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NATIONAL SECURITY COUNCIL
WASHINGTON, D.C. 20506

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NATIONAL SECURITY COUNCIL MEETING

DATE, TIME AND PLACE: July 16, 1982 -- 11:00 a.m.
Cabinet Room

SUBJECT: U.S.-EC Economic Relations

PARTICIPANTS:

The President
The Vice President

State
Secretary George P. Shultz

OSD
Secretary Caspar W. Weinberger
Under Secretary Fred C. Ikle

Treasury
Secretary Donald T. Regan
Mr. Marc E. Leland

Justice
Attorney General William French Smith

Agriculture
Secretary John R. Block

Commerce
Secretary Malcolm Baldrige
Mr. Lionel Olmer

Energy
Deputy Secretary W. Kenneth Davis

OMB
Mr. Joe Wright

CIA
Mr. William J. Casey

USUN
Ambassador Jeane J. Kirk

USTR
Ambassador William E. Brock

CEA
Mr. William Niskanen

JCS
General John W. Vessey, Jr.

OPD
Mr. Ed Harper

White House
Mr. Edwin Meese III
Mr. James A. Baker III
Mr. Michael K. Deaver
Judge William P. Clark
Mr. Robert C. McFarlane
Admiral John M. Poindexter
Mr. Richard G. Darman
Mr. Craig L. Fuller

NSC
Colonel Michael O. Wheeler
Mr. Norman Bailey
Mr. Henry Nau

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MINUTES

NSC Meeting, July 16, 1982

11:00 a.m.

Clark opened the discussion by recalling the sequence of events after the sanctions decision of June 18 concerning our response to European criticisms of recent U.S. policies. Bill Brock returned from Europe on June 24, relaying a message of strong opposition to the sanctions decision and a feeling in Europe that the cumulation of problems in steel, agriculture and other sectors represented a U.S. strategy to punish Europe. There was discussion of creating a U.S. task force and sending a special U.S. team to Europe. This led to suggestions for a new, permanent interagency group for international economic policy, but there were some questions about who would chair this new body. In the interim, some interagency meetings have been held to prepare initial papers on overall and specific issues. A draft NSDD has been circulated to create a new SIG to develop these issues further. Secretaries Shultz and Regan agreed last night that Don Regan would chair this group. Given that background, Mr. President, we have three broad issues to be examined:

-- Is there any reason to alter the basic approach and premises of our economic policy toward Europe?

-- What should be the general character of our approach to current European concerns? Do we take a high level approach or work the issues through regular channels?

-- What flexibility do we have in dealing with specific issues? Can we find areas where mutual concessions would product some agreements in the short run?

Let me now turn to Don Regan to begin the discussion. I will only add that this meeting, Mr. President, is not intended to reach any decisions, but rather to frame the issues for your consideration.

Regan pointed out that there had been no one central body or theme to U.S. foreign economic policy. We need to make a better effort to examine the impact of one problem on another. The overall impact of these economic issues on our foreign policy is particularly critical.

Shultz said he was looking forward to working under Regan's leadership. He was happy as long as he got his oar in.

Clark indicated that the next items on the agenda involved specific issues and asked Baldrige to discuss the steel issue.

Baldrige (with charts) began by noting that the steel problem was a case of one sick industry trying to feed on another sick industry. U. S. capacity utilization in steel was down to 43%, heading for 40%. At least 60% capacity utilization was needed to break even. The state of return in this industry plunged in the 4th Quarter 1981. Employment in both the US and Europe has dropped rapidly. Imports from the EC exacerbated the problem in the US. These imports jumped sharply in mid-1981, just as the US industry was beginning to slump. The EC accomplished this through heavy subsidies. We have now ruled preliminarily on the existence and magnitude of these subsidies. If the ITC finds injury and countervailing duties are applied, imports from the UK, Belgium, France and Italy will be knocked out completely. We do not want this and are trying to find an alternative solution within the limits of US law. We first had to convince the Europeans that we would file cases. Past US administrations talked the industry out of filing cases and devised a trigger price mechanism which basically disguised the problem. Now this problem is behind us. After recent discussions, there may be a light at the end of the tunnel. I would say the chances are now 50-50, perhaps a little better, that we will find a negotiated solution. We will need a little help from Commerce on customs and Justice on anti-trust aspects.

President asked if we could produce enough steel to meet our own needs.

Baldrige answered no, we would have to import some specialty steels but we would be self-sufficient in basic steels. The steel industry made serious mistakes in years past but is now trying to get itself together.

