

COMMENT

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The United States—Brazilian Informatics Dispute

On July 30, 1984, the Brazilian Government announced a proposed national computer law that would regulate imports of computer-related goods and services until 1990.¹ The move sparked instant controversy with loud protests from multinational computer producers.² On September 7, 1984, Clayton Yeutter, the United States Trade Representative (USTR), announced the filing of an investigation of Brazil's informatics policy under section 301 of the Trade Act of 1974.³ This investigation was one of the first to be self-initiated by the USTR.⁴ This comment analyzes the progress of that case and the pattern it establishes for future U.S. actions in trade disputes with developing nations.

I. Brazil's Economic Stance and Trade Relationship with the United States

In the late sixties, Brazil began a period of economic development.⁵ The Brazilian economy was stimulated through large government construction

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1. General Developments, *Brazil's Proposed National Computer Law Would Regulate Imports of Goods, Services*, 1 Int'l Trade Rep.—Current Rep. (BNA) 158 (1984) [hereinafter *Proposed Law*].

2. Botelho, *Brazil's Independent Computer Strategy*, TECH. NEWS REV., May/June 1987, at 37.

3. *News Highlights*, 2 Int'l Trade Rep.—Current Rep. (BNA) 1100 (1985).

4. *Id.*

5. Botelho, *supra* note 2, at 39.

projects, general industrialization, and modernization of the consumer durables industry. Brazil accomplished this through the importation of technology, sending students abroad for graduate study, public support for university research, and establishment of research and development laboratories in major state-owned companies.⁶ The Brazilian Government also acted to substitute imports with domestic products and increase exports of manufactured goods. Using a system of incentives for production and export, Brazil enjoyed success in several areas, most notably the aircraft manufacturing industry.⁷

After a recession in the early 1980s, Brazil entered a period of economic growth.⁸ Despite triple-digit inflation, the gross domestic product showed real growth of 5 percent to 8 percent per year from 1984 to 1986.⁹ During the same period, Brazil showed an average positive trade balance of U.S. \$11 million per year.¹⁰ Brazil also has one of the largest gross national products for developing nations.¹¹ The United States is Brazil's largest trading partner, accounting for 23 percent of Brazil's export sales and providing 16 percent of nonoil imports.¹²

Despite showing real economic growth and a positive trade balance, the Brazilian economy is beset with numerous problems. Brazil carries a foreign debt of about \$112 billion.¹³ At present Brazil has reached a shaky accord with her international creditors providing for repayment of the foreign bank debt over a twenty-year period.¹⁴ Compounding the problem are foreign banks that have become increasingly leery of lending to heavily indebted developing nations.¹⁵ This attitude tightens the supply of capital available for new ventures.

Brazil, like many developing nations, also faces inflation and unemployment problems. Inflation in 1987 was 366 percent.¹⁶ The 1988 levels could top the 1987 rate.¹⁷ Unemployment, which was 25 percent in 1984 and increased in

6. *Id.*

7. Carl, *The Brazilian Aircraft Industry and the Use of Law as a Tool for Development*, 50 J. AIR L. & COM. 513 (1985).

Professor Carl's article discusses Brazil's successful use of incentives for production and export to create and supply an international market for domestically produced aircraft.

8. *Marketing in Brazil* 3 (International Trade Administration's International Marketing Information OBR 85-07).

9. *Foreign Economic Trends and Their Implications for the United States: Brazil* 2 (International Trade Administration's International Marketing Information Series FET 88-18) [hereinafter *Foreign Economic Trends*].

10. *Id.* at 2.

11. *Marketing in Brazil*, *supra* note 8, at 3.

12. *Brazil—A Profile*, U.S. DEP'T ST. BULL. 85 (Nov. 1986).

13. Truell, *World Debt Situation Is Troublesome Despite Progress in Brazil's Negotiations*, Wall St. J., Mar. 1, 1988, at 24, col. 2.

14. Truell, *Brazilians Agree to Pay Bank Debt Over 20-Year Span*, Wall St. J., Mar. 7, 1988, at 25, col. 3.

15. Truell, *Debt Cure Hinges on Reactions to Brazil*, Wall St. J., Feb. 5, 1988, at 24, col. 2.

16. *Foreign Economic Trends*, *supra* note 10, at 3.

17. *Id.*

1987, will continue to be a problem.¹⁸ A decline in domestic purchasing power, weak foreign and domestic investment, and high interest rates are predicted as a result of current inflation levels and high unemployment.¹⁹

Brazil restricts imports through a licensing system administered by the Foreign Trade Department of the Bank of Brazil.²⁰ The imports are restricted by a number of regulations collectively known as the "Law of Similars."²¹ In essence, the Law of Similars restricts importation when similar domestically produced goods are available. State-owned entities, which predominate the industrial economy, face special restrictions and may only purchase imports if the price of the national similar is at least 15 percent higher than the import.²² Brazil's informatics policy, governing both imports and domestic production, is consistent with the general philosophy of the Law of Similars.

