains can be derived from joint promotions of tourist facilities and attractions, and that tourists are more likely to consider a given destination if there are several options available to them. For instance, a foreign visitor would be more likely to consider Hollywood as a destination if made aware that there would be near and ready access to a day or two of gambling, et cetera, in Las Vegas and a chance to view the splendors of the Grand Canyon and Yosemite National Forest. While it may be difficult to convince the Congress to make more funding available for national tourism promotions (there have been years in recent times during which the U.S. Travel and ~~Transport Association~~ Tourism Administration (USTTA) has had a budget less than our own Guam Visitors Bureau), the States themselves, along with the Territories, could institute a consortium to pool resources and target the international market for their marketing efforts; this could be in addition to or in lieu of efforts by the individual States to attract tourists from one another. The consortium could benefit from the adoption of the tried-and-true methods used by other nations that have been successful in promoting themselves as tourist destinations abroad, and the potential may exist for coordinating efforts with Canada and Mexico, as well.

Cabotage: The transportation of passengers between points within the United States, with a few notable exceptions, is restricted to U.S. carriers, so the issue of cabotage is relevant to tourism as well as trade. This certainly creates problems for Guam, but if the intent is to increase the number of foreign tourists visiting the United States, substantial gains could be made if foreign carriers were allowed to make stops in successive cities in the U.S., even if only at the major "hub" airports. This form of protectionism for the U.S. airline industry seems an anachronism now that deregulation has been implemented in an effort to improve competition; opening the market to foreign carriers would enhance that competition even further. An "open skies" policy would also improve the image of the United States internationally, since other countries often complain that the U.S. tends to arbitrarily interpret bilateral agreements in such a way as to make their effects one-sided.

Information Standardization and Dissemination: There is no unified source of consolidated tourism information about the United States available at present. It would be quite useful to have comprehensive data regarding the origins, demographic characteristics, expenditures, interests and so forth of foreign visitors to the country so that tourism facilities and promotions could be tailored to attract the most visitors (and the most tourist expenditures) with the resources available. This is one specific area in which the USTTA could play an invaluable role by standardizing reporting formats and the definitions of the various types of relevant data. Such information could be made available to each State and Territory so that they would have a basis for comparing their own performance in attracting tourists to that of other jurisdictions, and so that they could emulate the successful programs of others.

Aircraft Safety: Since the deregulation of the airline industry, and with an aging stock of aircraft in the United States, there has been an increased incidence of problems in air travel; this appears to be mainly associated with aircraft maintenance. Although the Federal government is charged with the responsibility of regulating aircraft maintenance, the States could also impose (ideally, uniform) controls on such things as maintenance schedules and the distribution of information regarding manufacturers' advisories. This could aid in ensuring that air travel remains safe in the country and improve the image of the U.S. as a safe tourist destination.

WESTERN GOVERNORS' ASSOC. UPDATES

UPDATE ON U.S.-JAPAN TRADE ISSUES[1]
MAY 1988

Trade and Economic Performance

U.S.-Japan Trade

Japan is the United States' second largest trading partner, taking approximately 11% of U.S. exports and supplying about 21% of U.S. imports during 1987. During 1987, the U.S. imported $24.6 billion worth of Japanese motor vehicles (the single largest category), an increase of 1 percent over imports in 1986. Total imports from Japan grew 2.5 percent to $84 billion in 1987. Through February 1988, U.S. imports from Japan totaled $13.4 billion, an increase of 9 percent over the same period in 1987.

U.S. exports to Japan were $26.9 billion in 1987. This represents a $4 billion or 17.5 percent increase over 1986 export levels. The top three U.S. commodities exported to Japan were logs, aircraft and seed corn. The 1987 U.S. merchandise trade deficit with Japan declined for the first time during the 1980's to 57.1 billion, a decline of $2 billion (3.3%) from the 1986 figure.

Global Japanese Trade

In 1987 Japan had a global current account surplus of $86.7 billion, a small increase from the 1986 level of $85.8 billion. During 1987, Japanese imports increased over 1986 levels by 18.2 percent to $149.4 billion. The single largest source of these imports was Southeast Asia. The top three commodities Japan imported in 1987 were mineral fuels, miscellaneous imports and foodstuffs. One reason the stronger yen did not generate substantial increases in total imports is that primary products continue to account for a majority of Japan's imports. Japanese imports of primary products (not including foodstuffs) in 1987 accounted for 34% of total imports.

Relative to income, Japan imports fewer manufactured goods than any other industrialized country. Manufactured imports accounted for only slightly more than 2% of the Japanese GNP in 1985, compared with 6% of the U.S. GNP and more than 10% of the GNP of EC (European Community) member countries. Through the third quarter of 1987, Japan's imports of manufactured goods increased by 31% from the EC and 60% from the NICs. Imports of manufactured goods from the U.S., however, declined by 5.5%. The increase in imports from the EC has been largely in luxury goods, while those from the NICs (Newly Industrializing Countries) have been low-priced consumer goods. U.S. exports have lagged in part because the U.S. comparative advantage tends to be in capital goods, chemicals and other non-consumer products. Japan runs substantial surpluses in manufactured goods trade with its trading partners. In 1986, Japan's ratio of exports to imports of manufactured goods with principal trading partners was as follows: Japan-U.S. 5.7:1, Japan-EC 3.1:1, Japan-Canada 10.9:1, Japan-Newly Industrializing Countries (Singapore, South Korea, Taiwan, the Philippines,

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[1] NOTE: This material is for limited distribution and is intended to provide background information on current issues in U.S.-Japan trade. It should not be cited as representing official U.S. Government positions on specific trade issues.

The U.S. Trade Representative's Office prepared this information, and WGA staff edited portions of the text for summary and clarification.

Mexico and Brazil) 4:1.

General U.S. Trade Objectives Toward Japan

The United States continues to urge Japan to stimulate its economy through domestic demand expansion and to increase its imports--especially of manufactured goods and processed agricultural products. The United States Government (USG) also continue to encourage Japan to liberalize its markets, allowing fair and equitable access to U.S. goods, services and investment.

Bilateral Issues

The Government of the United States (USG) and the Government of Japan (GOJ) have held numerous consultations on a wide range of outstanding bilateral issues over the past year. Following is a brief summary of some of the issues which affect the western U.S. region:

SEMICONDUCTORS: The USG and the GOJ signed a five-year Semiconductor Agreement on September 2, 1986 to bring about significantly increased sales of foreign semiconductors in Japan's $10.5 billion market, and an end to dumping in the U.S. and third country markets by Japanese producers. A thorough USG analysis in March 1987 indicated that the GOJ had failed to enforce two key provisions of the Agreement: (1) an end to dumping in third country markets and (2) a steady and gradual increase in sales of foreign manufactured chips in Japan.

In response to Japan's failure to implement fully provisions of the Agreement, the Administration on April 17, 1987 raised tariffs on $300 million worth of Japanese exports to the U.S. Of the $300 million, $135 million was imposed for third country dumping and $165 million for lack of foreign access to the Japanese market. On June 8, more than $51 million in sanctions were removed to reflect improvement in the price of DRAMs in third countries. The President made it clear that he would not hesitate to reimpose the sanctions if the positive pricing pattern did not continue.

On November 2, 1987, the Commerce Department announced that Japanese dumping of semiconductors in third countries had ceased and that the USG had received GOJ assurances that it was imposing no restrictions on the production, supply or shipment of semiconductors made in Japan. Accordingly, on the same day the USG announced the lifting of tariffs on more than $84 million worth of Japanese exports to the United States. Recent bilateral discussions have focused on initiatives to promote the market access objectives of the Agreement. In the meantime, tariffs on $164 million worth of Japanese exports remain in place because of lack of progress in opening Japan's market to foreign semiconductors.

On May 4, 1988 the GATT Council adopted a report by its disputes panel stating that Japanese measures taken in the context of third country monitoring constitute export restrictions inconsistent with the GATT. The GOJ has not opposed the report's adoption and has indicted that it would act soon to implement its recommendations. The USG and the GOJ are consulting to ensure that any Japanese modifications of its monitoring system to prevent third country dumping are consistent with the September 1986 Agreement.

SUPERCOMPUTERS: On August 7, 1987, after several months of negotiations, the USG and GOJ agreed on new procedures for the procurement of supercomputers by GOJ entities, including national universities and laboratories. These procedures attempt to address U.S. concerns about non-transparency and discriminatory treatment in public sector procurement. They are designed to reduce the bias in Japan's procurement process that has excluded U.S. firms from the public sector market until now, and they entitle U.S. supercomputer suppliers to be involved in early stages of procurement planning, when important decisions, such as setting the criteria for the final selection, are made. These procedures also establish a new discussion phase in the procurement process that should provide all potential bidders an opportunity to demonstrate the merits of their product to the GOJ.

Two sales were made to the Japanese public sector last year under the GOJ $1 billion import promotion program: one to MITI's (Japan's Ministry of International Trade and Industries) Agency for Industrial Science and Technology laboratory in Tsukuba, and the other to the Tokyo Institute of Technology. These constitute the first purchases ever of U.S. supercomputers by GOJ entities. However, no U.S. supercomputers have as yet been purchased by the GOJ under the new procurement procedures. The first formal review of the Agreement with the GOJ, held in February, focused on the continued concerns of the USG and U.S. supercomputer companies regarding GOJ procurement procedures and the severe discounting practices of Japanese companies. The USG provided the GOJ with a list of questions relating to ongoing bids. At the Trade Committee meeting held in Tokyo in April, the USG asked for written responses to our earlier questions regarding ongoing bids by Japanese entities. No response has yet been received.

MAJOR CONSTRUCTION PROJECTS: On March 29, 1988, the U.S. and Japan reached an ad referendum agreement on U.S. access to Japanese major construction projects. The agreement sets out open, non-discriminatory procedures allowing U.S. firms into the bidding process and gives American companies access to more than $16 billion in major projects in Japan over the next 10 to 15 years.

The U.S.-Japan agreement will be finalized with an exchange of letters between Ambassador Matsunaga and Commerce Secretary Verity. The agreement includes three sets of special bidding procedures which will apply to major construction projects. Procedures (K-1) developed for U.S. industry access to "private commissioning entities," will apply to the new Kansai International Airport, the Tokyo Bay Bridge, and the NTT Headquarters Building. Another set of special measures (K-2) will apply to several major public works projects, i.e., projects directly funded and managed by the GOJ. Under a third set of measures (K-3), the GOJ will encourage private and third sector (mixed government/private) entities that are funding or operating portions of these public works projects to provide non-discriminatory access for U.S. firms.

The implementation of the agreement will be monitored by the Ministry of Foreign Affairs, the Ministry of Transport, the Ministry of Construction and the U.S. Embassy in Japan. A comprehensive government-to-government review will be held after two years to decide if changes to these measures are warranted, including the possibility of adding additional projects to the list.

INTERNATIONAL TELECOMMUNICATIONS SERVICES MARKET: The Japanese Telecommunications Business Law, which went into effect on April 1, 1985, allows competition with Kokusai Denshin Denwa (KDD), the monopoly provider of international telecommunications services in Japan. The Law permits foreign equity participation of up to 33% in new companies in the international telephone service business. Two consortia have been issued licenses by the Ministry of Posts and Telecommunications (MPT) to enter the international telecommunications business in competition with KDD. One consortium, International Digital Communications (IDC), has 33% foreign ownership. IDC seeks to construct a trans-Pacific submarine fiber cable in 1990.

MPT, believing there is only enough demand to allow one competitor to KDD, at first attempted to induce IDC to merge with its all-Japanese rival. MPT initially proposed a settlement which would have reduced participation, eliminated the management role of foreign companies and eliminated any cable-laying capability for the new entrant.

After substantial pressure from the USG and the U.K., MPT dropped its opposition and has granted licenses to the two competitors. MPT has reportedly informed the parties that it will also grant approval for the construction of the cable. USTR will continue to monitor developments.

AGRICULTURE:

Japan is the largest consumer of the U.S. agricultural exports. In 1987, Japan purchased $6.9 billion of American feedgrains, fruits and vegetables, meat and fish. This represents an increase of 17% over the $5.8 billion purchased in 1986.

The USG is dissatisfied with a GOJ agricultural policy which protects domestic farmers and food processors through a system of high domestic prices maintained by quotas, high tariffs, tariff escalation and standards barriers. The USG believes that Japan would purchase millions of dollars of additional U.S. processed and value-added food products without these barriers. USTR Yeutter and Secretary of Agriculture Lyng visited Japan in April 1987 discussing Japanese agricultural policies that restrict U.S. exports. Agriculture issues, including beef and citrus and GATT 12, have been the subject of intense negotiations in 1988. The USG has been urging the GOJ to liberalize and restructure its markets so that competitive American agricultural products can gain market access.

Rice: Rice, the backbone of Japanese agriculture, is of particular concern to both the U.S. and Japan. U.S. trade potential is estimated at upwards of $1 billion. On September 10, 1986, the U.S. Rice Millers' Association filed a petition under Section 301 of the Trade Act of 1974 seeking removal of Japan's ban on rice imports. On October 23, 1986, USTR Clayton Yeutter announced that he would not initiate a 301 investigation at that time but that he expected Japan to put rice on the table for discussion in the forthcoming Uruguay Round of multilateral trade negotiations. The GOJ agreed to put all of its agricultural policies including rice on the table at the Uruguay Round, but serious doubts remain over its willingness to actually allow imports. During Prime Minister Takeshita's visit to Washington in January 1988, Secretary Shultz reiterated to Foreign Minister Uno that Japan must reform its agricultural policies, including rice. The USG has discussed Japan's import restrictions under the rollback provisions of the Uruguay Round, and we expect to press the GOJ to make its rice policy GATT-consistent at rollback meetings in early 1988.

GATT-12: In July 1986, the USG informed the GOJ that it intended to resort to GATT dispute settlement procedures against Japan's quotas on 12 categories of processed agricultural products. These categories contain more than 100 products including non-citrus fruit juices, preserved beef, tomato sauce and ketchup, and food preparations.

In November 1987, the GATT panel found that 10 of the 12 disputed import quotas are GATT-inconsistent. The remaining two import quotas were found to be GATT-permissible but not large enough. On February 2, 1988, the GATT Council accepted the panels findings. The GOJ has indicated it will remove quotas on six of the categories in two years, and two additional categories after two years, but has refused to remove the quota on starch and dairy. The USG continues to press the GOJ for phased elimination of quotas on all ten categories and significant enlargement of the two GATT-consistent quotas. The USG will demand compensation for any GATT-illegal quota which is not liberalized after two years.

Beef and Citrus:[2] On March 31, 1988, the 1984 USG-GOJ understanding on beef and citrus expired. The USG has insisted that upon expiration of the 1984 understanding Japan should remove its beef and citrus quotas, reduce tariffs, eliminate orange juice marketing restrictions, and eliminate impediments in the beef import distribution system. The USG views Japan's quotas as inconsistent with GATT Article XI.

Japan's Agriculture Minister Sato came to Washington in March and again in April to negotiate the elimination of market impediments with U.S. Trade Representative Clayton Yeutter. Talks broke off on May 4 over the following issues: date certain for quota elimination, amount of increase in access during the transition period, and border measures to be used after quota elimination. On May 4, the GATT Council agreed to the formation of a GATT panel to review the dispute.

Wine and Spirits: During 1986 and 1987, the USG held a series of discussions with the GOJ on barriers to U.S. wine exports. Since 1984, the most significant changes negotiated are: 1) a substantial cut in the tariff, from 55% to 21.3% ad valorem, and 2) elimination of a 50% excise tax on wines above a minimum price. Although the tariff cut was implemented effective April 1, 1987, the excise tax elimination was a part of the tax reform bill which Prime Minister Nakasone withdrew from Diet consideration in April.

Also in April 1987, the USG submitted a statement in support of the EC's GATT challenge to Japan's discriminatory taxes on alcoholic beverages. In October 1987, the GATT panel ruled these taxes illegal. The GOJ has proposed changes in the tax structure to come into compliance with the GATT findings. The Japanese Diet is expected to begin consideration of these policies this year, but no final action is expected to be taken until 1989.

At the April 20, 1988 Trade Committee talks held in Tokyo, the U.S. side urged the GOJ to take positive action on reform of the tax on alcoholic beverages, and discouraged the GOJ from raising the existing specific tax on wine. The USG request notwithstanding, the GOJ responded that they are considering raising the specific tax on wine by applying both a sales tax and an excise tax. The USG will pursue this issue through continued bilateral consultations.

