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SECTION 301: THE UNITED STATES' RESPONSE TO LATIN AMERICAN TRADE BARRIERS INVOLVING INTELLECTUAL PROPERTY

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The new Trade Representative has recently described Section 301 of the Trade Act of 1974 as one of her favorite "crowbars" with which she hopes to pry open foreign markets. Her immediate predecessor had previously described the Trade Act in a somewhat more menacing fashion as the "H Bomb of Trade Policy." The crowbar metaphor is more familiar to me, although either description reflects the importance attached to this particular trade remedy. Section 301 is the one trade remedy which members of the U.S. Congress most dearly love, and foreigners dearly hate. It has had a substantial amount of notoriety among our trading partners and is decidedly controversial. The discussion that follows is a brief background on Section 301 and a practical and informal description of how it can be used effectively to promote or hurt an exporter's or importer's interests.

First, in trade policy, it is critical to understand that every government and every administration engages in a "choreography of trade." Trade initiatives are always taking place simultaneously in the multilateral, bilateral, and unilateral arenas. Traditionally, the United States has relied most heavily on multilateral endeavors. Currently, for example, the United States has many of its trade policy eggs in the Uruguay Round basket. The U.S. multilateral endeavor is to achieve trade reforms on a sweeping scale among the greatest number of U.S. trading partners in a way that would be most beneficial to the international trading system, the U.S. economy, and the global economy.

However ideal multilateral reform is, because of the need to interact with so many different trading partners that may have

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conflicting interests, reform naturally proceeds slowly. Unfortunately, yet inevitably, this slow process results in a lowest common denominator effect. Reform is difficult to attain when trying to reach an agreement with more than ninety-six trading partners.

To complement this multilateral endeavor, the United States uses plurilateral, bilateral or unilateral initiatives. The most recent bilateral initiative is the U.S. Free Trade Agreement with Canada. Most controversial of all is the attempt by the United States to use judiciously, at least in the U.S. view (recklessly in the view of U.S. trading partners), the threat of unilateral action as a way of increasing the leverage of U.S. trade negotiators in their on-going attempts to open markets abroad. It is neither the United States' intention to wreak havoc in the international trading system, nor is the United States trying to undermine the multilateral system. Moreover, the United States takes no pride when it is forced to retaliate when confronted by the intransigence of a trading partner. But, nonetheless, unless the United States is willing to act vigorously when faced with an unfair trading practice or with a trading partner who is unwilling to reform (and preferably eliminate) that trading practice, the U.S. Trade Representative (USTR) must act vigorously or else look weak. Further, unless willing to do so, the USTR will not have the leverage needed to pry open foreign markets.

As previously mentioned, Section 301 is a trade remedy which foreigners dislike greatly. Foreign officials, however, ought to view Section 301 as their favorite U.S. trade remedy, because it has been the most active force for trade liberalization globally in the last three and one-half years. No trading partner has liked having the USTR point the Section 301 gun at them. However, each trading partner, in turn, got a free ride when the USTR achieved over twenty trade liberalizing agreements that provided benefits for all trading partners, not just the United States. For example, when the USTR persuaded Japan, after a difficult negotiation, to open its citrus and beef markets, not only were the cattle farmers in Montana and Texas elated, so too were their counterparts in New Zealand and Australia. Indeed, the USTR did a great service for the New Zealanders and Australians. Likewise, when trade reforms in Europe were achieved, the beneficiaries have not only been producers and exporters in the United States, they have also been producers and exporters of similar products around the world. Thus, even though U.S. trading partners malign Section 301 and it

is currently likely to be under attack in the General Agreement on Tariffs and Trade (GATT), U.S. trading partners ought to see the legislation for what it really is—one of the most vital forces for opening markets.

Section 301 was codified in 1974 in the Trade Act. Its predecessor was in the Trade Expansion Act of 1962. The Trade Act was always a rather curious statute because it had two very different purposes. The first purpose, as already described, is a means of providing leverage for the U.S. trade negotiators in their efforts to arrive at satisfactory trade agreements. Once trade agreements have been achieved, the trade negotiators must urge the trading partners to live up to the rules. After all, it would be a waste of time for the USTR to negotiate market-opening agreements if those agreements were disregarded with impunity. Thus, one of the major purposes of Section 301 became creating a credible threat of retaliation to persuade our trading partners not only to enter into favorable agreements in the first instance, but then to comply with them.