The Law of Similars is not, strictly speaking, inconsistent with article I of the GATT. Given that the aim of the GATT is to promote fair trade based on principles of nondiscrimination, however, the Law of Similars is in conflict with that aim. Additionally, article 24 of the GATT provides for special concessions to developing nations in an attempt to allow them to develop economic equality.²³ Thus, an argument can be made that the Law of Similars is fair under article 24 in that the Law of Similars is merely an attempt by Brazil to protect domestic industry until it can develop to the point of international competitiveness.

A. BRAZIL'S INFORMATICS MARKET

Informatics activities are those connected with the rational and automatic processing of information. Such activities include research, development, production, import, export, and marketing of computers, electronic components, software, and other digital technology-based devices including telecommunications equipment, process control equipment, and electronic instruments, and corresponding technology information services.²⁴

In the early seventies, Brazil attempted to develop a microcomputer industry. Foreign firms were to provide the technology while state and Brazilian private sector resources would combine to provide the capital and marketing expertise.²⁵ This is the same system that worked so well in the creation of an aircraft manufacturing industry.²⁶ Nevertheless, attempts to create joint ventures with

18. See *Foreign Economic Trends*, *supra* note 10 at 3; *Marketing in Brazil*, *supra* note 8, at 2.

19. *Foreign Economic Trends*, *supra* note 10, at 3.

20. *Marketing in Brazil*, *supra* note 8, at 4.

21. *Foreign Economic Trends*, *supra* note 10, at 11.

22. *Marketing in Brazil*, *supra* note 8, at 5.

23. *School Brief—That Trade Winds May Blow Fair*, THE ECONOMIST, Feb. 20, 1988, at 80.

24. *Brazilian Informatics—Background* (Nov. 16, 1987) (Unpublished report received from Robert Farris of the Brazil Desk in the International Trade Administration).

25. Botelho, *supra* note 2, at 39.

26. Carl, *supra* note 7, at 513.

foreign firms were largely unsuccessful in the microcomputer industry. Most foreign manufacturers, including all the major U.S. manufacturers, refused to participate in the program because the royalties and length of contracts were restricted by Brazil's Technology Transfer and Intellectual Property Code.²⁷ Only one manufacturing operation was started and it was stifled by poor product decisions and financial and managerial problems.²⁸

Despite the inability of the Government to create a domestic computer product, the data processing industry continued to grow rapidly in the early seventies. Large government purchases expanded the market at a rate 50 percent greater than the world market.²⁹ In 1974, the market was valued at \$700 million.³⁰

In 1976, computers and related products were Brazil's third largest import.³¹ From 1979 to 1985, the adjusted gross sales of U.S. firms in Brazil nearly doubled from \$533 million to \$1 billion.³² Despite the recessionary economic climate through 1984, the Brazilian informatics market grew 125 percent between 1981 and 1985.³³ In 1986, the domestic market was estimated to be \$2.7 billion, \$2 billion more than the market in 1974.³⁴

In 1986, 270 Brazilian firms controlled 55 percent of the market.³⁵ The domestic industry employed 20,000 people.³⁶ The U.S. Department of Commerce estimates that Brazilian restrictions on informatics imports and investment result in losses to U.S. firms of between \$337 million and \$452 million per year.³⁷ In 1985, the same year the U.S. investigation was initiated, domestic companies operating in Brazil exported \$11 million worth of equipment.³⁸ It seems premature to contend that Brazil is controlling the export market when domestically owned firms account for only 5 percent of the total export market.

B. BRAZIL'S INFORMATICS POLICY

In 1972, Brazil established the Commission for the Coordination of Electronics Activities (CAPRE).³⁹ The purpose of CAPRE was to coordinate federal

27. Botelho, *supra* note 2, at 39.

28. *Id.*

29. *Id.* at 39.

30. *Id.* at 41.

31. *Id.*

32. *Id.*

33. *Brazilian Informatics—Background*, *supra* note 24.

34. Botelho, *supra* note 2, at 41.

35. *Id.*

36. Seidman, *Transborder Data Flow: Regulations of International Information Flow and the Brazilian Example*, 1 J.L. & TECH. 31, 64 (1986).

37. *Brazilian Informatics—Background*, *supra* note 24.

