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THE WHITE HOUSE
WASHINGTON

October 28, 1992

MEMORANDUM FOR CARLA HILLS

FROM: D. ALLAN BROMLEY 

SUBJECT: GATT R&D SUBSIDIES

As President Bush has so often articulated, you have shown tremendous skill and determination in your efforts to build a firm foundation for free and fair global trade. I greatly admire your capable and effective representation of the United States in this difficult round of current GATT negotiations.

I have followed the negotiations with great interest, as you are aware, particularly because of their potential impact on science and technology in the United States. Given the importance of science and technology to economic competitiveness, we face a critical challenge in integrating technology policy concerns into trade issues. At the same time we need to ensure that trade concerns are adequately reflected in our international discussions on technology policy. This need for integration is perhaps most clearly seen in the discussion of R&D subsidies in GATT. The issue at hand is whether government support for research, as distinct from development, should be exempt from the category of potentially actionable domestic subsidies. As you know, my view is that research should be "green boxed" under the GATT, with the notification requirement removed entirely.

Section 8.2 of the Dunkel Text attempts to partially exempt government assistance for industrial research from being countervailed or challenged in the GATT (i.e. made non-actionable). Assistance for research activities conducted by firms or by higher education or research establishments on a contract basis with firms is non-actionable if the assistance does not exceed 50% of the costs of "basic industrial research" or 25% of the costs of "applied research," and if such assistance is limited exclusively to personnel costs, costs of instruments, equipment and land, and several other costs generally associated with overhead. Assistance to disadvantaged regions, under certain conditions is also non-actionable.

The Dunkel language leads to burdensome notification procedures, contains cumbersome and complex definitions (basic and applied research) and requires projections of research expenses (50% or 25% of total costs) to unknowable downstream innovations. Furthermore, for research assistance to be non-actionable, it must not only meet all the above criteria, it also must be notified to the GATT Subsidies Committee in advance of

its implementation and in sufficient detail to allow the Committee to evaluate the program's consistency with the non-actionability criteria. This process will impede utilization of government-sponsored research. Since the United States' research support system is much more transparent than that of other countries, and a greater portion of our total research is sponsored by the Federal government than is the case for our major competitors, the Dunkel language will harm the U.S. much more than other countries.

Allow me to elaborate on why the Dunkel language causes so much concern. Research expenditures are a small portion of the total costs of launching any product, process or service innovation compared to prototype development, scale-up, production and marketing, even for major products. They are nevertheless critical. A much larger fraction of U.S. research is supported by government than is the case with Japan or Germany. Thus, we are more vulnerable under the Dunkel language. Further, uncertainties created by the threat of tariff actionability will greatly inhibit future commercialization of, and the economic return on, the U.S. government's research expenditures.

The current Dunkel language will negate this Administration's efforts to effect technology transfer from government laboratories to industry through Cooperative Research and Development Agreements (CRADAs), a focus of the National Technology Initiative (NTI). Furthermore, the Dunkel Text language attempts to exempt agricultural research, presumably including biotechnology research related to agriculture. Yet it is not practical, and perhaps impossible, to separate biotechnology research, particularly at early stages, into categories of impact in medical, chemical, environmental, or other social and economic applications from those with potential benefit to agriculture.

Research leaders of U.S. industry and U.S. Government technical agencies overwhelmingly support green boxing research. For example, the Board of Directors of the Industrial Research Institute (representing companies that perform 85% of industrial R&D in this country) voted this month to support the following proposal concerning the GATT R&D subsidies issue:

"Research, but not development, should be exempted (green boxed) from countervailing import tariffs, and that the definition of Research and Development be essentially the same as in IRI's *Definitions of Industrial Research and Development*."

The research-oriented agencies of the Federal government have also considered this issue and agreed upon:

- o removing the "green light" notification requirement for research;
- o merging basic and applied research into a single green light research provision, using the OECD Frascati manual definition; and

- o permitting 100% government support for this category of green light research.

A final argument in favor of green boxing research is that member countries of the EC also support the concept, and we should be able to get concessions from them in the GATT negotiations on other issues of concern to the United States.

I hope you will agree that research should be green boxed and that the notification requirement should be removed for research. With the evidence for green boxing so compelling, the Administration should promptly and forthrightly accept such a position as its negotiating stance.

I shall give you a call in the next day or so to discuss this issue with you further.