The second purpose, which often conflicts with the first, is that it seemingly provides a private access remedy to persons who feel they are negatively affected by trade barriers by foreign governments. Section 301 allows a private party to complain to local government officials that a foreign trader engages in an unfair trade practice which has an adverse affect on U.S. commerce by reducing access to that foreign market. However, once a private party brings a petition, the government espouses the claim. The Trade Representative does not initiate an investigation in response to a private party's petition unless the USTR, with the advice of and after consultation with other interested agencies, decides to conduct such an investigation. If the USTR believes that there is a reasonable case of an unfair trade practice by a foreign government and initiates the investigation, it becomes a government case. It is then no longer a private action in which the private party has control over the proceeding. Obviously, the office of the USTR consults very closely and regularly with the private parties involved, its private sector advisory committees, and its partners in Congress, principally the Senate Finance and House Ways and Means Committees.

To reiterate, Section 301 has this dual, often conflicting, nature. It is, in a sense, designed to assist private parties which are faced with unfair trade practices abroad. It is also a way to enforce

trade agreements among governments.

Until August of 1988, the objective of Section 301 was to provide the President of the United States with the authority to respond, when faced with an unfair trade practice by a foreign government or its instrumentality, by taking unilateral action at the U.S. border. What can the President do if he finds that the criteria are met? Section 301 does not give the President *carte blanche*, but rather authorizes him only to take any action he is already empowered to take under other constitutional or statutory authority, or to increase duties or impose quotas at the borders.

When is the President authorized to invoke Section 301? When he finds that a trading partner has violated a trade agreement, such as the GATT, the President can use this authority. If the foreign government does not violate or deny benefits under a trade agreement, two criteria must be met for the President to respond: 1) it is either unreasonable, unjustifiable or discriminatory; and 2) such actions burden or restrict U.S. commerce (a cumulative test).

The foregoing discussion describes the status of the law before August 23, 1988. As everyone is aware, the United States has had a long debate about trade legislation. In 1985, when Ambassador Yeutter, the previous Trade Representative, took office, the U.S. bilateral trade deficit was skyrocketing, seemingly out of control. Many Congressmen were concerned that the executive branch had failed to exercise adequate leadership in this area and decided that they ought to pick up the reins of control. As a result, over three hundred omnibus trade bills were introduced. Many of the initial bills, in the administration's view at least, would have done far more harm than good. Many bills were protectionist, with a net effect of closing markets around the world, rather than opening them. But following years of debate and constructive interaction particularly with the Ways and Means and Finance Committees of the House and Senate, and with other members of Congress, a constructive bill emerged in August 1988, which is more likely to open markets.

On the recommendation of his principal economic advisors, President Reagan decided to sign the bill. Nonetheless, this did not mean that the USTR was pleased with all the provisions of the bill. Indeed, some of the most displeasing provisions were the amendments to Section 301. For three years the USTR argued against a number of draconian amendments to Section 301. While

some were modified, each of the major amendments about to be described was passed over the USTR's strong objection.

Why did Section 301 fare so badly, when the administration succeeded in many other areas of the trade bill? The reason was that in the view of even the moderate and sympathetic members of the Congress, Section 301 is a response to *unfair* trade. Congressional sentiment was that the United States must be tough when it comes to *unfair* trade. Noticeably, there was a prevailing view in the Congress that because Section 301 was aimed at *unfair* trade, it was fair game for tougher U.S. action.

The problem with this approach is that unfairness is sometimes subjective. Most actions taken under Section 301 have been in response to violations of agreements, whether trade agreements or otherwise. Therefore, there is an objective and internationally accepted basis for deciding whether the practice complained of was unfair. As a result, the use of Section 301 in those cases has not been very controversial. This does not mean that the party feeling the effect of Section 301 likes it; rather, it means that the party will not decry the United States for gross unilateral action.

Section 301 now authorizes that the practices be determined unfair—that is, unreasonable, unjustifiable or discriminatory—even if there has been no breach of any internationally agreed rules. In the eyes of U.S. trading partners, this gives carte blanche to the administration to complain about practices simply because other countries conduct business differently than the United States. Incidentally, the complaint encountered repeatedly is that it is hypocritical for the United States to use its economic might against trading partners only because they conduct their affairs in an “un-American” fashion.

What, then, were the amendments to Section 301 which, although the USTR dislikes them so much, it will nonetheless enforce faithfully to comply with the law? First, critically important authority under the statute was transferred from the President of the United States to the Trade Representative. The USTR opposed this transfer of power. If it had supported this transfer, other agencies might have viewed suspiciously the degree to which the USTR was pledged to continue to work collegially with them. The USTR, however, honestly opposed it because, in its opinion, the only reason this statute had so much clout in the past was because the President was the central actor. The political reality is that no one in the U.S. Government has as much clout and stature

as the President. Therefore, the USTR thought it was unfortunate to remove the President from the trade equation and to place this authority with someone of lesser standing, albeit a cabinet official. The argument on Capitol Hill, however, was that at least there would be some cases where the Trade Representative would be politically willing and able to take action, although it would have been too controversial for the President to do so. Thus, Congress transferred this authority in the hope that it would result in more frequent and vigorous use of Section 301.