Fish: Japan maintains import quotas on Pacific cod, mackerel, and squid. Recent exchange rate changes have opened major market opportunities in Japan for U.S. export of these species. The National Marine Fisheries Service believes that liberalizing Japan's import quotas on these species would yield $70-100 million in additional U.S. exports. The quotas are unquestionably GATT-illegal. At the Trade Committee meeting held on April 20, 1988, the USG requested a staff-level meeting to discuss removal of these species from the Japanese quota system.

On March 20, 1987, Japan unilaterally offered to take measures to eliminate the trade-restrictive effects on U.S. exports of quotas on herring and pollack while leaving the quotas in place. The Commerce Department estimates that exports of these two types of fish to Japan increased about $55-60 million through November 1987 over 1986 levels. On January 19-20, 1988, the USG and the GOJ held their first meeting under the unilateral undertaking to review performance. The Commerce Department estimates that exports

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[2] June 20, 1988 editorial note: today the U.S. and Japanese trade representatives signed an agreement to remove Japanese quotas on imports of U.S. beef and oranges in three years, and on orange juice in four years. The exact details of the agreement are not yet available.

are estimated to grow to $300-400 million annually later in the decade as the U.S. industry develops market opportunities in Japan. The primary beneficiaries will be the states of Alaska and Washington.

On February 9, 1988, Commerce Secretary Verity certified Japan under the Pelly Amendment. The Amendment provides for mandatory curtailment of fishing rights and discretionary trade sanctions against a nation that undermines an international fisheries conservation program. The issue of sanctions has arisen because of Japan's decision to proceed with a "research" kill of 300 Minke whales, without the approval of the International Whaling Committee (IWC). On April 9, the President ordered the curtailment of all present and future fishing rights for Japanese nationals in U.S. waters, but did not implement trade sanctions. He also ordered another review of Japan's practice to take place by December 1, 1988.

SODA ASH: U.S. sales of soda ash in Japan increased dramatically in 1983 and 1984 following the exposure by the Japan Fair Trade Commission (JFTC) of an illegal cartel of Japanese soda ash producers. In 1985 and 1986, despite lower price and superior quality, U.S. soda ash exports leveled off at 15-18% of the Japanese market. The U.S. industry alleged that business practices in Japan, such as market sharing arrangements, were continuing to depress exports of U.S. soda ash to Japan.

As a result of continued USG attention, the JFTC undertook a survey in June 1987 of allegations of anticompetitive activity in the Japanese soda ash industry. In November 1987, the JFTC issued a finding that "certain practices were found to be problematic and that it considers it necessary to continue the monitoring of the soda ash market with a review to assuring fair and free competition." The JFTC also instructed Japanese soda ash producing companies to "take care not to engage in any conduct that might obstruct fair competition through unduly restricting or hindering the sales of importers." It was anticipated that the JFTC action and its continued attention to the problem, along with new pricing initiatives from U.S. soda ash producers, would result in increased sales of U.S. soda ash and a greater share of the Japanese market. However, there has not yet been a significant increase in sales, nor are there indications of a change in buying patterns.

MOSS TALKS: In 1985 and 1986, the USG engaged the GOJ in the Market-Oriented Sector-Selective (MOSS) talks with Japan to open Japanese markets in four key sectors. A number of market-opening measures were implemented as a result of these talks. In telecommunications, access to the Japanese market has been improved for American equipment and services. Barriers to imports of American medical equipment and pharmaceuticals have been reduced by simplifying regulatory procedures, eliminating administrative delays, and making the rules and regulations more transparent. In electronics, several measures have been adopted that should improve access by U.S. companies to Japanese research and development projects and provide legal protection for semiconductor chips and computer software. In forest products, the GOJ committed to tariff reductions on wood and paper products.

According to Department of Commerce data, U.S. exports to Japan (in dollar terms) during the first half of 1987, compared to the same period in 1986, increased in these four sectors by a total of 19.4%. U.S. exports to Japan increased in telecommunications by 24% forest products (excluding logs) by 21%, medical equipment and pharmaceuticals by 13% and electronics (excluding semiconductors) by 22%. Some of these increases can be attributed to the appreciation of the yen since 1985.

SCIENCE AND TECHNOLOGY AGREEMENT:

The USG and the GOJ reached an ad referendum agreement at the end of March on a new five-year agreement on bilateral cooperation in research and development in science and technology. This agreement, to be signed soon by the President and the Prime Minister, will supercede the current S&T (Science and Technology) Agreement which has been in effect since 1980. After seven rounds of talks, the two governments resolved the outstanding issues and reached an agreement that should strengthen S&T collaboration and provide for comparable access to each nation's respective R&D system. The new agreement sets forth a policy framework and management structure, areas of cooperation, and steps to strengthen the bilateral S&T relationship. The protection of intellectual property rights and security concerns are also covered in the agreement. With the implementation of this new umbrella agreement, it is anticipated that cooperation in science and technology will increase to the benefit of both countries.

THE GENERAL AGREEMENT ON TARIFFS AND TRADE
URUGUAY ROUND PROGRESS REPORT
From the U.S. Trade Representative's Office (USTR)[1]

Overview

Despite some hardening of the European and Japanese positions at the OECD (Organization for Economic Cooperation and Development) Ministerial in Paris last month, especially regarding agriculture, we all agreed that the Uruguay Round has been proceeding satisfactorily. We were able to arrive at compromises that will keep the Round on track for the Midterm Review at Montreal this December. We agreed to strive for maximum progress in all the negotiating groups and to adopt a framework approach at the December meeting. As far as the United States is concerned, this means that the Review should provide clear destinations, roadmaps and timetables in all the areas of importance to us.

The process leading up to the Montreal Ministerial will go forward on both informal and formal levels. In addition to the negotiating sessions in Geneva, we will continue to consult with our trading partners in their capitals, and hold several conclaves with groups of key participants. Most notably, we have scheduled a meeting in Geneva in July and a somewhat larger meeting in Islamabad, Pakistan, in October. We will of course also be looking forward to even closer consultations with our private sector advisors as the Montreal meeting approaches.

Dispute Settlement/FOGS (Functioning of the GATT System)

We appear to be close to a consensus on procedural reforms in dispute settlement and several elements in improving the functioning of the GATT (General Agreement on Tariffs and Trade) system. On the former, early implementation looks possible for enhanced mediation, standard terms of reference, authorization for the Director General to select panelists if parties cannot agree within a specified period, an expanded and improved list of panelists including non-governmental panelists, a timetable for dispute resolution and the requirement to provide the GATT Council with a written explanation for any blocking of a panel report. Other issues such as enhanced surveillance or voluntary arbitration will probably require more time.

Similarly, in the FOGS group, a consensus seems to be emerging on strengthening ministerial level involvement (with perhaps a smaller advisory group of ministers meeting twice a year), and a trade policy review mechanism (TPRM) that would monitor trade policies and practices of all contracting parties and issue public reports. On the TPRM, however, we will have to persuade several LDCs that the review should go beyond GATT obligations to address all trade-affecting policies and practices.

Agriculture/Tropical Products

In March the EC (European Community) Council of Ministers took a number of steps which were portrayed as improvements of the situation in agricultural world markets. Unfortunately, we have concluded that although the EC actions may have been politically difficult and may have solved the Community's immediate budgetary problems, they clearly failed to deal adequately with the root cause of world agriculture problems: government supports linked to

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[1] This information was compiled by the U.S. Trade Representative's Office.

WGA staff has added some editorial clarifications to the text.

production. Furthermore, we believe that the measures will result in increased trade distortions working against our interests, rather than setting EC policy on a course towards a comprehensive, market-oriented approach to reform.

We have also continued to meet resistance to our linking the agriculture and tropical products negotiations. We point out, however, that the linkage makes sense since most tropical products are agricultural. Futhermore, it would be unrealistic to expect that we could implement concessions on tropical products without action in areas of interest to us--particularly agriculture. We also maintain that all participants, not just developed countries, are responsible for achieving liberalized trade in tropical products. Thus, we are working to convince the developing countries that the data base should include trade distorting measures maintained by all participants in the negotiating group -- not just those applied by a select group of developed countries.

Intellectual Property

We have continued to press very hard on this issue both in Geneva and in other meetings with our developed country partners. The EC and Japan are working on their internal processes, and we are seeing some signs of movement by moderate LDCs (Less Developed Countries). We want ministerial recognition at the midterm that an agreement must include substantive norms in all areas of intellectual property, an obligation to enforce these standards, and the inclusion of basic GATT concepts such as dispute settlement and transparency.

Investment

In February we presented a comprehensive set of real life examples of the trade effects of investment measures. We believe that we are now in a position to direct subsequent discussion to the nature of necessary trade disciplines. We intend to make a submission in this regard in June. Although many LDCs remain negative, we retain a core of developed country support. The Midterm Review should endorse two key points: 1) the scope of this negotiation is broad (reaching to practices like technology transfer as well as local content and export performance requirements); and 2) the focus shall be on the negotiation of appropriate disciplines for all of these measures.

Services

These negotiations are currently concentrated on 1) the mechanics and modalities for the negotiations, and 2) how developing countries can be brought in, including whether any special treatment should be extended to them. There are also differences among the developed countries over how a framework agreement at the Midterm Review should be structured. We want a framework of rules and principles that sets forth basic rules for trade in a wide range of sectors. We also want to reduce existing obstacles in as many areas as possible. The framework should cover procedural rules such as transparency and dispute settlement as well as substantive rules on such things as non-discrimination, national treatment, subsidies and treatment of monopolies, setting forth standards of government behavior for all sectors covered by the understanding. Subsequently, the negotiations could turn to which sectors the framework would apply, specific self-contained sectoral negotiations and the reduction of existing barriers on a request/offer basis.

Subsidies

Although many of our trading partners want to focus on developing an agreed definition of a countervailable domestic subsidy, we continue to argue that the group should first reach consensus on disciplines for trade-distorting subsidies. Progress has thus been slow, but we would like to see a consensus at the midterm review that current disciplines are inadequate, and an outline of a work program that would tackle all subsidies issues.

Market Access: Tariff and Non-tariff Measures

In accordance with a timetable agreed to in February, we will be submitting an informal, broad "request list" on NTMs (Non-Tariff Measures) in June, and have informed our partners that we firmly intend to negotiate non-tariff barriers on a tariff line basis in conjunction with the tariff negotiations. We may also table a few issues on a generic basis, such as preshipment inspection or, perhaps, rules of origin. Informal discussions have also led to the idea of developing a formulation of objectives and commitments that the Ministers could espouse at Montreal, including substantial tariff cuts and extensive bindings. The LDCs continue to resist participating in tariff reductions but a number have indicated a willingness to bind more of their tariffs. Agreement has also been reached to explore the development of data necessary to conduct the negotiations.

Safeguards

The safeguards negotiation has been moving slowly, largely due to the lack of agreement over selectivity vs. MFN (Most Favored Nation). We have generally supported the notion that safeguard actions should be taken on an MFN basis, but that some way must be found to deal with the proliferation of selective grey-area measures taken outside of GATT rules. To keep the discussions moving in a favorable direction, we submitted a paper in March describing USG (U.S. Government) practices with regard to determining injury.

GATT Articles

Progress in this group has proceeded fairly slowly in part due to the complexity of the issues and in part because there was little preparatory work leading up to the Punta Ministerial. Our strong efforts to improve the operations of the BOP (Balance of Payments) provisions of the GATT for general protection from imports, especially by LDCs, have generated considerable controversy. We also intend to increase further our pressure to put more discipline on the trade distortive effects of state trading enterprises. We have also opposed efforts by LDCs to expand the rights of import suppliers to seek compensation for increases in tariff rates to protect our interests.

MTN (Multilateral Trade Negotiations) Agreements and Arrangements (Codes)

We are hopeful for some tangible results at the Midterm Review in improving and expanding the Standards Code, and perhaps in the Import Licensing Code. On the other hand, there is growing interest among exporting countries in revising the Antidumping Code so as to oblige the US to change its practices. We have countered with a proposal for stronger action against recidivist dumping and certain diversionary practices.

Natural Resources

Work in this group has been progressing at a snail's pace, despite our efforts to focus on energy-based products in addition to the traditional areas of fisheries, forestry and nonferrous minerals and metals. Except for Australia, none of our developed partners has been very helpful, and many developing countries have wanted to concentrate on tariff escalation and other market entry questions being handled in other negotiating groups.

Textiles

Discussions in this group have focused primarily on information gathering, which has tended to be acceptable to most participants for the moment. Sooner or later, however, we will have to address how the Uruguay Round Ministerial Declaration is to be implemented. Some LDCs have acknowledged unofficially that they would prefer an extended phase-out period for the MFA (Multifiber Agreement), while others such as Pakistan are pushing for a much faster pace.

Standstill and Rollback

In March the EC offered to rollback 90 residual quantitative restrictions maintained by member states, conditioned on overall reciprocity and concessions from Japan and the eastern European countries. This "offer", however, has little economic meaning, and we have requested that the EC rollback all its GATT-illegal QRs (Quantitative Restrictions). We have also submitted cross-notifications on new trade restricting measures in Brazil (additions to the prohibited import list), Canada (dairy quotas), Greece (ban on almond imports), and the EC (rice subsidies). We have been asked to consult under rollback by Canada, Argentina, Uruguay and Chile. We also hope to complete multilateral consultations with Japan on a large number of agricultural and industrial product QR's.

June 16, 1988

THE U.S.-CANADA FREE TRADE AREA AGREEMENT STATUS REPORT[1]

The Senate Finance and the House Ways and Means committees have agreed upon common recommendations for the wording of the U.S.-Canada Free Trade Agreement (FTA) implementing bill after holding separate mock mark-up sessions. However the final approval process in Congress has still not been completed. While the FTA itself cannot be changed, the wording of the final implementing legislation will be written by the Reagan Administration, and it is expected that most of the recommendations of the Ways and Means and Finance committees will be included in the final bill. The Administration is expected to submit a final version of the FTA enacting legislation to Congress sometime in June. Congress will then have up to 90 days to vote on the legislation without amendments. The bill will only require a majority vote for approval. Assuming that the agreement is approved by Congress and the Canadian Parliament, it would go into effect on January 1, 1989.

The U.S.-Canada trade relationship is especially important because the two nations share the largest single bilateral relationship in the world. In 1987, total two-way trade between the U.S. and Canada equalled $131.3 billion. Exports to Canada equalled $59.8 billion and imports from Canada equalled $71.5 billion. The opinions of the western governors about the FTA range from strong support for the agreement, to strong objections to the agreement. Proponents of the agreement argue that while the agreement falls short of leveling all conceivable trade barriers, it is an important step in the process toward achieving free trade with Canada. Proponents also point out that the agreement promises the complete elimination of tariffs as well as a major reduction in non-tariff trade barriers. Opponents of the agreement in the West have generally cited concerns about the impact of the agreement upon natural resource industries competing with Canadian products which receive subsidies or other non-tariff barrier assistance from the Canadian government. The Reagan Administration has made concessions on the implementing legislation which have eased some of the concerns of western governors and lawmakers. However, some strong concerns about the impact of the agreement upon western states continue to persist.

Congress has pressured the Administration to address the issue of Canadian subsidies. Earlier this year 25 senators signed a letter sent to President Reagan urging him to put pressure on both the U.S. and Canada to eliminate subsidy programs that are not covered by the agreement. But now Senator Max Baucus (D-MT), formerly a principal opponent of the agreement, has become a supporter due to a compromise which has been reached with the Administration regarding Canadian subsidies. According to the compromise, the U.S. government would monitor Canadian subsidies programs, submit annual reports to Congress, and reserve the right to issue trade complaints against Canadian-subsidized industries. The two governments would also hold negotiations to reduce subsidies. The compromise also stipulates that the FTA would be terminated if progress isn't made in these negotiations after seven years. But the President would not have to end the pact if it were in the U.S. national economic interest to continue it. The FTA implementing language agreed to by Senate Finance and House Ways and Means also specifically calls for the Administration to enter into immediate consultation with Canada to end "Crow's Nest" subsidies for grains destined for export to the U.S. through eastern Canadian ports. In addition the recommended language

[1] Prepared by WGA staff.

calls for negotiations with Canada to reduce or end service subsidies and for discipline on subsidies that adversely affect U.S. industries that directly compete with subsidized import: such industries include, but are not limited to, coal mining, oil and gas production, non-ferrous metal mining and smelting, agricultural production, lumber production and fisheries

The Canadian government apparently feels that the language on subsidies worked out between the U.S. Administration and Congress, presents major difficulties. Recently, Prime Minister Brian Mulraney's Chief of Staff, Derek Burney expressed Canada's objections at a meeting with Treasury Secretary James A. Baker III.