38. Botelho, *supra* note 2, at 42.

39. *Brazilian Informatics—Background*, *supra* note 24.

data-processing activities and purchases.⁴⁰ The Commission was regarded as necessary because of the large volume of government purchases of data processing equipment. The drain in Brazil's foreign exchange reserves, caused by the first oil crisis, prompted the government to give CAPRE the additional task of formulating an industrial policy for informatics.⁴¹ This decision put the creation of a domestic informatics manufacturing industry in CAPRE's hands and included some power over the importation of the parts and components required by data-processing systems.⁴²

CAPRE responded quickly by imposing quotas on data-processing equipment imports. In June of 1976, with the backing of the National Bank for Economic Development, CAPRE came forth with a master plan to develop a Brazilian computer manufacturing industry.⁴³ Basically, the policy was to reserve to domestic industry the production of minicomputers, microcomputers, and peripheral devices wherever feasible.⁴⁴ The plan was implemented by encouraging the licensing of foreign technology by domestic manufacturers.⁴⁵ The present informatics policy is a continuation of this same basic philosophy.

In early 1977, the Council of Economic Development promulgated criteria for approval of new computer manufacturing ventures. The criteria examined were: (1) the national content of any equipment produced; (2) the export potential of the company; (3) total access to technology by Brazilian partners; (4) the market shares of the participating companies; and (5) the degree of control of the capital of the company by Brazilian nationals.⁴⁶ French, German, and Japanese firms participated in the program although the licensing period was limited to a nonrenewable five-year term and royalties were restricted to 5 percent of net sales.⁴⁷ U.S. firms considered the restrictions too harsh and did not participate.

In 1979, CAPRE was replaced by the Special Secretariat of Informatics (SEI). SEI continued CAPRE's policy objectives but greatly expanded their scope to encompass micro-electronics, telematics, and real-time control systems.⁴⁸ SEI's general mandate was to, "provide assistance in establishing the Brazilian informatics industry and to coordinate the implementation of such policy in the capacity of a superior policy, planning, supervision and control agency."⁴⁹ More

40. Decree No. 70.370, Apr. 5, 1972, art. 1. At the time CAPRE's duties were restricted to making an investigation of the private and government computer park, and to give an opinion on the purchase and lease of computer equipment by government agencies and entities.

41. Seidman, *supra* note 36, at 57.

42. *Id.*

43. Botelho, *supra* note 2, at 42.

44. *Brazilian Informatics—Background*, *supra* note 24.

45. Botelho, *supra* note 2, at 39.

46. Doing Business in Brazil § 22.101 (received from Santiago Irazabal Mourao, Head of the Commercial Section, Brazilian Embassy, Washington D.C.).

47. Botelho, *supra* note 2, at 40.

48. Seidman, *supra* note 36, at 58.

49. Doing Business in Brazil, *supra* note 46, § 22.102.

importantly, SEI mandated protection of the domestic industry's market until such time as international competition would be considered possible.⁵⁰ Thus, the domestic market was to be reserved to the infant Brazilian producers, thereby nourishing these producers until they had become sufficiently advanced to export their products competitively.

By 1982, the program was considered a success in Brazil. Foreign affiliates were participating in the program and the local industry's market share was growing.⁵¹ The number of Brazilian microcomputer manufacturers grew from two in 1979 to thirty-three by 1984.⁵² These firms stayed on top of the rapid technological developments and in at least one instance were able to produce an IBM PC-AT compatible that ran faster than the original. Prices, although initially high, had fallen by 1984 until they were lower in some instances than their foreign counterparts.⁵³ In the microcomputer sector of the market, Brazil's informatics policy obviously achieved its goal of creating a domestic industry.

Unlike the microcomputer sector, the minicomputer and mainframe markets did not fare as well. Brazil's rapidly expanding market attracted large American firms, who soon began cutting into the domestic market share. In 1984, IBM (U.S.) controlled 70 percent of the \$881 million mainframe market and with the entry of American producers the domestic minicomputer producers lost 30 percent of the market share between 1982 and 1984.⁵⁴ By 1984, Brazilian firms were calling for more protection as their market share began to decrease due to the entry of American manufacturers in the rapidly expanding market. The Brazilian Government responded with the Informatics Law of 1984.

II. Informatics Law of 1984

In essence, the Informatics Law of 1984⁵⁵ perpetuated the philosophy of SEI's earlier plan but further restricted domestic affiliations with multinational companies. In Brazil the prediction was that the 1984 Law would not lead to commercial retaliation from either the affected multinationals or their governments. General Danilo Venturini, head of the National Security Council, which has authority over SEI, said, "[t]hese methods of protection and government assistance to the national computer industry are perfectly compatible with obligations resulting from treaties or agreements to which Brazil is a party."⁵⁶ The magnitude of this misconception will become apparent below.

50. Seidman, *supra* note 36.

51. *Id.*

52. Botelho, *supra* note 2, at 41.

53. *Id.*

54. *Id.*

55. *Informatics Law*, Law No. 7.232, Oct. 30, 1984.

56. *Proposed Law*, *supra* note 1, at 159.