Another amendment even more adamantly protested by the USTR was a mandated retaliation. Our office, however, scored a political victory of sorts because the original mandates to retaliate were very broad and the original exceptions were quite narrow. The mandate to retaliate, as finally enacted, applies only when there has been a violation of an agreement. There are numerous reasonable exceptions, including an exception in extraordinary cases where the net benefit of action under the statute is outweighed by the harm to U.S. economic interests. The effect of inaction under the statute and the credibility of the entire Section 301 program must enter into the calculation. Even so, this mandate to retaliate, although limited in scope and containing reasonable exceptions, is a fundamental shift in the law.

Thirdly, instead of simply arguing about so-called unreasonable practices, Congress enumerated several practices of particular concern. The third major amendment listed export targeting, a persistent pattern of denying internationally recognized worker rights (such as the right of collective bargaining or the establishment of a minimum age for the employment of children), and a foreign government's tolerance of private systematic anticompetitive activities.

There was a final amendment that the USTR supported in principle, although we argued over the numbers. Now a date certain deadline has been set for action in all trade cases. This amendment closes the previous loophole. For cases under the GATT, the only deadline for action by the Trade Representative was thirty days following the conclusion of GATT dispute settlement.

We turn now to how these amendments can be used in Latin America to a U.S. trader's benefit or detriment. The ways to use this legislation beneficially are very simple. If a trader is faced with an act, policy or practice of a foreign government in a market in

which the trader is seeking to enter, that can be characterized as unfair within the very broad criteria of Section 301, the trader has a very powerful weapon. That is, even if no petition under Section 301 is filed, one can use the threat of filing a Section 301 petition as leverage in seeking to resolve the problem, hopefully without ever having to resort to any governmental or legal action. Indeed, the threat of Section 301 action has been immensely important and useful to many businesses in their dealings around the world.

If filing is chosen, one should give the USTR a draft petition, which safeguards both the trader and the USTR. From the USTR's viewpoint, this allows the USTR to get a head start perspective on what problem is brewing, and how their resources may have to be allocated. From the trader's viewpoint, any embarrassment is spared should there be substantial holes in the petition or critical facts. One should consult the USTR at the earliest possible date, even before the draft petition stage.

If a petition is filed, one must be aware of several pitfalls. There is an inherent tension in this trade remedy between private interests and public interests. The problem with Section 301, viewed by many, is that even though the USTR has used it very vigorously and effectively in the last three years, the results are still uncertain. Nonetheless, it is more perilous for the trader when the government runs the case. Although exploring this remedy is urged, one should not count on it. It can be quite useful and is not very expensive. However, an attorney counseling his client should make a disclaimer that there are no guaranteed results and also ensure that the client appreciates the pros and the cons of this course of action.

On the flip side, Section 301 can inadvertently or unintentionally be harmful. Although retaliation is not the central object under Section 301, it establishes the credibility of the *threat* of retaliation. Such threats—so long as they are credible—provide leverage to trade negotiators. To achieve an objective, one must persuade an adversary or reluctant trading partner that it is in its interest, not just your own, to meet your demands. It is the threat of credible retaliation that adds extra arrows in the quiver. If one never shoots those arrows, however, then the threat is simply an ineffective bluff.

The trick then is to decide judiciously, artfully, and appropriately when retaliation is necessary. When retaliation is undertaken to show toughness, it translates into raising duties or imposing

quotas on products coming into the United States. In the end, it is the importer who is liable. Every time retaliation ensues, soon after accolades and praise are received from the members of the Congress, the congressional staff rather sheepishly reminds the USTR to back off when retaliation results in harm to products produced by local constituents. The problem is that retaliation hurts. Indeed, on net it is probably harmful to the national economic interest. U.S. competitiveness is reduced by raising costs for goods, many of which are not used by the ultimate consumers, but by industries that use the inputs in making other products or services. To make matters worse, such industries tend to be angry and morally indignant because they are, in fact, innocent bystanders in this process. Although in principle industry regards greater access to foreign markets favorably, they do not want it to hurt their sales.

In truth, retaliation is a very painful process. Although done reluctantly in every case, the USTR tries to retaliate wisely. The USTR conducts public hearings on lists of proposed products to pick products that will hurt the United States least. Basically, retaliation seeks greater long-term benefits that hopefully outweigh short-term harm. Claiming particularity or uniqueness of a product does not always work. For example, the USTR recently retaliated against imports of paper in a Brazil case, but subsequently a major U.S. company needed Brazilian paper, and could not get it anywhere else.