Actually all U.S. members of Congress are satisfied with the subsidies language compromise agreed to by Ways and Means and Finance. Senators such as Pete V. Domenici (R-NM and Alan K. Simpson (R-WY) continue to express their opposition to certain portions of the agreement. They have some serious concerns about the impact of the agreement upon uranium independent petroleum producers. On June 15, the Supreme Court unanimously reversed a federal appeals court ruling that would have required the Department of Energy to restrict the enrichment or processing of imported uranium. The ruling is a defeat for U.S. uranium producers who have argued that the Department of Energy has been wrongfully denying import relief to the uranium industry under the Atomic Energy Act. The FTA exempts Canada from the import relief clause of the act.

Prior to the Supreme Court decision, the Reagan Administration offered to establish a $750 million account to fund the purchase of domestic uranium over a five year period if the mining industry and its supporters in Congress would end legal and legislative attempts to enforce the import relief section of the Atomic Energy Act. Furthermore, the Administration offered to include this procurement fund provision, along with Titles II and III of the uranium revitalization bill (S2097) in the FTA enacting legislation involving a total payout of up to $13.3 billion.[2] Since the Supreme Court has ruled against the uranium industry, members of Congress who support the industry will probably push harder for the inclusion of the uranium payment provisions in the FTA implementing legislation. Uranium industry supporters have been supporting the bill S 2097 passed by the Senate in March.[3] Title I of the bill which would put fees on domestic utilities that use more than 37% foreign uranium, would not be added to the FTA implementing legislation. Some members of Congress, such as Dan Rostenkowski (D-Ill), are upset by the fact that the Administration is willing to make these concessions to add uranium funding provisions to the FTA implementing legislation. Rostenkowski has told Treasury officials that he will block consideration of an agreement containing the uranium provision payout.

The trade of plywood with Canada has been another issue of concern in the West. Plywood producers have organized opposition to Canadian plywood standards and codes procedures which serve as nontariff barriers against U.S. plywood exports. But a plywood industry representative has stated that plywood negotiations between the U.S. and Canada have moved in the right direction. Discussions are now underway at a government-to-government level with the objective of finding agreement upon a common plywood performance standard which would be recorded in the building codes of both countries. Additionally, the Administration

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[2] This payout figure is approximate and is subject to differing interpretations about what the actual amount of debt is for unrecovered Energy Department losses which must be repaid by U.S. utilities.

[3] The WGA governors have supported Title II of this legislation which sets up a system for financing the reclamation of mill tailings at active mill sights.

has agreed not to lower U.S. tariffs on Canadian plywood until there is a satisfactory resolution of the plywood standards problem.

The interest of the western governors concerning the treatment of U.S. territories and commonwealth governments in the FTA has been recognized and begun to be addressed. Earlier this year the governors of Hawaii, American Samoa, Guam and the Commonwealth of the Northern Mariana Islands signed a statement issued by the Pacific Basin Development Council stating that they "wish to raise major concern over the fact that the territories and commonwealth have been excluded from the United States Canadian Free Trade Agreement." These governors (or their representatives) recently met with Administration representatives to draft acceptable model language regarding the treatment of the territories and commonwealth in any future bilateral trade agreements. Although the FTA cannot be changed, the USTR and other federal departments have agreed to represent the interests of the territories and commonwealth in negotiations with Canada and with any other countries with whom the U.S. is considering a bilateral agreement.

One issue which apparently remains unresolved is the wording of legislative language concerning the binational panel created under the FTA to resolve trade disputes. The Administration is concerned that the language recommended by Ways and Means and Finance regarding this binational panel would provoke a constitutional challenge under the appointments clause of the U.S. Constitution. The Administration will continue to work with Congress to reach a new consensus on this issue. However the issue is further complicated by the fact that a consitutional challenge of the binational panel may be imminent even if the pact is ratified in the U.S. and Canada because of controversy concerning the way in which the panel is set-up by the agreement to substitute arbitration for court appeals.

Another unresolved issue is controversy regarding the President's compliance with certain "fast-track" procedure statutory requirements for the FTA implementing legislation. For example, it has been contended that the President neglected to consult with all appropriate Congressional committees prior to entering into the FTA with Canada as required by the Trade and Tariff Act of 1984. It could be argued that because of this negligence, the FTA final implementing legislation should not be reviewed under "fast-track" procedures.

In Canada, the FTA had been expected to pass through the Canadian Parliament with the support of Prime Minister Brian Mulroney's Progressive Conservative Party majority. However the FTA legislation has met with an initial cool reaction in the House of Commons, in which the Conservative party has a large majority. It may take the Government several months to get the bill passed in that chamber. Moreover, even more time may be required to get the legislation passed in the opposition-dominated Senate of the Canadian Parliament. Apparently Canadian lawmakers are waiting to see what sort of action the U.S. Congress will take on the FTA. In general, experts agree that the impact of the FTA will be much broader in Canada than in the U.S. As a result, the issue presents a greater political risk to Canadian lawmakers. Opposition leaders have already stated demands for a national election on the issue. The Conservative ruling party is required to call a national election before September of 1989.

The Canadian Government appears to have failed in a last-minute attempt to persuade the Province of Ontario to comply with the free-trade agreement. Ontario's premier, David Peterson, has considered a court action to block the national government's ability to force compliance by the provinces. Under the status quo, the ratification process for the agreement does not require provincial approval. However some provisions of the pact which would affect provincial jurisdiction, such as clauses pertaining to provincial government liquor and wine pricing and distribution practices, could require provincial legislative action. The failure of Mulroney's administration to convince Ontario to comply with the agreement could threaten the movement toward approval of the pact in the Canadian Parliament and the U.S. Congress. Canadian International Trade Minister John Crosbie has admitted that as many as six of Canada's ten provincial governments are displeased with the impact of federal legislation to implement the FTA on provincial jurisdiction.

The issue of provincial and state compliance with the FTA is a significant one for both countries. Article 103 of the agreement states that: "The Partners to this Agreement shall ensure that all necessary measures are taken in order to give effect to its provisions, including their observance, except as otherwise provided in this Agreement, by state, provincial and local governments." The interpretation of this article has been a subject of concern to state governments that do not want to commit themselves to a preemption standard which would undermine states' constitutional rights based on federalism principals. Furthermore this issue is complicated by the fact that U.S. Administration officials have argued that the interpretation of this article in the U.S. has a crucial bearing upon how the Canadian government will act to require provincial compliance with the FTA. Canadian provinces have greater constitutional power vis-a-vis the Canadian national government in comparison to the U.S. federal-state formula.

The final wording of the implementing legislation recommended by the Ways and Means and Finance committees states that: "(The FTA will) (P)rovide that in the event of a conflict between the FTA or the implementing legislation and a provision of state or local law, the FTA or the implementing legislation will prevail. State law includes any state law regulating or taxing the business of insurance." Administration sources have indicated that the practical effect of the draft legislation, if it were implemented, would be that existing state laws in the areas of services and investment would be grandfathered into the agreement, and that any changes in state laws, or new state laws would need to comply with the agreement to the extent that there is a conflict between these laws and the FTA. Also states with liquor control administrative practices may be required to introduce appeals procedures for the denial of listing of Canadian products.

WGA staff will continue to closely monitor the progress of the FTA, and we will send out a copy of the final implementing legislation to the Governors as soon as it becomes available. The following table lists some economic and trade data about Canada.

and represent period averages
unless otherwise indicated.

INDICATOR	ACTUAL 1986	ACTUAL 1987	PERCENT CHANGE	FORECAST 1988	PERCENT CHANGE
OUTPUT, PRODUCTION, EMPLOYMENT					
GDP (Current Prices, C$ Billion)	509.9	553.9	8.6	594.9	7.4
GDP (Constant 1981 C$ Billion)	406.9	422.6	3.9	437.4	3.5
Industrial Production (Constant 1981 C$ Billion)	103.5	108.4	4.8	113.5	4.6
Private Investment (Constant 1981 C$ Billion)	77,125	85,712	11.1	90,426	5.5
Unit Labor Costs In Mfg. (¢) 1/	.6890	.7140	3.6	.7411	3.8
Wage Settlements (%) 2/	3.4	4.0	----	4.4	-----
Employment (000's)	11,634	11,955	2.8	12,230	2.3
Avg. Unemployment Rate (%)	9.6	8.9	----	8.0	-----
Housing Starts (SAAR, 000's)	200	246	23.0	190	-22.8
MONEY AND PRICES					
Exchange Rate: 1 C$ = US ¢:	71.97	75.43	----	80.00	----
Interest Rates:					
Bank of Canada Rate 3/	8.49%	8.66%	----	8.50%	----
Chartered Bank Prime Rate	9.75%	9.75%	----	9.75%	----
Price Indices:					
All-Items Consumer Price Index (1981=100)	132.4	138.2	4.4	143.7	4.0
Industrial Product Price Index (1981=100) 4/	119.6	122.6	2.5	126.9	3.5
BALANCE OF PAYMENTS AND TRADE					
Official International Reserves (US$ Millions)	4,095.6	8,203.2	100.3	10,467.3 5/	27.6
Balance of Payments (C$ Billion)					
Current Account Balance	-9.3	-9.6	-----	-10.0	-----
Merchandise Trade Balance	10.4	10.3	-1.0	10.0	-2.9
Non-Merchandise Balance 6/	-19.7	-19.8	0.5	-20.0	1.0
Merchandise Exports	120.6	125.7	4.2	129.0	2.6
(U.S. % Share of Total)	(78%)	(76%)	----	(75%)	-----
Merchandise Imports	110.2	115.5	4.8	119.0	3.0
(U.S. % Share of Total)	(70%)	(70%)	----	(70%)	-----
Travel Receipts	6.3	6.3	0	6.0	-4.8
(U.S. % Share of Total)	(71%)	(67%)	----	(68%)	-----
Travel Expenditure	7.5	8.8	17.3	9.0	2.3
(U.S. % Share of Total)	(59%)	(58%)	----	(60%)	-----

Main Imports from the U.S. (1987) (C$ billions): Automotive vehicles and parts, 27.5; communications and electronic equip. 7.4; industrial machinery, 6.3; equipment & tools, 5.6; chemical products, 4.7; aircraft & parts, 2.5; agricultural machinery, 1.7.

Footnotes:
1/ Labor income per unit of output.
2/ Compound average annual increase in base rates (%). Wage settlements in all industries, all agreements.
3/ Actual rate at end of year. Floating rate set .25% above 91-day treasury bill tender rate.
4/ Essentially a producer price index.
5/ Level as of February 1988.
6/ Includes services, transfers, and investment income.

Sources: Statistics Canada; Bank of Canada Review, U.S. Embassy and Conference Board of Canada projections.

Note: This table is listed in the U.S. Department of Commerce, "Foreign Economic Trends and their Implications for the United States" report, May, 1988.

MEXICO: TRADE AND ECONOMIC UPDATE[1]

United States-Mexico Framework Agreement

Prior to Mexico's accession to the GATT (General Agreement on Tariffs and Trade) in August 1986, there was no formal mechanism other than the 1985 bilateral subsidies agreement to govern our commercial relations. A Joint Commission on Commerce and Trade (JCCT) was formed in 1981 to address bilateral trade and investment issues, but it fell victim to the economic crisis which hit Mexico in 1982-1983, as well as to the belief that it was ineffective.

In April 1985, then USTR Brock and Mexican Secretary of Commerce and Industrial Development Hernandez signed a "Statement of Intention to Negotiate a Framework of Principles and Procedures Regarding the Trade and Investment Relations Between the United Mexican States and the United States of America". The goal was to begin negotiations in the fall of 1985, but an earthquake devastated Mexico City and destroyed the Commerce Ministry in October 1985. Framework negotiations were further delayed by Mexican GATT accession negotiations. The first framework negotiations were held in Washington, in February 1987.

The Framework is composed of three major sections: a statement of principles, a consultative mechanism, and an "immediate action" agenda. The statement of principles enunciates the goals for the Framework. The consultative mechanism calls for discussions to be held on any trade and investment issue within 30 days of a request from either side. If the dispute is not resolved within 30 days of consultations, either side may seek other means of redress, including GATT dispute settlement. The "immediate action" agenda calls for consultations on six sectoral issues: textiles, agricultural products, steel products, foreign investment matters, intellectual property rights, and electronic products. There will also be an exchange of information on the service sector to help in preparation for the Uruguay Round GATT negotiations.

In December, the United States announced that it was raising quotas on products covered by the US-Mexico steel trade agreement by approximately 30,000 tons. Mexico agreed to cover additional products, including steel fence panels, under the arrangement. Mexico announced that it was removing alcoholic beverages and certain other products from quotas and import licensing requirements. Mexico also announced in December that it was raising its quotas on textiles, giving the United States access to approximately $240 million of Mexico's textile market. At the Presidential Summit in February, the U.S. agreed to raise quotas on Mexican textile products and to give separate quotas to textile goods made from U.S. materials.

Background On The Mexican Economy

Mexico's modest economic recovery and strong balance of payments in the first three quarters of 1987 were undermined by rising budget deficits and inflation, collapse of the stock market, and a run on the peso in the fourth quarter of the year. In mid-December, the government implemented a tough economic stabilization plan--the Economic Solidarity Pact (ESP)-- to bring inflation down rapidly, restore financial confidence, and establish conditions for sustainable economic growth.

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[1] This information was prepared by the U.S. Trade Representative's Office.

WGA staff has added some editorial changes for purposes of clarification.

The ESP combined strong traditional medicine--a 22 percent devaluation of the peso, budget cuts, tight credit, and further reductions in import barriers--with an unconventional forward-looking indexation of key prices and wages in the economy. Between February and mid-April 1988, government-controlled prices, wages, and the exchange rate have been virtually frozen, interest rates cut in half, and private sector price increases generally kept in line with cost increases. The government maintains it is keeping tight control over public sector expenditures to ensure the public sector borrowing requirement and inflation abate permanently.

Mexico's GDP (Gross Domestic Product) grew 1.4 percent and industrial production 2.9 percent in 1987. Mining (including petroleum) and manufacturing led the recovery. Capital inflows and looser monetary policy boosted liquidity but the government kept M-1 (A narrow definition of money, as currency in circulation plus demand deposits), growth to less than the rate of inflation. Nevertheless, the financial deficit remained high--almost 16 percent of GDP--and (12-month) inflation climbed to 159.2 percent in December. By late September, deteriorating financial expectations and the collapse of the stock market generated pessimism about the economy and caused a shift to dollar assets. Net capital outflows of $2.5 billion (added to a narrowing current account[2] surplus) reduced gross international reserves by $1.6 billion in the fourth quarter. <u>Nevertheless, an $8.4 billion (manufactured goods export-led) trade surplus, a $3.9 billion current account surplus (helped by over $3 billion in net tourist and in-bond receipts), and $1.2 billion in capital inflows boosted reserves from $6.8 billion to $13.7 billion for 1987 as a whole.</u>

The Mexican government proceeded with structural reforms in 1987. Parastatal companies continued to be eliminated and trade liberalization accelerated. <u>The maximum tariff rate was cut to 20 percent</u> and official reference prices for imports were eliminated. The government reduced its external debt by $1.1 billion through an innovative swap of existing obligations at a discount for new bonds. Mexican authorities expect tough stabilization measures and further progress on structural reform to cut inflation and interest rates and permit a sharp reduction in the government's internal borrowing requirement in 1988. <u>At the same time, little or no economic growth and a weaker balance of payments are likely this year.</u>

The following table includes economic and trade data about Mexico.

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[2] Current account includes all payments made because of current purchases of goods and services.