Brock argued that we cannot criticize European subsidies as if we aren't sinners ourselves. Steel has become a protected industry and protected industries inevitably become more and more inefficient.

Regan noted that the problem was even broader. Many newly industrializing countries -- Brazil, Mexico, S. Korea -- had become competitive steel exporters, often on the basis of subsidies.

Baldrige agreed, pointing out that with lower tariffs and with invisible barriers at the border now being negotiated and hopefully reduced, our biggest single future problem would be subsidies. Our own steel firms were fat and inefficient but have started in recent years to correct this situation.

Clark asked Block to address the next agenda item on agriculture.

Block noted that the EC had gone from import dependence in agricultural products beyond self-sufficiency to the second largest agricultural exporter in the world. Again, they had done so on the basis of subsidies. They have taken poultry markets away from us in the Middle East, wheat markets in Chile where they now sell wheat flour while we used to export wheat which was milled into flour in Chile, and sugar markets around the world. What they need to do is bring their support prices down nearer to the levels of world prices. Instead they decided this year to increase their support prices by 10½%. By the end of the year, we expect them to be the largest agricultural exporters in the world, mostly processed commodities. We have been talking to them about the problem but we may have to start acting. We may have to target some of the markets they have stolen from us and win them back.

Clark asked Brock to address GATT issues.

Brock pointed out that the steel and agricultural issues taken together created real difficulties and threatened to undermine US objectives for the GATT Ministerial in November. We need to get a settlement on steel and quiet things down on agriculture. Then we still have a chance for a successful Ministerial, which may be the most critical meeting on the world trading system in the postwar period.

Shultz asked rhetorically if there were not some differences within Europe on the Common Agricultural Policy. Wasn't this largely a French interest and the basis on which France joined the original Common Market?

Block said yes, we must capitalize on these differences. We are working with non-EC countries to isolate the EC on agricultural issues.

Clark mentioned the issue of the grain agreement, noting that the President would have to make a decision on this issue sooner rather than later. He suggested that the participants come back to this issue after reviewing the sanctions question. On sanctions Clark reviewed events in the wake of the Polish crisis in December 1981. At that time the working group noted the economic and legal difficulties with extraterritorial application of the sanctions. Haig reported from his meetings with Gromyko in January that the Soviets had indicated a thaw in the situation in Poland by the summer. With this background, the President decided to defer the decision on extraterritorial application of the sanctions. Thereafter, nothing changed in Poland. In the preparations for Versailles, Buckley sought to persuade the Allies to take steps to restrict credits going to the Soviet Union. Mr. President, you came back from Versailles and made your decision. This was a matter of protecting human rights in Poland. Perhaps we failed to explain your rationale as well as we should have. Confusion developed in Europe where it was seen as a shot in a trade war with the Soviets. The Allies forgot what you had said in December and in Bonn in June when you urged them to go quietly to their counterparts in Eastern Europe and Moscow and press for some meaningful relaxation in Poland. Now the sanctions decision has cast a shadow over other issues. You will be sending a memo to the State Department, Mr. President, clarifying our position for the Allies. It may be late, but not too late to explain our position. Some feel that events on July 22 may produce movement away from oppression. This could become an occasion to review the sanctions.

Brock asked if we had had a discussion of what would constitute meaningful relaxation.

President noted that he had indicated in Bonn what would be necessary. The Polish government should resume discussions with Solidarity and release Walesa. He pointed out to the Allies that they were in a better position than the US to convey this message quietly to the Soviet Union, not facing the Soviet Union down in public, which would never work, but explaining to them frankly Western purposes. He said he could not avoid the feeling that the Soviets might, given their present difficulties, take this opportunity to perform some deeds, not just talk, that would improve our relations. We could then show them a better way, a better world to live in.

Regan asked how tightly we plan to apply the sanctions.

Baldrige answered as tightly as possible.

Olmer added that the 60-day period for appeal of the new regulations expired mid-August. We would then be faced with questions of what to do if sanctions are violated. We are looking at the companies involved and their relationships to the US. We could, if we wanted to, prohibit any exports from the US to these companies.

Regan noted that the heat on this issue will then go up in the next few weeks rather than down. We have here an ongoing festering problem.

Baldrige pointed out that at that point we could go back to December 29 and allow them to ship what they already had as of that date, if the situation in Poland merited it.

President asked if Baldrige meant allowing them to ship what they already had in Europe.

Baldrige said yes.