Another example concerns an American company that uses Brazilian coffee granules on top of coffee cakes that it produces. The company later got caught up in the confusion generated during the change from the Tariff Schedule of the United States to the Harmonized Tariff Schedule. While the credibility of a threat must be maintained, when the USTR is actually forced to retaliate, there are losers. In the end, this undermines the core of the U.S. trade policy program and, ultimately, the use of Section 301.

Turning to Latin America in particular, a lot is happening in the region. Probably one of the most controversial actions was the recent retaliation against Brazil, raising duties to one hundred percent ad valorem on a list of products, because Brazil adamantly refused to provide adequate patent protection for pharmaceutical products. The past, present, and future administrations and Congress strongly support the protection of intellectual property because of its future ramifications. U.S. comparative advantage is often in the high technology area. What encourages companies to

invest in the research and development necessary to maintain competitive vitality is assurances that for a reasonable period of time, such companies have monopoly rights on the products they have invented. In the pharmaceutical area, for example, it takes billions of dollars of research and development to create one product. It will not be profitable to invest such large sums of money unless patent rights can be secured.

Before concluding, ethics must be stressed. In the Brazilian case, there is a perhaps not unreasonable reply to the USTR's contention that Brazil is pirating U.S. intellectual property rights with respect to the pharmaceutical industry. The USTR asked for reforms and threatened action under Section 301. The Brazilian response was that what the United States calls piracy, Brazil characterized as making low cost pharmaceuticals available to its poor. The USTR, of course, responded that in the long term, if piracy is allowed to flourish, multinationals will be discouraged from investing in research and development. As a result, new and necessary drugs to fight diseases of the rich and poor alike will not be discovered and developed. Brazil further replied that it is easy for the United States, a highly industrialized country, to take a long-term interest. Developing countries point out that one has to live through the short term to get to the long term. In the end, they claim, it is simply a matter of realistic politics—pharmaceuticals must be available to poor people.

This is an admittedly very difficult dispute. It is not surprising that the USTR is unable to make much headway. Because the USTR is adamantly committed to protecting intellectual property rights, it felt that it had to retaliate and raise duties to one hundred percent. As a matter of fact, the United States had agreed under the GATT to leave those duties at a certain level, which has now been exceeded. The increase has led Brazil to charge that such action violates international obligations under Article II of the General Agreement. The USTR has consulted with Brazil about this matter and Brazil may pursue some controversial type of remedy in the GATT.

From the viewpoint of a U.S. trade negotiator, obviously the United States has to pursue vigorously its interests, which include the adequate protection of intellectual property rights. The USTR had to act strongly in the Brazilian situation, because of similar problems concerning Argentina and Chile. Lastly, the USTR wanted to set a precedent that the United States simply cannot

politically accept that piracy is going to flourish in South America to the detriment of U.S. pharmaceutical and other industries. Overall, Section 301 is flourishing in the pharmaceutical and intellectual property rights areas in Latin America.

Cases with Argentina point to the viability of Section 301. Two cases have been particularly interesting. One case was filed by the National Soybean Processors' Association, complaining that Argentina had a differential export tax system. Argentine practices placed a higher tax on soybeans and a lower tax on processed soybean products. The practices naturally had the effects of discouraging exportation of the raw beans and encouraging their processing in Argentina, much to the detriment of U.S. soybean processors. Initially, Argentina promised to eliminate the differential and ultimately lowered the differential by three percentage points. But, as is too often the case under Section 301, while Argentina eliminated the differential by three percentage points, Argentina undertook a different domestic program that basically leaves U.S. soybean processors in the same position. In the GATT, such actions are called nullification and impairment. Although Argentina did not breach its agreement, it nullified and impaired all of the bargained for benefits.

A second case with Argentina concerns air courier services. Sometime ago, Argentina took action such that U.S. air couriers, such as DHL, complained that there was a prohibition on carriage of very sensitive documents from the United States to Argentina. Not only was DHL (the direct party concerned) hurt, but also U.S. businesses who relied upon DHL for delivery services. Argentina repealed the prohibition, but a short time later imposed an exorbitant tax with a confiscatory effect.

This case illustrates the kind of difficulties inherent in an international trade agreement: no sooner is a problem solved, than it causes adverse ripple effects in other areas or a new variation of the same old problem crops up. In the view of the current Trade Representative, what the USTR wants is not just apparent progress, but rather results. The USTR does not seek to have illusory results as in the Argentina cases.

The forecast in the Latin America area is that the USTR will vigorously use Section 301. Although beneficial for exporters seeking access to markets, it has risks for importers from Latin America. The fuel for credibility of Section 301 action is import actions which, unfortunately, can hurt the importers in the short

term. Nevertheless, in the USTR's view, the long-term gain outweighs the short-term pain.