MEXICO
MARKET INDICATORS

U.S.-Mexico Trade ($US billion)	1981	1982	1983	1984	1985	1986	1987(est.)
U.S. Exports (fas)	17.8	11.8	9.0	12.0	13.6	12.4	14.6
U.S. Imports (cif)	13.8	15.9	17.0	18.3	19.4	17.6	20.5
U.S. Trade Balance	4.0	(4.0)	(8.0)	(6.3)	(5.8)	(5.2)	(5.9)
U.S. Share of Mexico's Imports (%)	66.2	57.0	65.0	62.0	67.0	65.0	60.0
U.S. Share of Mexico's Exports (%)	54.2	53.0	60.0	60.0	61.0	67.0	67.0
U.S. In-Bond (806/807) Imports from Mexico	3.2	2.8	3.7	4.9	5.4	6.4	8.2
(Dutiable Value)	1.3	1.4	1.8	2.3	2.5	3.0	3.9
Mexico's Balance of Payments ($U.S. billion)							
Exports (fob)	20.1	22.0	23.1	25.2	21.8	15.8	20.6
Imports (cif)	23.9	14.4	8.5	11.3	13.5	11.4	12.2
Trade Balance	3.8	7.6	14.6	14.1	8.3	4.6	8.4
Current Acct. Balance	-16.1	-6.2	5.3	4.2	0.5	-1.3	3.1
Foreign Direct Investment (Net Inflows, $million)		602.7	460.5	391.1	490.5	910.1	820.0
Foreign Debt (year-end)	74.9	89.6	93.1	96.2	97.4	100.6	105.4
Debt Service/Exports (%)	49.0	46.1	49.9	43.9	48.8	46.9	45.4
International Reserves	5.0	1.8	4.9	8.2	5.8	6.3	13.6
Avg. Exch. Rates (Contr.)	24.5	57.0	126.0	168.0	282.0	650.0	1122.4
(Free)	24.5	57.0	150.0	185.0	310.0	652.0	1125.7
Domestic Economy							
Population (millions)	71.1	73.0	75.0	77.0	79.0	81.0	82.0
GDP (current $billion at avg. exch. rate)	238.9	165.0	136.0	171.0	161.0	125.0	126.0
Per Capita GDP (current $)	3,443.0	2,260.0	1,813.0	2,201.0	2,043.0	1,541.0	1,537.0
GDP (1980 $billion)	80.9	80.5	76.3	79.1	81.2	78.4	79.2
GDP Real Growth (%)	8.0	-0.5	-5.3	3.5	2.7	-3.5	1.1
Unemployment		4.7	11.7	12.6	13.4	17.8	18.0
Inflation (%Chg., CPI)	28.7	98.9	80.8	59.2	63.8	105.7	159.0
Gvt. Deficit/GDP (%)		15.4	8.0	8.4	10.1	16.0	17.0
Foreign Direct Investment (US$billion)							
Total Authorized (cumulative, GOM data)	10.2	10.9	11.5	12.9	14.7	17.0	20.7
U.S. Direct Investment in Mexico (cumulative, U.S. data)	6.9	5.0	4.4	4.6	5.0	4.8	6.2

Prinicipal U.S. Exports (1986): automotive parts, telecommunications equipment, engines, mechanical shovels, computers, chemicals.

Principal U.S. Imports (1986): crude petroleum and derivatives, coffee, tomatoes, shellf automobile, automobile engines.

Sources: U.S. Department of Commerce, Bank of Mexico, International Monetary Fund, Burea Economic Analysis, U.S. Embassy, Mexico City

Note: Mexican trade statistics do not include "in-bond" trade

June 15, 1988

U.S. MERCHANDISE TRADE DATA INFORMATION[1]

It has been estimated that the U.S. experienced a merchandise trade deficit equalling approximately $170 billion in 1987. Since early 1985, the value of the U.S. dollar has been declining relative to the currencies of many trading partners. However this dollar depreciation did not bring about an anticipated level of improvement in the nation's trade balance until recently. Between 1986 and 1987 the merchandise trade deficit remained virtually unchanged. But it appears that the U.S. may now be facing a turning point in the balance of trade picture, since some of the positive effects of the dollar depreciation are reflected in recent monthly trade statistics.

In the last quarter of 1987 it appeared that an improved balance of trade picture was on the horizon. However, in February of 1988, experts were taken by surprise as the nation's trade deficit took a sharp monthly rise, and as imports surged more than twice as much as exports. Then in March, the picture changed again when the U.S. exported a record amount of goods in March, thereby shrinking the adjusted monthly trade deficit to $11.7 billion. In April, the nation's trade deficit was cut back again to $9.9 billion, the lowest monthly point in more than three years. In April, imports fell sharply, while exports slowed only slightly. The trade deficit for the first four months of the year was $47.28 billion, compared with $55.32 billion in 1987, and $50.49 billion in 1986. (See the last page of this report for a graphic depiction of the trade deficit).

The manufacturing goods deficit grew by $200 million in April. However in March, manufactured products had set the pace for increased exports $3.7 billion higher than in February, with big increases for aircraft and parts, office machines and automatic data processing equipment, electric machinery, power generating machinery, specialized industrial machinery, new cars and telecommunications equipment.

The agriculture sector showed a surplus for the second straight month in April, at a level of $1.2 billion.

Between March and April the U.S. trade position with Newly Industrialized Countries (NICS) changed. In March, the trade deficit improved with NICS such as Hong Kong, Taiwan and South Korea. But in April, the trade deficits with these countries grew. The NIC's currencies have generally appreciated far less against the dollar than have those of Japan and Western Europe. The trade figures in April and March include a purchase of about $600 million worth of gold by Taiwan, which has been under pressure to reduce its huge trade surplus with the U.S.

It is common knowledge that the U.S. government's merchandise trade figures are far from perfectly accurate. Monthly trade figures are not adjusted for inflation, exchange rate movements or various other seasonal factors. Analysts such as Kenichi Ohmae of McKinsey & Co., Robert Reich of Harvard, and Tim Kane of the University of Texas have argued that the Commerce Department's merchandise trade figures are seriously flawed because they do not show the effect of important variables such as U.S. foreign sales by U.S. corporations based overseas. Robert Reich has said that "these days about half of the total exports of American multinational corporations comes from their factories in other countries. Two decades ago it

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[1] Prepared by WGA staff. Merchandise trade figures do not include trade in services.

was about one-third."

Indeed the total trade picture is complicated given the realities of today's global economy. The complexity of the situation can be appreciated when one considers that the largest exporter of computers from Japan is I.B.M., a U.S. corporation. Furthermore, products which are considered to be American products (such as the Pontiac LeMans), often contain a substantial number of components which come from abroad.

The Commerce Department has taken a number of steps to improve the accuracy of merchandise trade data including: automating the trade data collection process, obtaining state of origin information for exports, and working with the Canadian government to improve the accuracy of U.S. information about U.S. exports to Canada. One significant problem which remains unresolved is the fact that the U.S. has not adopted a harmonized system of goods classification, after taking a lead on promoting the use of the system. Most of the world's lead trading countries have adopted this system. The omnibus trade bill which was recently vetoed by President Reagan would require the U.S. to convert to the harmonized system.

Recently the Department of Commerce issued some figures showing state import and export values for merchandise traded in 1987.[2] The data shows that the western states accounted for about 21% of the total merchandise trade deficit during 1987. Total exports for the region equalled about $48 billion, and total imports equalled about $85 billion.[3]

Some recent trends are developing in the West which indicate the trade picture is turning around for the region. A May 1987 report from the Federal Reserve Bank of San Francisco states that "because a large portion of products which pass through western ports are traded with Japan, against whose currency the depreciation of the dollar has been particularly pronounced, there is greater evidence of a current turnaround in the West's trade balance than in the balance of the rest of the nation." Futhermore the report states that, "Because of the West's proximity to the Far East, products which pass through western Customs Districts are much more likely to be traded with Pacific Basin nations than are American traded goods generally."[4]

Another report issued by the Federal Reserve Bank of Dallas in March 1988 indicates that the fall in the dollar should stimulate U.S. manufacturing throughout the rest of the decade, particularly in the Northeast, Upper Midwest, and West. Below average gains are projected for the Southern Atlantic, South Central and Northern Plains states according to the report.[5] The manufacturing industries which are projected to benefit substantially from the lower dollar include transportation equipment, instruments, electronic equipment, nonelectrical machinery, and chemicals. The report states that, in contrast, the production of lumber and wood products, pulp and paper, textiles, and processed food is not expected to respond significantly to the devaluation of the dollar.

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[2] One should be advised that this data is not perfectly accurate, particularly regarding the destination of imports. However this is the best information available from the Department of Commerce at this time regarding state merchandise exports and imports.

[3] This data does not include information about each of the U.S. territories and commonwealths because this information is not available.

[4] Underline emphasis added.

[5] Note: the study also projects below average gains in the manufacturing sector from the devaluation of the dollar in Alaska and Hawaii.

Furthermore one should bear in mind that the current severe drought in the West, Mid-West, South and Great Plains states has raised prospects for the most dramatic rises in food prices since the 1970's. Although it still is not certain exactly what the effect of the drought will be, it is a problem which threatens the stability of domestic agricultural production and exports.

An important point to bear in mind is that in contrast to the rest of the U.S., employment in manufacturing has actually grown during recent years in the West. From 1980-1987, 10 western states experienced positive growth in manufacturing employment. Whereas, on average, all 50 U.S. states experienced a 6.2% drop in manufacturing employment during the same period.[6]

This year the Department of Commerce is expected to release state-by-state export figures which are categorized by products and country of destination. The WGA plans to obtain this data in order to provide analyses of this information for the governors and their respective state trade directors.

The tables on the following page show yearly trends in the merchandise trade deficit, and figures for recent monthly U.S. merchandise trade deficits with Japan, Canada, Western Europe and the NICs.

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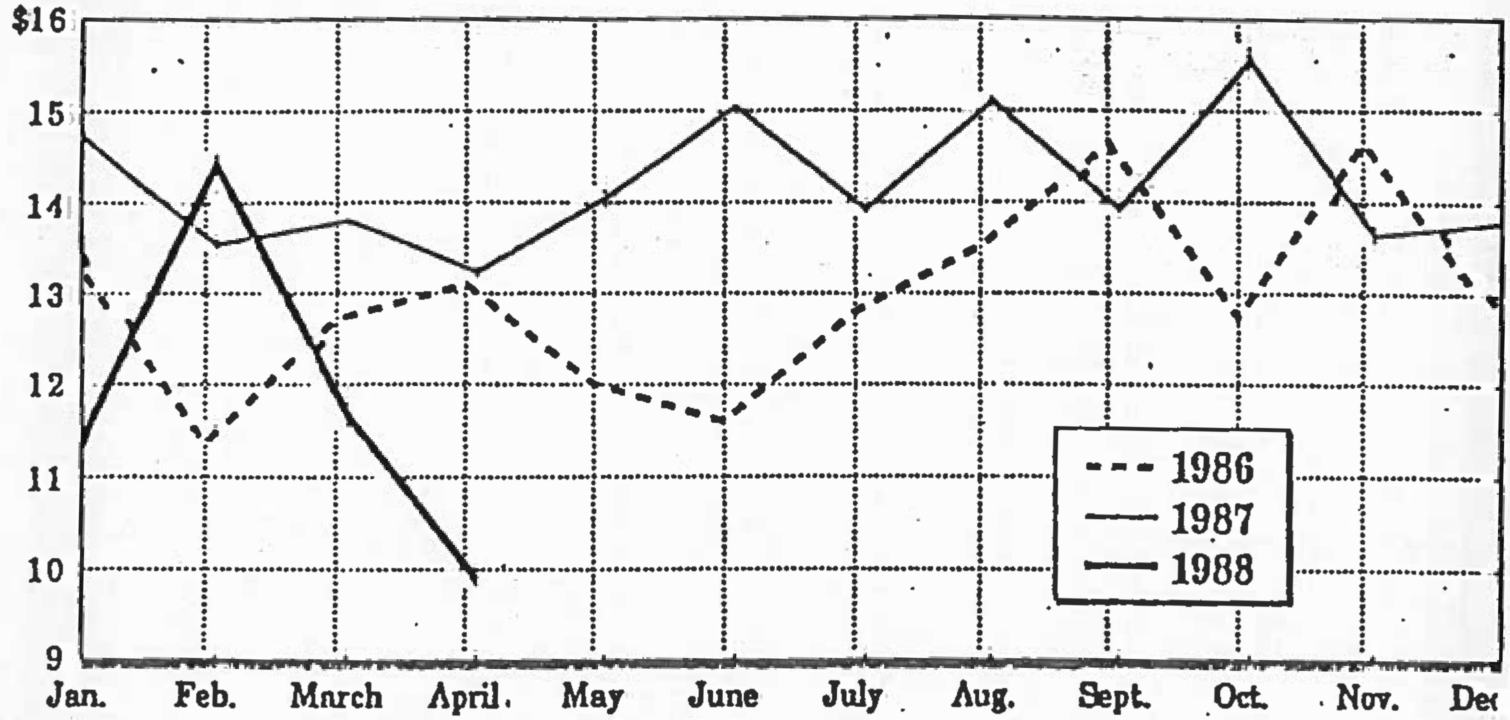
[6] Source: State Policy Databook, 1988, State Policy Research, Inc., Table B-36.

Tracking the Trade Deficit

(In billions of dollars, seasonally adjusted)



Note: Monthly figures for 1986 aren't adjusted for undocumented exports to Canada

Source: Commerce Department

U.S. Merchandise Trade Deficits

(In billions of U.S. dollars, not seasonally adjusted)

	APRIL '88	MARCH '88	APRIL '87
Japan	$4.44	$4.55	$4.95
Canada	1.08	1.14	0.76
Western Europe	0.81	0.91	2.55
NICs*	1.66	1.39	2.52

*Newly industrialized countries, including Singapore, Hong Kong, Taiwan, South Korea

Source: Commerce Department

POSSESSION TAX CREDIT

Pacific Basin Development Council
Suite 325 • 567 South King Street • Honolulu, Hawaii 96813-3036
Telephone (808) 523-9325 Facsimile (808) 533-6336

June 6, 1988

ACTION MEMORANDUM #31-88

To: The Honorable Joseph F. Ada
The Honorable Pedro P. Tenorio
The Honorable A.P. Lutali

INFO COPY: The Honorable John Waihee

From: Jerry B. Norris Jerry

SUBJECT: TRANSMITTAL - CONGRESSIONAL RESEARCH SERVICE (CRS) PUBLICATION ON THE POSSESSIONS TAX CREDIT (IRC 936)

The enclosed publication is provided for your information. Please note the section on the twin plant initiative discussed on pages 6-8.

If we can be of further assistance, please so advise.

JBNSpec/ca
ENCLOSURE

CRS REPORT FOR CONGRESS

THE POSSESSIONS TAX CREDIT (IRC SECTION 936): BACKGROUND AND ISSUES

The U.S. tax code's possessions tax credit provides a substantial tax benefit for U.S. firms that operate in U.S. possessions. The credit is designed to promote economic growth and employment in the possessions by attracting investment by U.S. businesses. Some have questioned the cost-effectiveness of the credit, arguing that its impact on employment has been weak compared to its cost in terms of forgone tax collections. But the government of Puerto Rico maintains that the tax benefit is indeed effective in promoting economic growth and continues to rely on the credit as a key part of its economic development strategy.

by
David L. Brumbaugh
Analyst in Public Finance
Economics Division

March 11, 1988

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CONTENTS

THE POSSESSIONS TAX CREDIT (IRC SECTION 936): BACKGROUND AND ISSUES

The U.S. tax code's possessions tax credit provides a substantial tax benefit for U.S. firms that operate in the U.S. possessions. Under the credit's provisions (also known as the "section 936" provisions, after the relevant section of the Internal Revenue Code), income U.S. firms earn from business operations in the possessions is exempt from the Federal corporate income tax, along with income from certain types of financial investment. To complement the tax benefit provided at the Federal level, the governments of Puerto Rico, the Virgin Islands, and other possessions have enacted their own business tax reductions that are designed to attract businesses to the possessions. In combination, the possessions tax credit and the possessions' own tax incentives result in more favorable tax treatment of possessions-source income than is generally available for income U.S. firms earn either in the mainland United States or locations in foreign countries.

The purpose of the possessions tax credit is to stimulate economic growth in Puerto Rico, the Virgin Islands, and other possessions by attracting business investment from the mainland United States and alternative locations abroad. The reduction of unemployment in the possessions has been a particular concern of policymakers. Puerto Rico, for example, has registered unemployment rates that are substantially higher than those of the mainland United States.

As by far the largest economy that is directly affected by the possessions tax credit, Puerto Rico has been the focus of an ongoing controversy over the effectiveness of section 936 in actually promoting economic growth. On the one hand, the government of Puerto Rico and others have argued that the possessions tax credit has indeed attracted a large amount of investment to Puerto Rico—investment that has been the foundation of economic growth, and which has created substantial new employment.[1]

Yet others have questioned the cost effectiveness of the possessions tax credit, arguing that its cost in terms of foregone tax collections by the U.S. Treasury has been high in comparison to the jobs it has created in the possessions. Such considerations led the U.S. Treasury to include the phasing-out of section 936 among the list of tax reform measures it set forth in 1984. For its part, Congress has addressed the cost-effectiveness of the possessions tax

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[1] Ture, Norman B. Measuring the Benefits and Costs of Section 936. Washington. Institute for Research on the Economics of Taxation, 1985. p. 26.

credit on several occasions, modifying the 936 provisions in an attempt to reduce the provisions' revenue cost and target them more closely to investment in the possessions. Most recently, Congress adopted rules to facilitate Puerto Rico's "twin-plant" initiative, which is designed to enhance the ability of 936 to attract employment-generating investment to Puerto Rico as well as other areas in the Caribbean.

The possessions tax credit thus presents policymakers with several issues. First, is it desirable to provide a tax incentive for businesses to invest in the possessions above and beyond that which is available on the U.S. mainland and in foreign developing countries? Second, if such a tax incentive is indeed desirable, are the current 936 provisions effective in providing it?