A. LEGISLATIVE HISTORY

Initially, two proposals were brought to the Brazilian Congress for consideration. Senator Roberto Campos sponsored the less restrictive proposal that was supported by many manufacturers who felt their competitiveness was threatened by inability to obtain current computer technology. Senator Campos's proposal would eliminate the market reserve policy. Instead, the Brazilian market would be opened and major incentives would be given to foreign firms to produce in Brazil. The incentives would be tied to the requirement that a portion of the foreign firm's domestic production be exported. Campos's primary reason for eliminating the market reserve policy was the high prices paid by the domestic consumers for the locally produced goods.⁵⁷

Zazi Correa Da Costa, however, speaking for SEI, said, "[t]here's not really any intention of liberalizing . . . the intention is to acquire capacity not only in producing, but in developing technology."⁵⁸ She stated that under the new law the micro- and minicomputer markets would be reserved for domestic firms, while the mainframe market would be left open. U.S. firms in Brazil were critical of the proposal.

The proposed legislation was strongly supported by domestic industry. The pervasive feeling was that domestic producers needed protection in their infancy from the large Japanese and American firms in order for the domestic industry to develop. Edson Fregni, president of a Brazilian microcomputer manufacturer, said:

In the computer field today in Brazil, the process of technological development is not up to date. It is behind foreign firms. For capitalists in Brazil, as well as foreigners, to invest in a certain sector, they need assurances of return. We need a law that will give us a more stable environment, maintained for a longer period, to justify the investment of Brazilian capitalists.⁵⁹

The supporters of the restrictive market reserve provisions felt the provisions were essential if domestic industry was to attract the needed capital.

A compromise proposal backed by domestic banking groups would allow foreign production in Brazil for export only, reserving the domestic market for Brazilian firms. The banking group, the U.S. firms and the Campos supporters all felt that the market reserve plan was unrealistic simply because Brazil did not have the capital necessary to fund the domestic industry.⁶⁰ In the end, however, the market reserve faction was victorious.

57. *Id.*

58. *Id.*

59. *Id.*

60. *Id.*

B. PROVISIONS

The 1984 Informatics Law established a new administrative body to control the Brazilian informatics industry and market: The National Council of Informatics Industry and Market. The National Council of Informatics and Automation (CONIN) now has authority over SEI.⁶¹ CONIN, which is under civilian control, operates at the cabinet level and is directly responsible to the President of Brazil.⁶² The Law requires that CONIN submit a National Plan for Informatics (PLANIN) every third year to the National Congress.⁶³ CONIN is now responsible for establishing the informatics policy within the legal framework provided by the 1984 Informatics Law.

The Law adopted restrictions on production, operation, marketing, sale, and importation of goods and services in the informatics industry.⁶⁴ These temporary restrictions may be imposed by the government at any time.⁶⁵ The intent is that they will remain in force until the national companies are consolidated and are competitive in the international market.⁶⁶ Specifically, the markets for minicomputers and microcomputers are reserved to national firms.⁶⁷ This market is to be reserved for seven years until 1992.⁶⁸ The 1984 Informatics Law thus insures national firms a monopoly in the mini- and microcomputer markets for a period thought to be sufficient for them to obtain a competitive status.

Under the Law a "national" firm is one in which control of decision, technology, and capital is "permanently, exclusively and unconditionally," in the hands of Brazilian nationals or domestic public entities.⁶⁹ The firm must be autonomous in the sense that its external sources of technology and capital do not have the real or potential ability to wrest control of the firm from the Brazilian nationals.⁷⁰ One hundred percent of voting capital must be controlled by Brazilian nationals.⁷¹ Control of technology must extend to development, acquisition, transfer, and modification.⁷² Perhaps most importantly the most that

61. Seidman, *supra* note 36, at 61.

62. *Id.*

63. *Id.* at 63.

64. Doing Business in Brazil, *supra* note 46, § 22.106.

65. *Id.*

66. Seidman, *supra* note 36, at 58.

67. *Brazilian Informatics—Background*, *supra* note 24.

68. *Id.*

69. Doing Business in Brazil, *supra* note 46, § 22.107. Control was defined to mean: I. Decision-making control—the power to elect the officers of the company and to direct the operation of administrative bodies; II. Technological control—the power to develop, generate, acquire, transfer and alter product and production process technology; and III. Capital control—the direct or indirect ownership of all the capital having actual or potential voting rights and at least 70 percent of the capital stock. *Id.*

70. *Brazilian Informatics—Background*, *supra* note 24.

71. Turner, *PABX Suppliers Quitting Brazil*, *ELECTRONICS WEEK*, Dec. 17, 1984, at 40.

72. *Brazilian Informatics—Background*, *supra* note 24.

a foreign firm can control is 30 percent of the nonvoting capital.⁷³ Joint ventures, as a practical matter, are prohibited by the definition of national firms.

