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August 1, 1974

MEMORANDUM FOR MICHAEL HELFER

Customs and Excise Taxes in the Marianas

You have asked for comments and recommendations on Sections 607-611 of the Commonwealth Agreement and Sections 501 and 502 of Covenant, both attached to your Memorandum to me dated July 30, 1974. Specifically you have asked, "[I] What are the differences between the two proposals [II that are] worth fighting about? [III] Assuming that the provisions of the status agreement relating to customs and excise taxes are not subject to mutual consent, is there a reason to be as specific as our draft is? [IV] Is it desirable or undesirable to have the provisions relating to customs and excise taxes come into effect before termination of the Trusteeship?"

I. The Differences

Sections 501 and 502 of the Covenant are deficient, both compared to Sections 608 and 607 of your draft and in general, in the following respects:

(a) Section 501. Similar treatment of imports into the United States from the Marianas and Guam is consistent with our intention to secure the equivalent of Headnote 3(a) treatment, assuming that the treatment of

Guamanian imports into the United States does not change. To guard against an automatic change if either Headnote 3(a) or the statute conferring such treatment on Guam is amended, the final agreement should contain language that explicitly and independently confers such treatment on Marianas exports to the U.S. In addition the agreement should make specific mention of the undertaking by the United States to negotiate a special exception to the General Agreement on Tariffs and Trade (GATT) for such preferential treatment should that be necessary, and the agreement by the U.S. to cover into the Marianas' treasury any customs or excise taxes collected by it on goods entering the United States from the Marianas. A weak argument could be made that both of the latter provisions are implicit in the Covenant drafted by the United States; I much prefer your explicit formulation found in Sections 607 and 612 of the Commonwealth Agreement.

(b) Section 502. I assume, since similar language appears in our draft, that the restriction "in a manner consistent with the international obligations of the United States" on duties levied on imports into the Marianas is acceptable to us. I would have preferred not to have any restrictions in the interest of "maximum self-government," but the point may not be significant since the Marianas will probably be a duty-free port in any event. The prohibition

against duty on goods from the United States is also probably not serious since it appears unlikely that United States goods could compete against whatever labor-intensive industries may develop in the Marianas. But the parallel prohibition against duty on goods entering from U.S. "territories or possessions" should be resisted. The Marianas now conducts, and will probably continue to conduct, much of its trade with Guam. It may be important to the long range economic self-sufficiency of the Islands to be able to protect nascent industries against unrestricted imports from Guam or American Samoa; I am guessing that industries suitable for the Marianas are also suitable for the latter two territories.

Enormous administrative complexity would follow from a distinction between "U.S. goods" and "U.S. territories or possessions goods." Since the U.S. interest in duty-free entry of its own goods into the Marianas is minimal, I suggest that the restriction be resisted as a whole. To the extent the United States is concerned about discriminatory treatment of its products or those of its territories or possessions, our draft's reference to GATT (carrying with it the principle of Most Favored Nation treatment) should assuage those concerns.

(c) In General. In addition to the above differences, the government draft omits any mention of the following items:

1. The Covenant does not expressly state that the Marianas are outside the customs territory of the United States. That principle is fundamental and should be made explicit, as does your Section 607.

2. Your Section 609, dealing with the obligation of the United States to negotiate favorable trade treaties with other countries, is omitted from the government draft. Although Jim Leonard does not foresee any significant export trade developing in the short term, such development may well occur in the future. A statement by the U.S. along the lines of Section 609, perhaps toned down to suggest that the obligation to negotiate such treaties is dependent on the actual or potential development of an export trade by the Marianas, could be useful.

3. The ability to impose export taxes, while not likely to be significant as an economic matter, is important as an incident of self-government. Your Section 610 preserves that right; the Covenant is silent on the point. Moreover, your memorandum indicates that the United States has recently proposed that Article I, Section 9, Clause 5 of the United States Constitution ("No tax or duty shall be laid on articles exported from any state") apply to the Marianas as if it were a state. I see no justification whatever for making that clause of the Constitution applicable. The TTPI

government at present may and does impose export duties; similar power appears to exist in Guam (see 48 U.S.C. § 1423a) and American Samoa, though not in Puerto Rico and only to a limited extent in the Virgin Islands. The revenues from such export duties derived by the TTPI in the past, particularly on scrap, have been of some significance. It is true that Jim Leonard does not anticipate any sizeable export trade by the Marianas anytime soon, and thus the power to impose export duties will have no immediate significant impact on the Marianas. Also, Jim Leonard informs me that the Marianas' scrap is largely depleted. Nevertheless, it is not inconceivable that such a tax could be significant in the future. Furthermore, any provision making applicable to the Marianas that cause of the Constitution is, pro tanto, inconsistent with the principle of "maximum self-government" and is in derogation of the ability of the Commonwealth to control its own local affairs. Finally, I do not see how the legitimate interests of the United States are affected by reserving the power to impose such a tax to the Marianas government.