HOW THE POSSESSIONS TAX CREDIT WORKS

Section 936's tax benefit is technically in the form of a tax credit: an offset against Federal taxes. But since the tax code provides that the credit is always equal a firm's Federal tax liability on income earned in the possessions, the credit has the effect of a tax exemption.

To qualify for the credit, a firm must be incorporated in the United States and must meet two requirements designed to link the tax benefit to active business operations in the possessions: it must earn at least 80 percent of its income in a possession; and at least 75 percent of its income must be from the active conduct of a trade or business in the possessions.

If a corporation meets these requirements, any income from its active business operations in the possessions qualifies for the possessions tax credit and is thus tax-exempt. But the tax exemption applies to only a limited range of income from financial investment. Income from assets such as stocks, bonds, and other financial instruments qualifies for the credit only if the investments are made out of funds generated by business operations in the possessions, and only if the investment is made in the possessions.

U.S. firms generally pay Federal taxes on income from operations on the mainland United States; section 936 clearly provides favorable tax treatment to operations in the possessions by comparison. But the possessions are often viewed as competing with developing countries for U.S. investment. It is thus important to note that section 936 also provides favorable tax treatment for the possessions compared to income U.S. firms earn in foreign countries.

A tax benefit known as the "deferral" principal is available in many cases to U.S. firms that invest in developing countries. Under deferral, income U.S. firms earn through foreign subsidiary corporations is exempt from Federal taxes as long as it remains in the hands of the subsidiary. However, when the foreign income is ultimately remitted to a U.S. parent corporation as dividends, it is taxed by the United States. The tax benefit deferral provides is thus ability to postpone the payment of U.S. taxes on foreign income.

Most U.S. firms that use the possessions tax credit do so by establishing subsidiary corporations that meet the section 936 requirements; it is the qualifying subsidiaries that earn tax-exempt possessions-source income. But unlike the deferral principle, the section 936 provisions permits possessions subsidiaries to remit their income to their U.S. parents, free of Federal taxes. The possessions tax credit thus provides a permanent tax exemption compared to the temporary tax exemption for foreign income under deferral.

If a firm keeps its foreign income overseas for an extended period of time, the difference between deferral and a permanent tax exemption such as the possessions tax credit diminishes. But section 936 can provide an additional tax advantage over deferral to some firms: in some situations, a firm can use the possessions tax credit to shelter income earned in the mainland from Federal taxes along with income from the possessions.

The opportunity for additional tax savings occurs when a U.S. firm develops an intangible asset (such as a copyright or patent) in the United States and then transfers ownership of the asset to its possessions subsidiary -- a transfer that can be effected free of Federal taxes. In such a situation, firms can attribute a least part of the profits the asset generates to its possessions operations, and obtain the section 936 tax exemption for the income. Because, in theory, income generated by an asset developed in the United States has its source in the United States the possessions tax credit thereby exempts U.S.-source income from taxation in these situations.

As described in the following sections of the report, the ability of firms to use section 936 to shield U.S. income from taxes was at least partly eliminated by Congress in 1982.

PUERTO RICO'S ECONOMY AND SECTION 936

The Federal tax benefit for income earned in the possessions has been a central part of Puerto Rico's long-range economic development strategy since World War II. In the years immediately following the War, Puerto Rico formulated a development strategy known as "Operation Bootstrap," which relied on the development of a manufacturing sector to spearhead growth in income and employment. The centerpiece of Operation Bootstrap was tax incentives; Puerto Rico enacted its own industrial tax incentives to attract manufacturing investment. Equally important, however, was the Federal tax exemption for income earned in the possessions.

By all accounts, Operation Bootstrap succeeded admirably for almost three decades. Manufacturing investment poured into Puerto Rico over the period 1948-74, transforming the island's economy from one based largely on agriculture to an economy led by manufacturing and services. The development of manufacturing was accompanied by prodigious growth in Puerto Rico's Gross National Product; real GNP grew at an average annual rate of 6.1 percent. By comparison, the growth rate for the United States was significantly slower over the same period, averaging 3.6 percent per year. A number of factors helped stimulate the influx of capital to Puerto Rico: labor was inexpensive compared to the United States; Puerto Rico was inside the tariff boundaries of the United States, giving Puerto Rican products easy access to mainland markets. But, clearly, the Federal and Commonwealth tax incentives combined to make Puerto Rico attractive for U.S. manufacturing firms.

Beginning in 1974, however, economic growth in Puerto Rico slowed. Over the period 1975-86, real GNP grew at an average annual rate of under 2 percent and the island's economy registered several years of negative growth. The unemployment rate, which was high even during the halcyon days of Operation Bootstrap, has been over the 20 percent mark since 1982.

There are a number of important reasons for the slowdown in Puerto Rico's growth that have nothing to do with taxes. The introduction of the Federal minimum wage rules, for example, reduced the cost advantage of Puerto Rico over the U.S. mainland. Also, in the 1960s the United States reduced its tariff barriers substantially, thus reducing the cost advantage of Puerto Rico over manufacturing locations in less developed countries.

But the slowdown in Puerto Rico's economic growth also brought the section 936 Federal tax benefit under scrutiny, and divergent views developed of the provision's effectiveness. One view focuses on both the lack of growth in Puerto Rican employment and the cost of section 936 in terms of foregone Federal tax revenues and concludes that the possessions tax credit is not cost effective. This view of the possessions tax credit has appeared most prominently in the U.S. Treasury Departments 1984 tax reform proposal — a program that advocated the repeal of section 936. [2] In contrast, the government of Puerto Rico has argued that the possessions tax credit is still vital to Puerto Rico's economic future, and has maintained that the Treasury Department's estimates of the provision's cost are overstated. These views of section 936 are discussed in more detail in the next two sections of the report.

THE COST-EFFECTIVENESS OF THE POSSESSIONS TAX CREDIT

Since 1976, the U.S. Treasury has been required by law to submit annual reports to Congress on the operation and effects of the possessions tax credit. A focus of these reports has been the cost effectiveness of section 936. Each report has estimated the tax revenue cost of the possessions tax credit and the direct employment of possessions corporations, and has used these estimates to calculate the revenue loss of section 936 per employee. The Treasury calculations imply that the cost of section 936 is high compared to its benefits. For example, the revenue cost of section 936 was estimated to be more than $22,000 per employee in 1982. In comparison, average compensation of possessions corporations' employees was estimated to be only $14,210. [3]

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[2] U.S. Department of the Treasury. Tax Reform for Fairness, Simplicity, and Economic Growth: the Treasury Department Report to the President. Washington, 1984. Vol. 2, p. 327-9.

[3] Ibid., p. 328.

While such calculations are eye-catching and have been used to support arguments against the possessions tax credit, they may well understate the benefits of section 936. Investment by possessions corporations creates jobs outside the possessions corporations themselves. For example, a factory that qualifies for the possessions tax credit may create employment in industries that supply inputs to the factory. Similarly, a possessions corporation may stimulate the development of other plants that use the possessions corporation's product as an input.

On the cost side, the Treasury Department's estimates assume that if section 936 did not exist, income of possessions corporations would be taxed like income of corporations operating in the United States. In actuality, if the possessions tax credit were to vanish, firms might seek to minimize their U.S. taxes by changing their legal form in order to take advantage of the deferral principle either in Puerto Rico or in a foreign country (see above, page 2). Thus, the cost side of the cost/benefit calculation may also be overstated.

But regardless of whether the cost-per-employee figure is strictly accurate, the Treasury Department reports pointed out a number of reasons to suspect that the revenue cost of section 936 was high compared to its impact on employment. First, as noted above, firms that develop intangible assets on the mainland United States may be able to shelter U.S.-source income with the possessions tax credit by transferring the intangibles to subsidiaries in the possessions. In cases such as this the employment impact of the possessions tax benefit is probably small compared to its revenue cost. Second, the possessions tax credit is an incentive to employ capital investment in the possessions and stimulates employment of labor only as a by-product of capital investment. Indeed, in recent years the bulk of the section 936 tax benefit has been claimed by capital-intensive, high-technology firms in industries such as pharmaceuticals and electronics rather than firms in labor-intensive industries such as textiles.[4]

In 1982 Congress sought to contain the revenue cost of section 936 by restricting the use of the possessions tax credit to shelter U.S.-source income from intangibles. The Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA; Public Law 97-248) required possessions corporations that use intangible assets developed by U.S. parent firms to make payments to the parent firms for the use of the intangibles. The payments reduce the income of a possessions subsidiary and increase the income of its parent, thus reducing the amount of U.S.-source income that is tax-exempt under section 936.

THE WAGE CREDIT PROPOSAL

Another response to questions about the cost-effectiveness of section 936 came in 1984 when the U.S. Treasury published its broad

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[4] U.S. Department of the Treasury. The Operation and Effect of the Possessions Corporation System of Taxation: Fifth Report. Washington. U.S. Govt. Print. Off., 1985. p. 47.

program of tax reform. The Treasury asserted that the possessions tax benefit is "one of the most complex in the tax law, expensive, difficult to administer and yet has not been effective in creating jobs in the possessions."[5] Accordingly, its plan for general tax reform included a proposal to replace section 936 with a "wage credit" a tax credit linked to the wages a firm pays in the possessions. The initial Treasury proposal would have phased out the wage credit itself over a period of 11 years.

But the Treasury's tax reform plan was not the final program that the President submitted to Congress; the plan the Administration proposed in 1985 differed from the Treasury's program in numerous ways. With regard to the possessions tax credit, the Administration stated that it:

> recognizes its special obligations toward, and supports the goal of encouraging increased employment and economic growth in, the possessions. The Administration also recognizes a special interest in the economic health of the Caribbean region.[6]

In accord with this view, the Administration proposed replacing the current possessions tax credit with a wage credit that would be permanent rather than one that would be phased out. In proposing its wage credit, the Administration noted that the current tax exemption is based on the income a possessions corporation earns rather than directly on employment. The wage credit was intended to provide a direct incentive for firms to increase employment in the possessions.

The proposed wage credit was not included in the version of the Tax Reform Act of 1986 that Congress enacted. Instead, Congress slightly increased the payments possessions corporations must make for the use of intangibles and modified the types of income that qualify for the possessions credit so as to facilitate the operation of Puerto Rico's own "twin plant" initiative.

THE TAX REFORM ACT OF 1986 AND THE "TWIN PLANT" INITIATIVE

The government of Puerto Rico objected to both the Treasury Department's assessment of section 936's cost effectiveness and to the wage credit as a policy for economic development. It views the current possessions tax credit as effective in creating employment in the possessions and considers it a vital part of its long-term development plans.

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[5] U.S. Department of the Treasury. Tax Reform for Fairness, Simplicity and Growth. Vol. 2, p. 328.

[6] U.S. President. The President's Tax Proposals to the Congress for Fairness, Growth, and Simplicity. Washington, 1985. p. 311.

The Puerto Rican government has argued that the Treasury Department estimates of section 936's effectiveness overstate the provision's cost and understate its benefits. With respect to costs, for example, it argues that the Treasury Department calculations do not take into account TEFRA's changes to section 936, which were aimed at reducing the revenue loss associated with the provision (see above, p. 5). With respect to benefits, the government of Puerto Rico has used multipliers to arrive at estimates of section 936's benefits that take into account income generated above and beyond the direct wage payments to possessions corporations' employees. After these adjustments, the government of Puerto Rico estimates that in 1982, the cost of section 936 was $14,960 per employee and that the provision generated $28,204 of additional income in Puerto Rico for each employee of a possessions corporation.[7]

The opposition of Puerto Rican officials to the Reagan Administration's proposed wage credit was partly based on their evaluation of the credit's impact on overall employment. The government of Puerto Rico pointed out that the firms most attracted to the credit would be labor intensive ones. It asserted that even the proposed wage credit would not reduce labor costs enough for Puerto Rico to compete with developing foreign countries for labor-intensive investment. Accordingly, the Puerto Rican government argued that employment generated by the wage credit would not be sufficient to offset employment loss from repeal of section 936.[8]

In more general terms, the government of Puerto Rico views the high-technology, capital-intensive investment promoted by section 936 as fitting its development strategy better than the labor-intensive investment that would be attracted by a wage credit. A report by the Economic Development Administration of Puerto Rico stated:

> Section 936 has allowed Puerto Rico to attract a growing high technology sector which positions it for leadership and growth in high-tech production and economic development in the Caribbean.[9]

As an alternative to the Administration's wage credit proposal, the Puerto Rican government proposed its "twin plant" initiative. The plan is designed to enhance section 936's effectiveness as an incentive to invest in Puerto Rico and to extend part of the 936 tax incentive to investment in other Caribbean areas. While the Administration's wage credit proposal was not included in the Tax

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[7] Economic Development Administration of Puerto Rico. An Analysis of the President's Tax Proposal to Repeal the Possessions Tax Credit in Section 936 of the U.S. Internal Revenue Code. in Testimony of the Hon. Rafael Hernandez Colon, Governor of Puerto Rico before the Committee on Ways and Means, July 11, 1985. p. 58.

[8] Ibid., p. 74-86.

[9] Ibid., p. ii-iii.

Reform Act of 1986 (Public Law 99-514), the Act did contain provisions designed to facilitate the twin plant initiative.

The initiative works as follows. As noted above, income from investment that is strictly financial can qualify for the possessions tax credit as long as the investment is made out of funds derived from business operations in the possessions. Prior to 1986, the financial investment must also have been undertaken in the possessions. U.S. Treasury and Puerto Rican government regulations were implemented to ensure that once a firm deposited investment funds in a Puerto Rican financial institution, the funds remained in Puerto Rico and were not immediately invested outside the Commonwealth.

Under the twin plant initiative (as implemented by the Tax Reform Act of 1986 and by changes in Puerto Rican regulations), investment can be undertaken in qualified Caribbean countries as well as the possessions and still qualify for the possessions tax credit. To qualify, the investment must be undertaken either through a qualified bank or through the Government Development Bank of Puerto Rico. The banks must then use the funds to invest in active business assets in a qualified Caribbean country. The projects thus funded are intended to be labor-intensive operations that will ship their partially-finished output to more capital-intensive operations in Puerto Rico for final assembly (hence the term "twin plant").[10]

To be a qualified location for investment under the twin plant initiative, a country must be a beneficiary country under the Caribbean Basin Initiative (CBI), and must have reached an exchange of tax information agreement with the United States. As of December 31, 1987, three countries had signed the required agreements: Barbados, Grenada, and Jamaica.

CONCLUSIONS

The most general issue posed by the possessions tax credit is whether or not Federal tax treatment of investment in the possessions should be more favorable that provided to most investments in the mainland United States or to investment abroad. The issue is complex. In 1986 the U.S. Congress enacted a broad tax reform program that sought to improve the efficiency of the U.S. economy by eliminating other tax provisions that distorted investment decisions. These efficiency considerations and burgeoning Federal budget deficits made the possessions tax credit a candidate for close scrutiny by policymakers.

Yet whether elimination of the possessions tax credit would produce substantial gains in tax revenue is not clear; the affected corporations might simply move to other low-tax locations in foreign countries. Further, economic efficiency and cost may be only secondary considerations in evaluating section 936. At the very

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[10] U.S. Congress. Joint Committee on Taxation. General Explanation of the Tax Reform Act of 1986. Joint Committee Print, 100th Cong., 1st sess. Washington, U.S. Govt. Print. Off., 1987. p. 1005.

least, a flourishing Commonwealth of Puerto Rico is important to the United States as a demonstration of how a free market economy can develop and prosper.

The Treasury Department's proposed elimination of the possessions tax credit was not included in the Tax Reform Act of 1986; both the Reagan Administration and Congress ultimately supported a continuation of a tax benefit for operating in the possessions. However, the Administration's proposed modification of section 936 highlighted a second issue: are the current section 936 provisions the best way to stimulate gowth and employment in the possessions? The Administration proposed replacing the current tax exemption for income with a wage credit: a tax incentive linked directly to employment.

The government of Puerto Rico, however, maintains that the current section 936 tax benefit and the high-technology firms it attracts are vital to Puerto Rico's future development. A part of Puerto Rico's development strategy is to rely on its high-technology manufacturing sector to lead economic development both in Puerto Rico and the Caribbean Basin in general. The this end, Puerto Rico has implemented a policy of encouraging the establishment of "twin plants" in Puerto Rico and neighboring Caribbean countries -- a policy that relies heavily on the possessions tax credit.

db/af

TRADE/TOURISM ISSUES

FRANKLIN J. GUTIERREZ
Vice-Speaker

Office of the Vice Speaker

Nineteenth Guam Legislature
Post Office Box CB-1
Agana, Guam 96910
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Chairman, Committee on Tourism, Transportation
and Communications

RECEIVED
JUN 20 1988
GOVERNOR'S
OFFICE

June 17, 1988

The Honorable Frank F. Blas
Acting Governor of Guam
Office of the Governor
Agana, Guam 96910

Dear Governor Blas:

Apologies are in order for the delay in responding to your letter of May 24, with reference to the National Conference on Trade and Tourism.