Foreign firms, those that do not meet the criteria of a "national" firm, are prohibited from domestic production in markets where national firms have actual or potential production capability.⁷⁴ If the technical capacity does not exist in a particular market, a joint venture may be approved by SEI.⁷⁵ This is an exception to the general rule. It means that the mainframe market will remain open to foreign firms because Brazil does not have the technology or capital to enter this market at present.

The Law provides several major financial incentives for domestic firms. Imports and industrial products brought in by the national firms for research and development projects may be up to 100 percent tax exempt, provided the components are not produced domestically.⁷⁶ The same is true of imports brought in for the production of goods and informatics services for the national firms. The national firms also enjoy exemption from export taxes, which should make their products less expensive and, thus, more competitive in the world market. In addition, the firms may receive a reduction or exemption from various domestic taxes.⁷⁷

In addition to tax incentives, the law provides for a line of fiscal incentives to encourage the purchase of shares of the domestic firms.⁷⁸ Investors may receive tax deductions up to the purchase price of the shares.⁷⁹ National firms also receive priority in obtaining government procurement contracts.⁸⁰ These incentives seek to make attractive an investment in the emerging Brazilian production industry.

The 1984 Law also attempts to entice foreign companies to base their production facilities in Brazil and thereby increase export earnings. Foreign companies can manufacture equipment in the informatics export districts, located in the north and northeast regions of Brazil, provided that production is exclusively for export.⁸¹ These foreign firms do not enjoy many of the tax benefits granted to the domestic firms.

The Law also provides that foreign firms that sell in Brazil must disclose the technical information necessary to allow the interconnection of their products with products produced by other firms.⁸² Because of Brazil's lack of copyright protection, foreign producers are not likely to be eager to make such disclosures.

73. Turner, *supra* note 71, at 40.

74. *Brazilian Informatics—Background*, *supra* note 24.

75. *Id.* at 65 n.247.

76. Seidman, *supra* note 36, at 61.

77. *Id.*

78. *Id.*

79. *Informatics Law*, Law No. 7.232, Oct. 30, 1984.

80. *Id.*

81. Seidman, *supra* note 36, at 61.

82. *Id.* at 63.

The 1984 Law is unclear, however, as to the amount of disclosure required; thus there may be room for negotiation on this point.⁸³

III. Foreign Response

Despite General Venturini's optimistic predictions,⁸⁴ the 1984 Informatics Law quickly gave rise to negative responses from several sources. Almost immediately, several large multinational corporations pulled out of joint ventures in Brazil, their positions made untenable by the 1984 Law. Within a year, President Reagan initiated an investigation of Brazil's informatics policy under section 301 of the Trade and Tariff Act of 1974. The repercussions of President Reagan's and Brazil's actions are discussed below.

Under section 301 of the Trade Act of 1974, the President may impose duties or other import restrictions in response to unfair trade practices by foreign nations.⁸⁵ In addition, he may take any other "appropriate and feasible action within his power."⁸⁶ Actionable practices under section 301 include any act or practice of a foreign government that either: (1) deny benefits to the United States under a trade agreement; or (2) are unjustifiable, unreasonable, or discriminatory and pose a burden on U.S. commerce.⁸⁷ GATT is included as a trade agreement under this section.⁸⁸ "Unjustifiable" and "unreasonable" are defined under the statute to include the denial of the right to establish an enterprise in a foreign country.⁸⁹ The definitions of "unjustifiable" and "unreasonable" also include the denial of protection of intellectual property rights.⁹⁰ The Brazilian Informatics Law of 1984, which prohibited imports of certain American computer products into Brazil, was deemed actionable by the President in that it was "unreasonable" under the provisions of section 301.⁹¹

Investigations may be initiated in three ways under section 301: (1) by the President on his own motion; (2) by the USTR on the USTR's own motion; or (3) by the USTR in response to a petition by an interested party.⁹² From a substantive standpoint it makes little difference who initiates the action. When a petition from an interested party is received, the USTR must decide within

83. *Id.*

84. *See supra* note 49 and accompanying text.

85. 19 U.S.C. § 2411 (1982 & Supp. III 1985).

86. *Id.*

87. *Id.* § 2411(e)(3)-(5) (Supp.1985). *See generally* Bello & Holmer, *U.S. Trade Law and Policy Series #10: Significant Recent Developments in Section 301 Unfair Trade Cases*, 21 INT'L LAW. 211 (1987).

88. *See* Bello & Homer, *supra* note 87, at 212 n.3.

89. 19 U.S.C. § 2411(e)(3)-(4) (Supp. 1985).

90. *Id.*

91. *Brazil to Consider Retaliatory Measures Following U.S. Announcement of Sanctions*, 4 INT'L TRADE REP. CURRENT REP. (BNA) 1419, 1419 (1987); *see infra* text accompanying note 130.