4. Your Section 611, dealing with excise taxes, is fundamental and should be made explicit since control over sales and excise taxes has been and will continue to be very important. The revenue interest, according to Jim

Leonard, is not insignificant.

II. Differences Worth Fighting About

First, a disclaimer: Obviously not all interests can be reduced to economic considerations. Other considerations, for example, the pride and confidence of the Marianas people in their own government, may be much more important. I have no way of assessing such factors, not do I have any feel for what would be unacceptable to the United States or why. Furthermore, without knowing the history of the negotiation, your present bargaining position or posture, what other points are also important, the client's willingness to compromise, etc., it is difficult to assess what is "worth fighting about." I think our whole draft is worth fighting for; but if you must compromise, I offer the following suggestions:

1. From a revenue standpoint, the most significant omission in the Government's Covenant is the power of the Marianas government to levy its own internal excise and sales taxes. That point should be insisted upon.

2. I believe the failure to state expressly that the Marianas are outside the customs territory of the United States should definitely be corrected. The ability to operate as a free port, or to tailor customs duties to the particular needs of the Marianas, depends on that principle and it should be clearly stated.

3. I suggest that the provision securing the equivalent of Headnote 3(a) treatment for exports to the U.S. be made explicit. As drafted, your Section 608 probably accomplishes that, but perhaps a clause should be added to the end of the first full sentence as follows: "but shall not be subject to duty in excess of the duty imposed on like products entering the United States from non-communist countries."

4. Notwithstanding the lack of any foreseeable export industry by the Marianas, revenues collected in the United States on such things as imports, passports, immigration and naturalization service fees, or any other taxes that may, consistent with the Commonwealth Agreement, be levied by the Congress on the inhabitants of the Mariana Islands, should be covered into the treasury of the Marianas. The other insular territories and possession of the United States are accorded this treatment, and the Marianas should receive no less. Similarly, the agreement by the United States to negotiate, if necessary, a special exception to GATT for preferential treatment of imports into the United States from the Marianas should be made explicit.

5. Any restriction on the ability of the Marianas to impose protective tariffs should be resisted. Although the immediate economic considerations are insignificant,

such protective measures may be necessary at some point in the future. That is highly speculative, however, and Jim Leonard does not feel that that protectionist interest is really worth fighting for. Get it if you can.

6. The Marianas have, in the past, resorted to export taxes on scrap, and to a lesser extent, copra. Jim Leonard tells me that, at present, there is virtually no export industry whatever. Thus the ability to impose export taxes can have no signficant present impact on either the Marianas or any other country including the United States. But such an export trade may develop in the future; since the Marianas are accustomed to having and exercising this power, and since the United States' legitimate interests do not seem to be affected one way or the other, I see no reason not to press the point.

7. The same consideration, namely the possibility that at some time in the future the Marianas may develop an export trade, suggests that the United States should be asked to agree to negotiate favorable trade treaties with other countries, including any required special dispensation under the GATT, should the actual or potential development of a Marianas export trade ever appear likely. This may be a throw-away point.

III. The Degree of Specificity

In assessing the need for specificity, I do not see that it makes any difference whether the provisions relating to customs and excise taxes are subject to change by mutual consent or not. It seems only sensible to me to state in the status agreement exactly who has what rights, and which rules are to govern. That way all parties concerned know what they have and any changes in the agreement will have to be made explicitly, whether by mutual consent or unilaterally. Thus, if the Marianas is given the right to preferential treatment of its exports into the United States, a change in that preferential treatment would have to be made overtly, and not as a result of a change in the status of Guam. In short, I see no reason not to state in the agreement exactly what we mean.

IV. Immediate Applicability

The answer to your question whether it is desirable to have the customs and excise tax provisions come into effect before termination of the Trusteeship depends, of course, on the terms of the Commonwealth Agreement ultimately settled upon by the Marianas and the United States. To the extent the negotiated provisions are as favorable as those presently in effect (under which the TTPI government has complete control over import, export,

excise and sales taxes), and assuming that the TTPI government will act in the best interests of the Marianas, it makes no difference when the new provisions go into effect; to the extent you are unsuccessful in negotiating provisions at least as favorable as those now in effect it seems preferable to postpone the effective date of such provisions. With respect to the applicability of the provisions conferring preferential treatment on Marianas' exports to the United States, none presently exist and none are likely to occur in the near future; accordingly, it makes no difference when these provisions go into effect.

HANES

cc: HPLO