Frankly, the delay in responding was due in part to my efforts to be national and international in my views. It has been difficult to get out of the local/regional syndrome because not many of your colleagues in the conference would find it easy to include Guam in their thinking.

But, I have arrived at a position that nearly everything we do here and everything your colleagues do have at least an indirect effect on Guam and vice versa.

Let's take the pilot visa waiver program that names nine countries allowed to enter the U.S. for 90 days without a visa. That has a direct effect on Guam because Guam is an American port, and those countries named in the pilot program could never enter Guam without a visa. But, the law was written without Guam even in mind.

Looking at the Guam Visa Waiver Act, it affects Guam only and does not directly have an impact on the rest of the United States.

But, for your benefit during the conference, I believe that the area in which Guam gets short-changed as compared to the rest of the nation is applicable promotional air fares.

MEMBER
Vice Chairman -- Economic Development, Insurance & Banking • Rules • Education • Energy, Utilities & Consumer Protection • Justice, Judiciary & Criminal Justice.

Franklin J. Gutierrez

Vice Speaker

Chairman, Committee on Tourism, Transportation and Communications

Because of the great distance from the U.S., the fares to Guam are the highest in the world. We can accept that because we have no control over our geographical location, and we certainly cannot expect the air carriers to reduce fares when the cost of operating to Guam is a great deal more than say between Honolulu and San Francisco.

But, where we lose out is in the promotional fares. You will recall Pan Am's Balikbayan fare. That was outright discrimination. The fare applied from San Francisco to Manila, a distance shorter than San Francisco to Guam. Yet, it did not apply to Guam for anyone, not even Filipinos who claimed Guam as their home and, of course, not to the 50,000 or so Chamorros who may have wanted to visit their home island.

In Aviation Daily, we continually read of two-for-one fares or drastically reduced fares from one point to another within the U.S. That's because there is so much competition within the U.S. points.

Continental did bring their fares down while both Hawaiian and SPIA were on the routes. As soon as SPIA dropped off, the Continental fares went up and those included student and senior citizen fares and the family fares.

are ?

Because of our geographical location, we were not at the mercy of the air carrier. There is no way to beat it except the possibility of the nations' Lieutenant Governors to back you in appealing to the air carrier serving Guam to include Guam in promotional fares and special fares that relate to our students, senior citizens, and those travelling as families.

COMMUNICATIONS

For reasons best known to the Federal Communications Commission, Guam's communications tariffs are considered international. While the fares for overseas telephone calls have come down, other fees have not. For instance, for a voice grade line,

Franklin J. Gutierrez
Vice-Speaker
Chairman, Committee on Tourism, Transportation and Communications

both RCA and ITT are charging the international tariff of $3500 per month.

This is the line used by international news networks to bring in voice and telex news. Because of this fare, United Press International, as an example, must charge more for the use of the line than for UPI's services. The fees charged for the line go to RCA not to UPI.

The smaller radio stations cannot afford $3500 a month for the line, and there are not enough of them to significantly reduce the cost by prorating the cost. There are some businesses that afford it. The Guam Tribune pays $400 a month for the line and $300 for UPI's services. K-57 pays $400 a month for the line and $250 for the services. It is the same for KTWG.

Neither RCA or ITT have a choice in the matter. That tariff is dictated by the FCC.

I wish I could be of more help to you in the national or international arena. Perhaps we could discuss the points stated with you before you leave.

Sincerely,

FRANKLIN J. GUTIERREZ

GUAM AIRPORT AUTHORITY
(ATURIDAT PUETTON BATKON AIREN GUAHAN)

P.O. BOX 8770/Tamuning, Guam 96911/Telephone: 646-0300, 646-0301, 646-0302
Telex: 6456 GUMARPT GM
FAX: (671) 646-8823

June 14, 1988

MEMORANDUM

TO: Lieutenant Governor

FROM: Executive Manager

SUBJECT: Input for National Conference of Lieutenant Governors

Following are several topics the Guam Airport Authority feels could be of interest to the Lieutenant Governors attending the conference, in the field of aviation/airports, with, in some areas, impact on tourism and trade.

1. Airport Access: There appears to be a congestion at many airports, both in access for aircraft traffic to airports, and in land transport access to airports. Solutions that come to mind are enlarged capacity of airports' aircraft stands/gate positions for aircraft access. Land access might be enhanced by close cooperation with municipalities that benefit from air transportation, in designing/constructing roadways to airports, maybe better design of public transport routes, affecting bus and rapid transit facilities.

2. Security: Though the FAA emphasizes security, both at airports and aircraft manufacturers, all aviation entities should constantly be aware of security measures that must be taken. Aircraft design and manufacturer must insure to the greatest extent possible, the safety of the aircraft. Our second security emphasis must be at the airports, where hijacking and sabotage begins. Though the FAA has recently enhanced security regulations at airports, people still breech security with weapons and explosive devices. The United States aviation industry should also encourage tighter security at overseas airports in other countries. American planes and passengers have been victims of hijacking and sabotage in other countries more than in the U.S., at least since the Cuban "crisis".

3. Visa Waiver Program for Non-Inmigrant Alien Tourist and Businessmen: International tourism can be greatly enhanced by a program similar to the one Guam is now in process of implementing. This would greatly encourage tourism entering from our international airports. These programs might

be tied into bilateral agreements between countries. Guam achieved it, and though it could be more complicated on a national level, it is a possibility. INS would probably discourage such a program, but only, we feel, because of the magnitude of implementation.

4. Privatization of Airports: In an era when many municipal, state and federal institutions are being privatized, or operated by private entities (clinics, hospitals, even prisons), it stands to reason that airports if privatized, might take a financial load off municipalities. We now have some general aviation airports under private ownership, and large fixed-base operators. Either complete privatization, or complete management such as is popular in the hotel industry -- "We build it - you manage it"...such as the Pacific Star Hotel concept.

The Guam Airport Authority has formulated the above topics we suppose might be of interest to mainland aviation authorities, mainly from articles published in aviation trade periodicals. But being a territory with only one civil aviation airport, we can understand a Lieutenant Governor of a state with several or many airports, may have a different set of priorities concerning aviation. We hope, however, the above topics might be useful at the Conference.

JESS Q. TORRES

Guam Visitors Bureau
Setbision Bisitan Guahan

GVB

ly.

June 22, 1988

MEMORANDUM

To : Lieutenant Governor

From : General Manager, Guam Visitors Bureau

Subject : Input for National Conference of Lieutenant Governors Committee on International Trade and Tourism

In response to your memorandum of May 24, 1988, provided herein is our suggested list of topics and issues:

1. Open Skies Policy/More say on civil aviation in international bilateral agreements;
2. Visa Waiver - include other countries in our visa waiver program;
3. Elimination of various federal barriers such as trade restrictions, Headnote 3(a) which inhibits the growth of cottage industries; agricultural restrictions which do not allow for export of fruits and vegetables; cabotage laws, etc.
4. More control over immigration policies to allow flexibility in hiring alien labor to augment local labor force - unemployment rate of 3% is near zero for all intrinsic purposes;
5. Development of a comprehensive development plan encompassing tourism;
6. The Japan government's 10 Million Program: How to garner our proportionate share;
7. Incentive for upgrading the tourist plant: private vs. public sector;
8. Marketing Strategies for a World Class Resort.

Thank you for giving us this opportunity to submit our input. Should you need further elaboration , please do not hesitate to contact us at the Bureau.

JOEY B. CEPEDA

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RECEIVED
JUL 06 1988
GOVERNOR'S OFFICE

JUL 06 1988

MEMORANDUM NO. GM88-644

To: Lieutenant Governor

From: General Manager

Subject: Topic/Issue Suggestion-National Conference of Lieutenant Governors Committee on International Trade & Tourism

The following information is provided as per your memorandum dated May 24, 1988.

Despite limitations placed on certain imports into the United States, we should still see a world of free and fair trade for the goods America wants to export to the international marketplace. While the United States has benefited greatly from the Japanese for example, Japan could benefit more if it were as open as the U.S. market is. Greater exchange comparatively would allocate resources more efficiently...both would produce more of what they best produce and ultimately raise the standards of living for their common people. This would result in America being fully engaged in the shaping of resources to lead the world toward greater economic growth, more coordinated international economic policies, and above all, openness which would unlock the door to a better future for the American people. Japan continues to lead the world in technology. America's open market for imports has probably led to the U.S. decline in technology. U.S. firms have even linked internationally to take advantage of new technologies and markets not only in Japan, but around the world. Known as multinational sourcing, manufacturing, and marketing, a firm branch-to-firm branch sales occurs and is computed as trade between two or more countries, such accounting for about 40% of U.S. trade. If this continues, then the United States, should seriously begin at looking into absorbing savings that otherwise would be available for investment in the private sector, providing assistance and incentives for business industries, and private entrepenuership in America. The Federal Government must begin to re-examine foreign policy to allow these incentives to work for the benefit of the American people. We now know that the American economy can no longer successfully pursue U.S. commercial interests without considering global trends and conditions. Therefore, global economic openness and not just

American economic openness must become a primary tool of American international policy.

You'll find below several specific national issues which directly affect American ports today. Please bear in mind that although most of these issues are generally American Port Issues of which Guam is one, the national demise of Continental U.S. ports greatly affect the Port of Guam's ability to profitably function.

1) Decline in Unique Cargo Markets-Pressure from enviromental groups to outlaw the sale of logs internationally; steel quotas affect amount of American business coming through American ports; 90% of annual shipments are iron ore and the market is declining;

2) Trade Restrictions and Protectionist Legislation-American ports are an inbound port and legislation limiting imports have a negative impact on port business; ports are in the middle between federal government and markets;

3) Depressed Exports-American port areas are more service-based than production-based; dependency on export markets are tied to U.S. trade;

4) Adverse International Trade Policies-trade with Asia is favored and East Coast Ports are affected;

5) Foreign Companies Manufacturing in U.S.- Need to find a replacement for import autos.

(Japanese investments in Guam alone have affected the U.S. Market in terms of competitive pricing of construction materials used. Asian prices of goods are so low thus discouraging the purchase of U.S. made materials and moreover, other textile goods and further resulting in a substantial amount of dollars going out of the United States.)

DAVID B. TYDINGCO

RECEIVED
JUL 06 1988
GOVERNOR'S OFFICE

cc: Public Information Officer, PIO

BACKGROUND INFORMATION ON MEMBER STATES

The state prospered and declined through boom and bust cycles until the 1930's, when a combination of legalized gambling, reduced divorce requirements and the construction of the Hoover Dam established the basis for economic growth. In the 1950's, the state became the main testing site for atomic energy experiments and the site of major military munitions depots. About 87 percent of Nevada's land is owned by the federal government.

Rainfall varies from 4 to 24 inches and averages 9 inches per year. Temperatures vary from an average July high of 86 degrees farenheight, to an average January low of 24 degrees. Climate and soil conditions are not suitable for cultivation without irrigation, but ranching and forage production is well developed in most valleys. The growing season is about 120 days.

In the decades 1960 - 70 and 1970 -80, Nevada experienced higher percentage in population increases than any other state, 72 and 64 percent, respectively. In spite of its tremendous growth, Nevada remained the third least densely populated state (after Alaska and Wyoming). In 1980, 82 percent of the population lived in the metropolitan areas of the two largest cities, Las Vegas and Reno.

Although the traditional basis of Nevada's economic life, mining and agriculture, remain important, they are far overshadowed by tourist-supported trade and service industries and governmental activity. A surge in gold-mining activities occurring during the 1980's increased the state's mineral production value, reversing the trend caused by the virtual shutdown of the copper industry in 1977. Other important minerals mined are silver, barite, tungsten, and mercury.

Tourism and its related activities in the Las Vegas and Reno areas are the state's leading industries. Long centers of legalized and state-regulated gambling, they are also major convention and entertainment centers. Liberal divorce laws early made Nevada a place for quick and simple divorces. The state also has long legalized and regulated prostitution. Las Vegas and Reno offer excellent opportunities for scenic and recreational activities at Lake Mead and Lake Tahoe. Military and defense installations and other government agencies are major employers in the state.

Nevada's tourism industry is heavily dependent on air transportation, and both Las Vegas and Reno have international airports. Three major railroads and two interstate highways cross Nevada from east to west.

HAWAII - capital Honolulu

Lt. Governor Benjamin Cayetano

The majority of the state's residents live on Oahu Island, with almost two-fifths in Honolulu city. Hawaii's growth rate between 1970 and 1980 was more than twice the national average.

Tourism, federal defense, and plantation agriculture are Hawaii's primary industries. Additional areas of economic growth capitalize on the climate, ocean site, and/or location in the heart of the Pacific. They include diversifed agriculture, aquaculture, movie and TV filming, sports training, oceanography, marine-related and other high technology, and international interchange of education and business. Hawaii is currently a world leader in both renewable energy research and astronomy.

Plantation agriculture remains of prime importance in the Hawaiian economy. Hawaii is the largest producer of sugercane in the United States. Pineapple is also an important cash crop; sorghum and corn arewidely cultivated. There are no important mineral resources.

Industries include an oil refinery, a steel mill, two cement plants, and an aluminum-extrusion plant. Canning of Hawaiian-grown food stuffs is also important. Hawaii's largest industry, however, is tourism, with gross expenditures by visitors of more than $2 billion a year. The federal government is the second largest source of income, spending more than $1 billion annually on defense related items. There were approximately 122,300 armed forces personel and dependents in Hawaii as of July 1, 1985. The armed forces use approximately 2.8 percent of Hawaii's total land area, or about 116,000 acres.

Ocean surface shipping is Hawaii's lifeline, Honolulu Harbor is the main port. There are three major airports and more than 4,000 miles of roads.

VIRGIN ISLANDS - capital Charlotte Amalie

Lt. Governor Derek Hodge

The economy of the Virgin Islands is based on tourism and manufacturing. The Gross National Product in 1985 was $1,030 million, or $7,780 per capita, the highest in the Caribbean area. About one-fifth of the total land area is farmland, most of it on St. Croix. Agricultural production in the 1970's to 1980's underwent transition from the traditional reliance on sugarcane to more diversified crops. Citrus fruits, tamarinds, mangoes, bananas, sorghum (for animal feed) and vegetables, all for internal consumption, were the main crops grown. Cattle (ranched on St. Croix), goats, sheep, and pigs are the principal livestock.. St. Croix produces milk, sufficient for island needs. Only 5 percent of the land is forest. A bay tree forest on St. John supplies leaves for the bay rum industry.

Fishing is restricted to supplying local needs and to sports fishing. A marine biological laboratory has been established on St. John.

Manufacturing has diversified beyond the traditional rum-distilling industry to include oil refining, watch assemble, and the manufacture of alumina, chemicals, pharmaceuticals, and clothing. The United States governmnent has encouraged industry by allowing certain manufacturers to enter the United States duty-free, and the local government has offered tax incentives. The oil-refining and alumina industries were expanded facilities in the early 1980's.

Tourism, based on the pleasant tropical climate, attractive scenery, good fishing, proximity to the United States mainland, and free-port status, has rapidly expanded and dominates the economy. The Virgin Islands National Park, covering two-thirds of St. John, and the Buck Island National Monument, set on the islet's coral reef, are other major attractions. Souvenir and handicraft industries have developed for the tourist market.

The leading sectors in employment are government service; retail trade, including personal, business, and domestic services; agriculture and self employment; manufacturing; and hotels.

In 1982, roads totalled 532 miles. Charlotte Amalie, on St. Thomas, and Frederiksted, on St. Croix, are deep-water ports. A container port was under construction in the 1980's at Frederiksted. There is ferry service between the three main islands and also to Puerto Rico. There are two international airports, Harry S. Truman on St. Thomas, and Alexander Hamilton on St. Corix. Interisland seaplanes serve the islands, and also Puerto Rico, the British Virgin Islands, and Saint-Martin.

Exports total more that four-fifths of imports in value annually. Refined petroleum, alumina, clothing, watches, and rum are the main exports, shipped mainly to the United States, Puerto Rico, and the British Virgin Islands. The main imports are crude petroleum, bauxite, and semi-manufactures and components.