92. 19 U.S.C. § 2411(a), (c).

forty-five days whether or not to initiate an investigation.⁹³ Once an investigation is initiated, by any one of the available methods, section 301 calls for consultations with the offending foreign government. The Trade Act of 1974 imposes deadlines by which the USTR must recommend to the President what action he should take.⁹⁴

Under section 301 the President has discretion to decide if the practice is actionable and if so what type of relief should be provided.⁹⁵ The President must publish his determination and the reasons for it.⁹⁶ The act is the primary instrument of the United States in seeking more open access to foreign markets.⁹⁷ During the first eleven years of its existence the act was used sparingly; only forty-eight investigations were conducted, all in response to petitions by interested persons.⁹⁸ In 1985, the Administration, committed to a more vigorous pursuit of fair trade, self-initiated section 301 action for the first time.⁹⁹ The Brazil informatics case was among the first to be self-initiated by the President.¹⁰⁰

The action was initiated by the USTR in September 1985 at the direction of President Reagan. By April of 1986, USTR Clayton Yeutter reported that no progress had been made in bilateral meetings with Brazil.¹⁰¹ In May, the White House announced that retaliation against Brazil was under consideration.¹⁰² The list of Brazilian imports for possible retaliatory sanctions included footwear, steel, aircraft, and agricultural products. While Brazil protested that the new government under President Sarney had not been given time to formulate a new policy, the USTR claimed that Brazil had categorically denied all U.S. obligations. At that point the United States Government estimated that U.S. companies had lost \$1.5 billion in sales.¹⁰³

The United States and Brazil continued to negotiate. In July 1986, the governments reported "that they had found common ground which offered real possibilities for achieving progress, but no agreement on the section 301 complaint appears to be in sight."¹⁰⁴ The situation remained tense, however,

93. *Id.* § 2412(a).

94. *Id.* § 2414(a)(1).

95. *Id.* § 2411(c)(2).

96. *Id.* The Brazilian Informatics determination is published as Memorandum of Oct. 6, 1986, for the United States Trade Representative, Determination Under Section 301 of the Trade Act of 1974, 51 Fed. Reg. 35,995 (1986).

97. Bello & Holmer, *supra* note 87, at 215.

98. *Id.*

99. *President to Announce Clearer Trade Policy Stance Dependent on Opening Markets Abroad*, 2 Int'l Trade Rep.—Current Rep. (BNA) 1100 (1985).

100. *Id.*

101. *Blum Asserts International Trading System Must Either Be Improved or Replaced*, 3 Int'l Trade Rep.—Current Rep. (BNA) 521 (1986).

102. *White House Council Agrees to Pursue 301 Complaint with Brazil Over Informatics*, 3 Int'l Trade Rep.—Current Rep. (BNA) 685 (1986).

103. *Id.*

104. *Korean § 301 Intellectual Property, Insurance Cases Near Resolution, No Brazilian Deal Seen*, 3 Int'l Trade Rep.—Current Rep. (BNA) 890, 890 (1986).

with the U.S. Administration accusing Brazil of "stonewalling."¹⁰⁵ The United States continued to threaten that sanctions would be forthcoming if progress was not made.¹⁰⁶ A September 16th deadline was set for making a determination in the case.¹⁰⁷

Talks held in August and a meeting held in early September between Brazil's President Sarney and President Reagan failed to be fruitful in reaching a compromise. The deadline for determination in the case was extended to October 6th.¹⁰⁸ On that date, the President released a determination under section 301 that Brazil's informatics acts, policies, and practices posed an unreasonable burden on U.S. commerce.¹⁰⁹ Due to pending elections in Brazil, the Administration forestalled any major action against Brazil. The United States did, however, notify the GATT of its intention to suspend tariff concessions on some Brazilian products.¹¹⁰

On December 9th, Brazil reacted by proposing a new software protection law as a gesture of "good will."¹¹¹ The proposed law relaxed the technology control requirements of the 1984 Law and provided for copyright protection of twenty-five years, with fines and jail sentences of up to two years for violations.¹¹² On December 18, 1986, the White House notified Brazil that the December 31st deadline for action had been extended to July 1, 1987.¹¹³ Brazil Foreign Relations Minister, Abreu Sodre, said retaliation was no longer being considered in the negotiations and that the two nations had reached an understanding on the substantive issues in dispute.¹¹⁴

In a March 1987 hearing the USTR listened to U.S. computer industry officials who urged that Brazil's policies were still unfairly restrictive and action should be taken.¹¹⁵ Oliver R. Smoot of the Computer and Business Equipment Manufacturers Association argued that even though the law permits up to 30 percent foreign equity investment, in practice no investment is possible because the law requires complete relinquishment of technology control. Smoot charged

105. *Id.* at 891

106. *U.S., Korea Settle Intellectual Property, Insurance Cases, More Talks Set with Brazil*, 3 Int'l Trade Rep.—Current Rep. (BNA) 937 (1986).