Clark said that this general question of how we manage the sanctions should be the subject of work by the new interagency group. He then turned the discussion to the grain agreement.

Block noted the loss of markets to US farmers as a result of the 1980-81 grain embargo.

Clark asked what the options were.

Block said one was a new agreement with higher limits, but he was ready to concede that they may not be possible under present circumstances. He did feel, however, that the next possibility was an extension of the agreement for one year with higher limits and then perhaps a renegotiation of a new agreement next year if possible.

Shultz said there must be an element of consistency here with the sanctions. To negotiate a new agreement would be inconsistent. Nevertheless, we need a framework for trade with the Soviets. Perhaps an extension or some new limits. We can't have the

Soviets burn us again. Their disruptive behavior in the market was one of the original reasons for the agreement. We can't let that happen again. Each of these actions has long-term implications. The worst decision I think we made the last time I was in government was to put export controls on soybeans. Extraterritoriality scares the business community, not because of immediate loss of sales but because it tells foreign companies to go elsewhere to find their business partners. We are faced here with long-term issues. The problem in steel, for example, is that supply capacity has been built up at the same time that demand has gone down. Capacity building is simply out of line with long-term market trends.

Brock added that the grain agreement was the single most important and sensitive issue in the farm community. We should be very careful not to say anything until we decide what we want to do.

President said he did not want to make a decision now but he had never tied this issue to Poland. It was not part of the sanctions.

Weinberger pointed out that the extension of the agreement would be inconsistent with the pipeline decision. The best solution would be no agreement. Let them buy what they want but don't sanctify it with an agreement.

Kirkpatrick noted that Latin American countries also have problems with EC policies in the agricultural area. We should ask our friends to cooperate on grain trade in the pursuit of human rights.

Shultz noted that if we could ever get an agreement with others to raise the price or curb the sale of grain, it would work.

Weinberger called it a "cartel for human rights."

Regan said he disagreed with Weinberger that we did not need an agreement. The Soviets ruined our market once. We must have an agreement.

Weinberger said they ruined our market once because we were not watching. We can keep closer watch and improve our information about Soviet market behavior without an agreement.

Brock said no, we can't, because we have no legal basis.

Clark closed the meeting by calling on Regan to sum up.

Regan noted that we would now be looking at the relationship of these issues to one another and would be coming back to the President with an overview.

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16 July 82

NSC Meeting US/EC Economic Relations

Clark - Introduction -
Shultz - Regan will review NSDD and get to the President this weekend.

Regan - endorsed need for SIG-IEP.

Baldridge - Review for steel problem.
EC trying to solve their unemployment problem by transferring it to us.
Negotiating gov't to gov't. Have to have acquiescence of US industry.

UK, Belg., France and Italy would be excluded from US market if we impose duties.
Both sides want to settle out of court.
50-50 chance of reaching agreement.
Need help from Treasury on customs and Justice.

Pres Does US produce enough steel for our own US. Do we export?

Bald Only some specialty steel.
Bad management and lack of capital invest makes our steel too expensive. Improving.

Brock Our steel industry has been uncompetitive

Pres Jorgensen is doing OK.

Block High support of EC agri by EC govts has driven EC production up

Problem: Our support of NATO defense and strategic defense allows EC to spend taxes on supports and subsidies while we can't afford these supports.
EC growing to be largest agri exporter.
US farmers are fed up with EC practices.
EC believes all we will do is talk.
We need to take some action.

Brock GATT ministerial - it is crucial we make progress to avoid a trade war.
We need rules on agri products.
Making progress

Shultz Strain in EC over agri policies.
It's a French policy that others don't like

~~F~~Clark: Review of sanctions. History -

Brock Has there been any definition of the linkage between lifting sanctions and Polish actions?

President I am willing to consider that.

Regan How tight are we going to make regulations?

Baldrige As rigorous as legally possible

Ikle Question is how we will enforce. It will be done at policy level.

Baldrige One relaxation could be letting them go ahead and use rotors shipped prior to 29 Dec.

Block LTGA —

Options - complete new agreement
- extend for 1 year with higher limits
- (preferable for 2 years).
- no agreement

Shultz - must be consistent but see we must sell. Should be done under an agreement.

~~Block~~

Brock should hold up any decision.

President Will withhold decision today on LTG agreement.

Cap Not extra-territoriality.
Why have an agreement. Will sell anyway.

USUN We have support in this hemisphere in being upset with EC methods on trade.

Regan Must have an agreement

Cap We can control grain sales without an agreement

Brock - not legally.