ECONOMIC INDICATORS: 1985

	Guam	Virgin Is.	Hawaii	Nevada
	DEMOGRAPHICS/LABOR FORCE			1980
pulation....................	118,338	110,800	1,051,500	800,493
uare Miles..................	212	132	6471	109,894
nsity per square mile.......	558.2	839.4	162.5	7.3
hool Enrollment.............	31,832	31,943	200,952	154,139
gh School Graduates.........	1,203	1,361	12,516	479,601
tal Labor Force.............	39,990	42,960	481,000	433,573
tal Employment..............	32,190	40,450	454,000	398,566
employment Rate	6.4	5.8	5.6	10.1
	VISITORS			
tal Visitors................	378,146	1,315,400	4,884,110	N/A
Tourists....................	236,473	411,460	3,431,690	N/A
Excursionists...............	...	903,946	...	N/A
Air (Day Trip)...........	...	130,000	...	N/A
Cruise Passenger.........	...	678,946	...	N/A
Other....................	...	95,000	...	N/A
isitor Accomodations (Units).	2,991	4,862	65,919	N/A
Hotels......................	N/A	65	207	N/A
Hotel Rooms..............	2,991	3,541	44,115	N/A
Condominiums for Transients	N/A	N/A	274	N/A
Condominium Units........	N/A	1,321	21,804	N/A
	EMPLOYMENT BY INDUSTRY			
otal Non-Agricultural Wage & Salary Employment.....	37,990	37,360	423,150	N/A
Private.....................	20,650	23,180	329,850	N/A
Manufacturing...........	1,217	2,080	21,850	N/A
Construction & Mining...	2,579	2,390	16,950	N/A
Transportation/ Public Utility........	1,817	2,310	33,350	N/A
Wholesale/Retail Trade..	7,099	8,070	115,500	N/A
Finance/Insurance/ Real Estate..........	1,629	1,770	32,000	N/A
Other Services..........	6,309	6,560	110,200	N/A
Federal Government.........	7,230	640	32,400	N/A
State and Local Government.	10,110	13,540	60,900	N/A

	Guam	Virgin Is.	Hawaii	Nevada
INCOME & EARNINGS				
Gross Territorial Product ($Million)........	114.8	1,030.0	16,678.9	N/A
Personal Income ($Million)....	N/A	862.0	14,558.0	N/A
Disposable Income ($Million)..	N/A	765.5	12,607	N/A
Per Capita Personal Income ($)	N/A	7,780	13,814	N/A
Percent of U.S. Average....	N/A	57.7	101	N/A
Total Payroll ($Million)......	611.9 p	591.0	4,824.5	N/A
Annual Average Gross Pay ($)..	11,166	15,525	16,070	N/A
Electric Sales (Thousand KWH).	473,100	366,185	6,635,158	N/A
Residential.................	175,800	147,727	1,879,027	N/A
Commercial/Industrial/Other.	297,300	218,458	4,756,131	N/A
Fuel Consumption (Thousand Gallons).........	N/A	57,200.0	970,555.0	N/A
Gasoline....................	N/A	25,400.0	327,021.0	N/A
Diesel......................	N/A	31,800.0	100,783.0	N/A
Aviation fuel...............	N/A	...	538,055.0	N/A
Other.......................	N/A	...	4,696.0	N/A
	1980			
Total Imports ($ millions)....	544.2	3,740.6	7,296.2	N/A
U.S.A.......................	133.8	2,031.3	5,564.2	N/A
Crude Petroleum...........	0.5	1,566.2	N/A	N/A
Other.....................	133.3	465.1	...	N/A
Foreign.....................	410.4	1,709.3	1,732.0	N/A
Crude Petroleum...........	278.9	1,508.9	579.1	N/A
Other.....................	131.5	200.4	1,152.9	N/A
Total Exports ($ millions)....	61.0	3,357.1	1,336.3	N/A
U.S.A.......................	5.9	3,271.2	947.5	N/A
Petroleum.................	0.0	3,197.0	...	N/A
Alumnia...................	0.0	10.1	N/A	N/A
Other.....................	5.9	64.1	...	N/A
Foreign.....................	55.1	85.9	388.8	N/A
Export Shipments to the U.S.A.				
Rum (000 Proof Gallons)....	0.0	2,324.8	0.0	N/A
Watches (Thousands)........	...	2,144.0	...	N/A
Ocean Freight Imports (Tons)..	1,041,800	648,346	8,972,870	N/A

	Guam	Virgin Is.	Hawaii	Nevad
OTHER BUSINESS INDICATORS				
Bank Deposits ($ million).....	524.9	N/A	8,605.2	N/
Value of Construction Permits ($ thousand)........	133,666	113,000	990,897	N/
Retail Sales ($ million)......	524.9	624.7	8605.2	N/
Business Licenses (F/Y) (No.).	N/A	11,645	N/A	N/
Registered Vehicles (No.).....	81,553	43,901	767,892	N/
Telephones (No.)..............	23,527	52,314	N/A	N/
TAXES AND GOVERNMENT (F/Y) ($000)				
Total Operating Budget..........	190,800.0	263,347.0	586,445.0	N,
Total Taxes and Duties.........	168,127.7	218,908.0	3,922,943.0	N,
Federal Expenditure...........	621,000.0	594,000.0	4,568,000.0	N,

F/Y Fiscal Year data; p Preliminary; N/A Not available; ... Not applicabl

ASIA - PACIFIC COUNCIL OF AMERICAN CHAMBERS OF COMMERCE POLICIES

POLICIES

ASIA - PACIFIC COUNCIL OF AMERICAN CHAMBERS OF COMMERCE

At its March 26, 1988 semi-annual meeting on Guam, APCAC adopted policies in the following areas as presented in the attached report:

- Market Access
- International Trade Services
- Intellectual Property Rights
- Agricultural Trade
- Taxation (Section 911)
- Export Controls
- Banking & Financial Services
- Research & Development Tax Provisions
- Investment Restrictions
- Commercial Service Funding
- A&E/Construction Services
- Multi-National Company Taxes
- Export Promotions
- GATT
- Foreign Corrupt Practices Act
- Export/Import Bank
- Trade & Development Program
- Taxation of Self-Employed Americans Abroad
- Subchapter S Taxation
- Textile & Apparel Protection
- Regional Security
- Domestic Content Legislation
- International Relations
- Alternative Minimum Tax
- Asian Development Bank
- Transportation Policies
- ASEAN
- Privatization
- Workers Rights
- Transborder Data Flow
- Department of International Trade
- Voting Rights
- Trade Agreement Exclusions
- Mandatory off-set programs
- Generalized System of Preferences
- American Cigarettes
- Land Tenure & Use

ASIA - PACIFIC COUNCIL OF AMERICAN CH ABERS OF COMMERCE

Chairman: Harvey Goldstein c/o Resources Management International, Inc. Jalan Sultan Hasanuddin 28, Kebayoran Baru Jakarta Selatan, Indonesia Phone: 734588 Fax 734586 Telex: 47129 RMI JKT Cable: RESOURCES JKT

Executive Director: Ann R. Wise c/o Honeywell Inc. Nagai International Building 2-12-19 Shibuya, Shibuya-ku, Tokyo 150, Japan, Phone: 409-1611 Fax: 409-2770 Telex: J22902 Cable: Yamatakeco.

Guam, March 26, 1988 - At the 39th semi-annual meeting of the Asia-Pacific Council of American Chambers of Commerce (APCAC), delegates representing Guam, Hong Kong, India, Indonesia, Japan, Korea, Malaysia, New Zealand, Okinawa, Philippines, Republic of China, Saipan, Singapore, Thailand and the United States Government, met under the theme "APCAC - 20 Years as the Voice of American Business Community in Asia - Pacific Region," adopted the following resolutions:

MARKET ACCESS

APCAC calls on the U.S. Government to immediately redouble efforts to effectively liberalize international trade and investment. APCAC reminds our Asia-Pacific trading partners that the U.S. is the most open market in the world. Despite previous U.S. Government efforts, American business continues to be excluded from free and equal competition in goods, services and agricultural products in many Asia-Pacific countries. Tariff and non-tariff barriers still exist as a matter of host government policy and practice. APCAC laments the deliberate restrained pace by host governments in implementing tariff and non-tariff reforms toward market access for U.S. goods and services.

In negotiating market access with our Asia-Pacific trading partners, we must ensure the following is understood:

- A vigorous, open international trading system is vital to the future economic growth, competitiveness and security of all the nations of the Pacific Basin.

- Immediate, strong measures must be taken to equalize the trading environment and provide fair market access.

- U.S. market access should be contingent on fair access to overseas markets. Where this fails, the U.S. must take all necessary action to combat unfair trade practices.

SERVICES IN INTERNATIONAL TRADE

APCAC recognizes the vital role that services play in the U.S. economy and urges equitable access to overseas markets. APCAC believes that trade in services must have parity in treatment with trade in goods. To this end, export incentive and promotion policies relating to manufactured goods must be expanded to include services. Bilateral and multilateral trade discussions must include the principle of open access for all service industries.

APCAC reaffirms its support of the Trade and Tariff Act of 1984 and endorses Title III of that Act which calls for national treatment for American service industries. APCAC commits itself to assisting the United States Government in compiling an inventory on service barriers in Asia to assist the U.S. Government in fully implementing its reporting requirements under the Act.

Services are defined herein to include, among others :

- transportation, communications and utilities;

- finance, banking, securities, insurance, rental/leasing and real estate brokerage;

- business and professional services such as law, accounting, advertising, medicine, data processing, tourism, amusements, and consulting services; and

- construction, architectural and engineering services.

APCAC respectfully urges that host governments encourage the entry of American and other foreign service firms into their domestic markets recognizing that :

- this will result in the transfer of service technology, the training of nationals and the growth of internationally competitive indigenous service industries -- these host country service industries will contribute to enhance the international competitiveness of other indigenous industries;

- international investment follows the availability of services -- services are an essential infrastructure component to attract foreign investment; and

- the essence of free trade is to allow nations to pursue those industries in which they have comparative advantage.

APCAC resolves that the U.S. Government should :

- establish an insurance procurement policy on lending by U.S. Government entities such as the Department of Agriculture, USAID, Department of Defense and Exim Bank to assure fair and equitable opportunities to all providers of insurance;

- expand the Trade Development Program (TDP) and increase funding to reflect "current day" project costs and so provide U.S. consulting, engineering and construction companies with access to world-wide markets -- the TDP program should be enhanced to provide the opportunity for a maximum flexible market response, including the assistance of Exim Bank, when appropriate; and

- intensify its efforts to include services under GATT -- the U.S. Government should continue to work toward removal of host governments' discriminatory restrictions on foreign service firms in their markets.

INTELLECTUAL PROPERTY RIGHTS

APCAC welcomes and encourages the positive steps being taken by many countries in the region to strengthen laws and practices relating to intellectual property in all areas - patents, copyrights, trademarks and other related topics. However, much still needs to be done. Legislation remains inadequate or is simply not enforced. APCAC vigorously demands that protection of intellectual property continue to be an important factor in U.S. trade and investment policy.

APCAC supports the U.S. Government in its stepped-up program to:

- Vigorously encourage host governments to bring a quick end to the counterfeiting and piracy of U.S. goods.

- Conclude, in the GATT round of multilateral trade negotiations, an enforceable multilateral trade agreement against unfair trade practices arising from inadequate protection of intellectual property.

- Incorporate protection for intellectual property as a major objective in all trade and investment negotiations with particular emphasis on the strategic use of U.S. technical and economic assistance programs.

- Enact legislation that strengthens protection for owners of patents covering manufacturing processes so that a patent cannot be circumvented by manufacturing offshore and importing into the U.S.

- Enact legislation to eliminate the requirement for proof of injury in intellectual property cases under Section 337 of The Trade and Tariff Act of 1930.

- Amend the Freedom of Information Act to prevent proprietary data of U. S. businesses being a source of disclosure of trade secrets.

- Expedite the legislative process required to join the Berne Convention.

APCAC calls on Host Country Governments to :

- Revise and update their intellectual property laws and enforcement mechanisms to protect pharmaceuticals, chemical compounds and formulations on both a product and process basis, new uses of chemical compounds and new forms of technology such as biotechnology and semiconductor-chip designs.

- Amend their copyright laws adequately to protect all forms of computer software (including firmware), motion pictures, video tapes, sound recordings, books and other printed matter.

- Adopt or further strengthen protection relating to trademarks, trade names, servicemarks, and passing-off.

- Improve enforcement procedures and impose effective penalties for infringements of intellectual property rights.

ANNEX

Based on a critical analysis conducted during the Guam APCAC Intellectual Property Workshop, APCAC developed the following overall ranking of member countries' intellectual property protection in terms of:

- Adequacy of laws compared to APCAC standards;
- Adequacy of enforcement and penalties;
- Willingness and "Good Faith" to correct remaining deficiencies.

BEST ↑

HONG KONG
AUSTRALIA
NEW ZEALAND
JAPAN
SINGAPORE
INDIA
REPUBLIC OF CHINA
MALAYSIA
INDONESIA
PHILIPPINES
KOREA
THAILAND

WORST

APCAC will review this ranking at future semi-annual meetings, based on the progress made in each member country.

TRADE IN AGRICULTURAL PRODUCTS

APCAC actively encourages liberalization of trade in agricultural products including export of more consumer ready agricultural products, elimination of quotas and development of methods by which nations can be guaranteed food security within the free trade system. APCAC believes that trade in agriculture must have parity in treatment with trade in goods. APCAC fully supports the President's objective to achieve agricultural trade liberalization, including the elimination of all existing farm subsidies, in the context of the new GATT Trade Round. APCAC calls on the American Government to reject protectionist provisions in the trade bill which would affect agricultural trade.

TAXATION - SECTION 911

With the continuing trade deficit, and the vital role that the export of U.S. goods and services plays in reducing that deficit, it is imperative to place American taxpayers abroad on an equal footing with their competitors. Since no other major industrialized nation taxes its non-resident citizens on income earned abroad, APCAC continues to urge the full exclusion of foreign earned income and strongly opposes any further reduction in the amount of the Section 911 exclusion.

EXPORT CONTROLS

1. The Reagan Administration has recently announced its policy to eliminate unnecessary trade-limiting provisions of the 1979 Export Control Act, and has requested Congress to move legislation forward speedily toward this end. APCAC is gratified that the Administration has recognized the trade-inhibiting influence of the 1979 Export Control Act and looks forward to the introduction of a more realistic legal framework that establishes a better balance between economic and national security interests of the United States.

2. APCAC wishes to remind our national leadership that :

   - streamlined rational and predictable export controls will improve competitiveness;

   - the overall security of our country requires both economic and military security - a strong, vital industrial base is key to a strong military readiness;

   - indecision and uncertainty about export license approval wastes valuable management resources, eroding competitiveness;

   - the perception that U.S. controls are more severe than multilateral controls has caused a shift away from American products (de-Americanization) and "designing out" of American components. This adds to our general trade imbalance and in 1986 may have caused our first high technology trade deficit ever recorded; and

   - greater weight should be given to commercial considerations before invoking export controls for foreign policy reasons.

3. APCAC supports the recommendations of the National Academy of Sciences' study on Export Controls.

4. APCAC believes legislation should include provisions which:

- provide specific deadlines for determination and more precise definition of foreign product availability;
- eliminate licensing requirements for low-level technology exports to our non-COCOM trading partners;
- maintain DOD authority to review licenses, but place a reasonable time limitation on this procedure;
- make the U.S. Commodity Control List identical to the COCOM list, while strengthening multilateral controls;
- eliminate re-export licensing requirements to COCOM and 5(k) countries and eliminate re-export controls to any country, or parts and components incorporated into foreign goods when the parts or components are 35% or less of the value of the foreign goods; and
- give greater weight to commercial considerations before invoking export controls for foreign policy reasons.

BANKING & FINANCIAL SERVICES

APCAC continues to endorse efforts by the U.S. Government and the private sector to secure market access and national treatment for U.S. banks, securities companies, insurance companies and other financial service companies in those countries which restrict the competitive capabilities of U.S. companies.

Banks and other financial service institutions experience discriminatory treatment in many areas, including leasing, merchant banking, corporate finance, securities and retail banking. In many countries, restrictions on local currency funding continue to be a major constraint.

In most countries, U.S. insurance companies face restrictions in licensing in the types of insurance coverage which may be offered. Premium funds received from policy holders often are subject to remittance restrictions, discriminatory tax rates and local investment restrictions.

This lack of access for financial services and products offered by U.S. financial services companies is particularly discriminatory when compared to the access granted to host country companies operating in the U.S. financial services markets.

TAX PROVISIONS AFFECTING RESEARCH AND DEVELOPMENT EXPENDITURES

Prior to the 1986 Tax Reform Act, 100 percent of research and development expenditures spent in the United States were allocated against US source income. The 1986 Act reduces this automatic allocation to 50 percent for one year and then to none. This increases the tax cost of US multinational companies and will encourage U.S. companies to move research and development expenditures to foreign countries. This will reduce US competitiveness.