107. *Id.*

108. *Sarney Says Brazil Taking Steps to Rectify Trade Imbalance, But Debt Problems Remain*, 3 Int'l Trade Rep.—Current Rep. (BNA) 1125, 1125 (1986).

109. Memorandum of Oct. 6, 1986, for the United States Trade Representative, Determination Under Section 301 of the Trade Act of 1974, 51 Fed. Reg. 35,995 (1986).

110. *U.S. Settles Tobacco Dispute with Japan, No Deal Seen with Brazil on Informatics*, 3 Int'l Trade Rep.—Current Rep. (BNA) 1215, 1215 (1986).

111. *Brazil Proposes New Software Law in Hopes of Resolving U.S. Informatics Complaint*, 3 Int'l Trade Rep.—Current Rep. (BNA) 1495 (1986).

112. *Id.*

113. *U.S. Informs Brazil that Action Delayed Until July 1 on Informatics Dispute*, 3 Int'l Trade Rep.—Current Rep. (BNA) 1534, 1534 (1986).

114. *Id.*

115. *Industry Representatives Strongly Oppose Brazil's Informatics Policy, Urge 301 Action*, 4 Int'l Trade Rep.—Current Rep. (BNA) 387, 387 (1987).

that although negotiations to this point had obtained a list of products that Brazil would allow to be imported, that list did not contain "products in the mainstream of our industry."¹¹⁶ Smoot also complained that the proposed software law was inadequate in that it was unclear, left SEI officials with too much room for interpretation, and in effect extended the Brazilian market reserve to software with indirect forms of compulsory licensing.¹¹⁷ Other industry leaders testified that Brazil was also being hurt by the informatics policy because of higher consumer prices, lost foreign investment capital, and slipping rank in the global industry. They also testified that the lack of adequate copyright protection hurt both the United States, through lost revenues, and Brazil, through lost investments. The consensus among industry representatives was that the proposed software regulation did not solve the major problems of the 1984 Informatics Law and that although Brazil had the right to impose commercial regulations it should not be allowed to restrict world trade unduly.¹¹⁸

On June 29, 1987, sources in the Reagan Administration predicted the Administration would again extend the deadline in the Brazil informatics case.¹¹⁹ Industry leaders indicated that Brazil appeared to be moving its software protection laws toward conformity with international norms. In addition, signs of progress in the area of foreign investment were viewed as positive.¹²⁰ Vico E. Henriques, president of the Computer and Business Equipment Manufacturers Association, said, "It would be unwise of the U.S. to allow an arbitrary deadline to force retaliation just as we're about to make significant gains in software protection."¹²¹ On June 30, 1987, President Reagan suspended indefinitely the intellectual property portion of the section 301 investigation.¹²² President Reagan directed the USTR to continue the foreign investment portion of the investigation "as appropriate," however.¹²³

The Administration's refusal to impose sanctions was strongly criticized by members of the House Energy and Commerce subcommittee. Representative James Florio said that the enactment of market-opening legislation was imperative. "At stake," he said, "is nothing less than the right of U.S. patent and copyright holders to benefit from the technology they create."¹²⁴ On October 13, 1987, however, despite the subcommittee's negative comments and new allega-

116. *Id.* at 388.

117. *Id.*

118. *Id.*

119. *Industry Group Calls for Delay in Trade Sanctions Consideration Against Brazil*, 4 Int'l Trade Rep.—Current Rep. (BNA) 842 (1987).

120. *Id.*

121. *Id.*

122. *President Suspends Copyright Part of Brazil Case, But Talks Will Continue on Investment*, 4 Int'l Trade Rep.—Current Rep. (BNA) 867, 867 (1987).

123. *Id.*

124. *Administration Move on Brazil Informatics Comes Under Congressional Fire at Hearing*, 4 Int'l Trade Rep.—Current Rep. (BNA) 930, 930 (1987).

tions of software piracy involving Apple's Macintosh and Microsoft's MS-DOS system, the cabinet level Economic Policy Council postponed a decision on whether to reopen the intellectual property portion of the investigation.¹²⁵

At the same time, Brazil acknowledged that a new crisis was emerging because of SEI's refusal to approve distribution of the MS-DOS software in Brazil.¹²⁶ SEI refused to allow distribution because it claimed that a Brazilian substitute was available.¹²⁷ Francisco Ramalho, president of the Brazilian Informatic Services Companies' Association, said that rather than overreact to SEI's decision the United States should lobby for changes in the new software law that was still pending before the Brazilian Senate.¹²⁸ Although SEI officials said that retaliation by the United States would be "totally absurd," four Brazilian computer companies announced that they would appeal to CONIN to overturn SEI's decision. Sodre, Brazil's Foreign Affairs Minister, called for further negotiation to overcome the crisis. He said, "The Brazilian point of view is stated on the informatics law, which is in the interest of our country We should negotiate with the U.S., defending our sovereignty."¹²⁹