Recognizing this, H.R. 1116 and S. 716 were recently introduced in the House and the Senate by a bipartisan majority of members of the House Ways & Means Committee and the Senate Finance Committee. These bills restore the 100 percent allocation of research and development expenses to U.S. source income and they make the provision a permanent part of the tax law.

APCAC strongly supports these two bills.

Further, with respect to research and development, the Tax Reform Act of 1986 reduced the credit for these expenditures from 25 percent to 20 percent and has made the credit available for only three years.

APCAC urges Congress to restore the credit to 25 percent and to make the credit permanent.

RESTRICTIONS ON INVESTMENT

APCAC opposes the additional restrictions on foreign investment contained in the Bryant Amendment. For many years, APCAC has worked to reduce restrictions on U.S. investment in our host countries. We have made progress with the argument that foreign investment is desirable. The Bryant Amendment undermines these arguments as well as U.S. Government efforts to include investment liberalization in the new GATT round.

U.S. & FOREIGN COMMERCIAL SERVICE FUNDING

APCAC appreciates the efforts of the United States and Foreign Commercial Service (U S&FCS) and other U.S. Government export promotion activities in their endeavors over the past year to spark awareness in Americans to look abroad at trade and investment opportunities as key to their future financial success. While it is vital that these efforts be redoubled, broad-brush budgetary reductions are crippling their ability to carry out the Administration's repeatedly stated trade policy. At the same time, our competitor trading nations are significantly increasing their already substantial export promotion efforts.

APCAC strongly urges the restoration of the US&FCS's pre-1986 budget levels.

ARCHITECT/ENGINEER AND CONSTRUCTION SERVICES

APCAC supports open competition in the Architect/Engineer (A/E) and Construction Services Industry, and other related activities.

However, in countries such as Japan and Korea where barriers, through government regulations or association and industry practices prevent United States companies from participating in such services, the U.S. Government should work toward the elimination of such barriers.

TAX REGULATIONS AFFECTING U.S. MULTINATIONAL COMPANIES

The 1986 Tax Reform Act has many provisions affecting companies operating abroad. Such companies will be uncertain about the tax consequences on their operations until implementing regulations are issued. As an example, the so-called "Super Royalty" provisions affect all multinational companies that own patents, copyrights, or other intangibles, and could result in double taxation. APCAC urges the U.S. Treasury to issue regulations which clarify this provision and other provisions affecting U.S. multinationals at the earliest possible date.

EXPORT PROMOTION

APCAC welcomes and encourages the positive steps being taken by the U.S. Government to strengthen the competitive position of American firms in the Asia/Pacific area through trade policy negotiations on a government-to-government basis. However, APCAC reaffirms its belief that the principal role of the Government is to support American businesses abroad. This should be done not only through trade policy issues but also through domestic policies and business services abroad that encourage participation by more U.S. firms in international trade. APCAC supports the establishment of a Council on Competitiveness.

GATT

APCAC congratulates the U.S. Government for its success in having expanded the agenda of GATT to include services, agriculture, intellectual property, and investment. We urge Congress to grant adequate GATT negotiating authority to the President. At the same time, we urge the President to continue bilateral negotiations to promote the further liberalization of international trade.

Finally, APCAC urges the U.S. Government to give high priority to securing NIC and LDC ratification of the Tokyo Round Codes of Conduct. While the "New Round" will take several years to complete, American exporters could enjoy substantial, immediate benefits from a broader acceptance of the existing codes.

FOREIGN CORRUPT PRACTICES ACT

APCAC supports the amendment of the Foreign Corrupt Practices Act to clarify the ambiguity which is regarded as a major disincentive by American firms doing business overseas.

EXPORT/IMPORT BANK

APCAC congratulates the Administration and Congress on the passage of the Export-Import Bank Act Amendments of 1986 which extend the Exim Bank's charter for 6 years and authorize the establishment of a "war chest" to be used until other countries eliminate their export subsidies.

However, in order for U.S. manufacturers to succeed in foreign markets, ongoing competitive financial support is required to help U.S. exporters compete internationally today and in the future. Accordingly, the "war chest" should be funded independently of allocations to the direct credit program.

APCAC continues to believe U.S. exporters and Exim will benefit by having Exim representatives in the field to effectively market its proposals.

2% Up-Front Fee - APCAC believes the only solution is elimination of this fee. As a beginning step the fee could be spread over the life of the loan, but we feel this still results in a higher cost compared to other OECD members financing.

Budget - APCAC believes that at best there is significant confusion and perhaps misunderstanding regarding Exim's budget authorizations. We, therefore, recommend that Exim should be moved "off budget," since it is highly questionable and probably indefensible that a credit agency such as Exim should have its appropriation authority handled as part of the foreign aid function and be treated as cash expenditure.

Mixed Credits - While the recent action to allow the United States Agency for International Development (USAID) to participate in mixed credits is welcomed by APCAC, we believe that the $5 million limitation is too restrictive and could seriously hamper the competitiveness of American firms in large scale projects. We believe USAID should be able to use, at its discretion, all non-earmarked funds to support mixed credits. This action in no way should diminish USAID funding for humanitarian purposes.

APCAC is gratified with Exim's recent use of its "war chest" to provide $100 million lines of credit to Thailand and Indonesia. This aggressive action greatly expanded American sales to these countries and helped to regain valuable market position that had been lost due to predatory financing practices of our competitors. APCAC urges Exim to request from Congress authorization to continue, on a standby basis, this concessionary finance facility and to make it available to purchasers of U.S. capital goods when conclusive evidence is provided to Exim that such a facility is needed to overcome competitive financing offers from export- promotion institutions of other nations.

TRADE AND DEVELOPMENT PROGRAM

APCAC supports increased funding for the Trade and Development Program in fiscal 1988 and 1989. APCAC continues to support the valuable efforts of this program in expanding business opportunities for American firms in the region.

TAXATION OF SELF-EMPLOYED AMERICANS ABROAD

APCAC considers that self-employed Americans living and working abroad provide indispensable services to America's international trade. At present, these individuals are denied their full rights to the Section 911 exclusion by the provision limiting to 30 percent the amount of net profit which can be considered earned income in some cases and the provision disallowing deductions attributable to excluded income. This is an inconsistency in the definition of earned income since the same limitation is not applied when calculating social security self-employment tax. In order to give these individuals the same benefits of the exclusion of income earned abroad that is extended to corporate employees, APCAC urges the following changes in the provisions of Section 911:

- delete the provision of Section 911 (d) (2)(B) limiting the percentage of net profits that can be considered as earned income for purposes of the exclusion; and

- limit the provisions of Section 911 (d)(6) to apply only to the deduction or credit of foreign taxes paid on excluded income.

TAXATION - SUBCHAPTER S CORPORATIONS FOR FOREIGN PERSONS

The U.S. tax law unfairly discriminates against individual foreign investors who invest in the United States in corporate form because it precludes foreign persons from owning an interest in an S Corporation. Such foreign investors are subject to Federal taxation as high as 53.8 percent on remitted profits. U.S. citizens and residents will pay only 28 percent on the same remitted profits if they operate through an S Corporation. By precluding foreign investors, the tax law also unfairly discriminates against U. S. citizens who wish to associate with foreign investors in an S corporation. APCAC believes that the tax statutes should be changed to allow foreign individuals to own shares in an S Corporation.

TEXTILE AND APPAREL PROTECTION

APCAC objects to legislation and unilateral actions by the U.S. designed to interfere with textile and apparel imports from countries in the Asia-Pacific area as such action disrupts legitimate trade.

APCAC continues to oppose any new U.S. legislation to control the import of textiles and apparel by global quotas or otherwise.

SECURITY IN THE ASIA-PACIFIC REGION

APCAC emphasizes the political, economic and strategic significance of the Pacific to the U.S. As the nations of the area continue to move toward economic prosperity and interdependence, and as other world powers project their presence in the area, APCAC underscores the importance of the U.S. giving priority attention to its leadership role in maintaining the security of the region.

In this regard, APCAC fully supports negotiations between the governments of the Philippines and the United States and is in favor of the successful conclusion of such negotiations whereby the military facilities of the United States in the Philippines will be retained. APCAC acknowledges the importance of these facilities not only in maintaining a necessary balance of power in the region, but also the vital role that the retention of these facilities will continue to have with respect to investment, trade and commerce in the region.

DOMESTIC CONTENT

APCAC is opposed to domestic content legislation in the United States or elsewhere in the world.

TRANS-NATIONAL CORPORATION (TNC)/ HOST COUNTRY RELATIONS

APCAC encourages its members to formulate and pursue programs designed to inform host country nationals and their governments regarding the contribution of TNCs to the economic and social development of host countries.

ALTERNATIVE MINIMUM TAX

APCAC urges repeal of the provision in the 1986 Tax Reform Act which limits the allowable foreign tax credit to 90 percent of the alternative minimum tax since that provision can result in double taxation which is contrary to traditional United States taxation principles. Such double taxation of foreign earned income amounts to a self-imposed tariff on the export of American goods and services.

ASIAN DEVELOPMENT BANK (ADB)

APCAC believes that U.S. economic and commercial goals are furthered through our membership in the Asian Development Bank (ADB). We support the continued U.S. leadership of the ADB, continued funding of the institution and the Administration's attempts to make the institution a more effective agent for assisting the economies of the region. Emphasis should be on furthering private industry and free market economies as the effective method of achieving growth.

HOST COUNTRIES TRANSPORTATION POLICIES

APCAC opposes restrictions which prohibit U.S. flag vessel and air cargo carriers from conducting self-handling and ancillary freight services in many Pacific Basin countries, in sharp contrast to the freedom enjoyed by national flag carriers of such countries to engage in these operations in the United States. APCAC urges that such regulations, laws and other protectionist devices, which prohibit U.S. flag carriers from engaging in trucking operations or from being owners of companies acting as shipping agents, container terminal operations or sea cargo forwarders be revised. Such prohibitions limit the ability of U.S. flag carriers to provide integrated service which could speed shipment and reduce shipping cost.

ASEAN

APCAC notes that ASEAN has vast untapped potential which can be realized through economic cooperation, both within ASEAN and with other countries. APCAC agrees it is the role of the ASEAN private sector to be the engine of growth in ASEAN. Governments should create an environment that is as favorable as possible for ASEAN commerce and industry, but it is for the private sector to assume the role of leadership.

ASEAN - U.S. Trade

APCAC urges that the U.S. and ASEAN continue to work toward the objective of gradual removal, on a mutual basis, of constraints to the free two-way movement of goods, services, investment and technology between ASEAN countries and the U.S. In this connection, APCAC calls on the U.S. Congress not to enact into law any bills to require that labeling on any food product containing so-called "tropical oils" (coconut oil, palm oil or palm kernel oil), should disclose which oil is present and to identify it as a "saturated fat". These bills are discriminatory and protectionist by singling out only tropical oils rather than all similar substances containing saturated fats. If enacted, these bills could have extremely serious effects on the ASEAN economies involved and create strong retaliatory attitudes impacting our long term trade with the ASEAN region.

APCAC urges that initiatives aimed at the removal of trade constraints, provide for national treatment of American businesses and recognize as ASEAN-based those U.S. businesses established in the region.

APCAC/ASEAN Relationship

APCAC encourages all ASEAN governments to continue to lower external tariffs unilaterally to allow maintenance of export competitiveness and prevent illegal trade. There should be urgent action to roll back non-tariff barriers which impede the flow of trade.

U.S.-ASEAN Center for Technology Exchange

APCAC endorses the plans and programs of the U.S.-ASEAN Center for Technology Exchange (CTE). Strengthening trade and investment relations between ASEAN and the United States is a major objective of APCAC, which the CTE has been particularly active in promoting. APCAC strongly encourages the U.S. Government to renew and increase its financial support for the CTE.

PRIVATIZATION

APCAC lauds the efforts of governments in the region to privatize state- owned enterprises and encourages further reduction of direct government management or equity control over business enterprises. APCAC urges foreign equity participation be permitted in privatized companies.

WORKERS' RIGHTS

APCAC opposes the addition of violations of workers' rights (Pease Amendment) to the list of Unfair Trade Practices actionable under Section 301.

The linkage of workers' rights to trade issues would be likely to generate an adverse reaction from our trading partners and would therefore retard rather than improve the condition of workers in developing countries.

TRANSBORDER DATA FLOW

APCAC believes that the continued growth of international trade in goods and services depends on freedom of communications and information exchange. Legal or economic restrictions inhibiting the free flow of information between countries can only impede such growth.

APCAC supports the interest of the U.S. Government in the area of Transborder Data Flow, as evidenced by the establishment of the Bureau of International Communication and Information Policy in the Department of State. APCAC looks to the U.S. Government to establish a firm and coherent policy to handle these issues.

APCAC urges host governments to refrain from actions which would restrict international data flow. We accordingly urge the U.S. to assume a leadership role and pursue relevant policies.

DEPARTMENT OF INTERNATIONAL TRADE

APCAC calls for the establishment of a Cabinet-level Department of International Trade and therefore supports the President's Commission on Industrial Competitiveness which, in January 1985, recommended the establishment of such a Cabinet-level post.

The need for the agency is made clear to APCAC members who attempt to deal with the fragmented, underfunded Federal agencies charged with the responsibility of promotion of U.S. exports in general and Asia in particular. The resources committed by the U.S. to developing export trade are inadequate in relation to its national importance and in relation to what our trading partners unhesitatingly spend. APCAC believes that the creation of a Cabinet-level Department of International Trade would be of sufficient scope and budget to focus the United States' external trade policies and efforts.

VOTING RIGHTS OF U.S. CITIZENS

APCAC considers it appropriate to recognize that the right to vote for President of the United States of America should not be abridged to any citizen of the United States as a result of that citizen's choice of residence.

APCAC Resolutions
Guam

APCAC believes that every citizen of our nation regardless of his or her place of residence should be permitted to vote for President. APCAC is disturbed to note that in Guam, a territory of the United States since 1898, citizens may not vote for President unless they maintain a residence in one of the 50 states or the District of Columbia and thereby forfeit their right to vote in the Territory's elections. This same discrimination exists in all of the other territories and possessions of the United States, the Commonwealth of the Northern Mariana Islands, American Samoa, the Virgin Islands and Puerto Rico.

Therefore, APCAC endorses the petition of the people of Guam, as expressed in a resolution introduced to the Congress of the United States by Guam's delegate to the Congress that the Constitution of the United States be amended so that citizens of the United States residing in Guam and other insular American jurisdictions may vote for the President of the United States.

FREE TRADE AGREEMENT EXCLUSIONS

APCAC supports the U. S.-Canada Free Trade Agreement but opposes the exclusion of any U. S. territory or commonwealth from its provisions.

MANDATORY OFFSET PROGRAMS

APCAC opposes mandatory offset programs of foreign governments as a requirement for sale of United States products. Such requirements force the distortion of investment and trade patterns. APCAC recommends the U.S. Government work within the GATT and OECD and in multilateral negotiations to eliminate mandatory offset requirements.

GENERALIZED SYSTEM OF PREFERENCES (GSP)

APCAC supports present GSP legislation which has brought important economic benefits to many less developed countries, and urges the Administration to use the authority of the Trade and Tariff Act of 1984 to obtain liberalized access to foreign markets and adequate protection of U.S. industrial and intellectual property rights. APCAC opposes changing the GSP graduation provisions since any changes would undermine ongoing trade negotiations.

AMERICAN CIGARETTES

APCAC opposes the restrictive practices of countries which prevent U.S. cigarette manufacturers from competing fairly in local consumer markets. With the active support of the U.S. Government, significant progress has been achieved during the past year in liberalizing the domestic cigarette market in Japan and Taiwan. Commitments have been made by other Asian countries to open their markets, but it is essential that liberalization is genuine and not mere tokenism. Still, other Asian countries remain virtually closed to imports of U.S. cigarettes. Such restrictive practices prevent the American cigarette industry, of vital importance to a broad agricultural constituency in the U.S., from maximizin g its key contribution to lowering the U.S. trade imbalance. APCAC applauds the efforts of the U.S. Government to urge all countries to take meaningful steps to open their domestic cigarette markets to American companies in the near future.

LAND TENURE AND USE

APCAC urges host governments to extend reciprocal land ownership rights to U.S. firms and individuals requiring real property to support their investments and calls upon the U.S. Government to include land ownership reciprocal rights as part of appropriate bilateral treary negotiations.

If land lease is the only viable alternative to real property acquisition, host governments are urged to allow long term occupancy, 50 years minimum, preferably 99 years, at a predictable cost throughout the lease contract.

APCAC also calls upon the U.S. Government to include the issue of land tenure rights in any future negotiations of appropriate bilateral treaties.