On November 13, 1987, President Reagan announced that tariffs totaling \$105 million would be placed on Brazilian imports because Brazil was not keeping the commitments it made to cooperate.¹³⁰ In response, Brazilian President Jose Sarney ordered an immediate study of U.S. imports that could be targeted for counter-retaliation.¹³¹ Sarney called the White House action, "an undue and discriminating threat."¹³² In the United States the Administration's actions were applauded by both Congress¹³³ and U.S. industry.¹³⁴ The Brazilian attitude was that the sanctions would probably not become reality because CONIN was likely to overturn the SEI decision that had sparked the Administration's move. There was, however, strong support for the imposition of counter-retaliatory measures should the U.S. sanctions go into effect.¹³⁵

Brazil also complained to the GATT that the imposition of sanctions by the United States would be a violation of GATT rules.¹³⁶ Brazil called for article

125. *Cabinet Council Reportedly Puts Off Decision on Reopening Brazil Informatics Policy Probe*, 4 Int'l Trade Rep.—Current Rep. (BNA) 1250, 1250 (1987).

126. *Id.* at 1251.

127. *Id.*

128. *Id.*

129. *Id.*

130. *Brazil to Consider Retaliatory Measures Following U.S. Announcement of Sanctions*, *supra* note 91, at 1419.

131. *Id.* at 1420.

132. *Id.* at 1419.

133. 133 CONG. REC. E4549 (daily ed. Nov. 19, 1977) (Statement of Rep. Chandler).

134. *Brazil to Consider Retaliatory Measures Following U.S. Announcement of Sanctions*, *supra* note 91, at 120.

135. *Id.*

136. *Brazil Claims U.S. Retaliation in Informatics Dispute Would Violate GATT Standstill Pledge*, 4 Int'l Trade Rep.—Current Rep. (BNA) 1563, 1563 (1987).

XXIII consultations, which provide for bilateral negotiations to resolve a dispute on or prior to a decision by a GATT panel.¹³⁷ "We cannot accept a claim by the United States to have a right to resort to unilateral actions, based on domestic legislation, without due regard to GATT rules and in breach of commitments assumed," said Brazilian delegate Jose Alfredo Graca Lima.¹³⁸ United States delegate Charles Blum replied, "[the Brazilian informatics policy] is clearly unfair, and since bilateral consultations have failed, we have been barred from a market. We are not prepared to accept this."¹³⁹

In view of the United States' threatened retaliations President Sarney vetoed a 200 percent fee on foreign software contained in the new software law.¹⁴⁰ Unhappy Brazilian industrial leaders vowed to overturn the veto in Congress.¹⁴¹ Although the United States continued to move toward sanctions, Brazilian leaders were hopeful that passage of the new software legislation and an expected reversal of SEI's MS-DOS decision would lead to a new round of negotiations.¹⁴²

On January 20, 1988, CONIN overturned SEI's decision and authorized the licensing of Microsoft's MS-DOS 3.3 operating system.¹⁴³ The decision prompted Brazilian business executives to send a letter to the USTR calling for an end to the United States' sanction threat. Proceeding with sanctions now they said, "would be throwing a nuclear bomb after having won the war."¹⁴⁴ The Brazilian group also pledged to monitor the regulations that would be promulgated under the software law.¹⁴⁵ On March 1, 1988, USTR Clayton Yeutter announced that the Administration would forestall the proposed sanctions until the regulations implementing the new Brazilian software law could be studied.¹⁴⁶ Thus, at the time of this writing, although the section 301 case has not been resolved it is currently on hold for an indefinite period.

IV. The Utility of Section 301 as a Negotiation Tool

After more than two years of investigation the Administration's section 301 case against Brazil seems no closer to resolution than the day it started. Progress has been made by the two countries in the informatics dispute, however, and the

137. *Id.* at 1564.

138. *Id.* at 1563.

139. *Id.* at 1564.

140. *Brazil's President Sarney Vetoes 200 Percent Ad Valorem Fee on New Software Legislation*, 5 Int'l Trade Rep.—Current Rep. (BNA) 18, 18 (1988).

141. *Id.*

142. *Id.* at 19.

143. *Brazilians Want End to Sanctions Threat, Sales of Some Microsoft Software Approved*, 5 Int'l Trade Rep.—Current Rep. (BNA) 116, 116 (1988).

144. *Id.*

145. *Id.*

146. Lachica, *U.S. Postpones Trade Sanctions Against Brazil*, Wall St. J., Mar. 1, 1988, at 34, col. 2.

section 301 action may well have been a necessary part of that progress. The Administration moved quickly in ascertaining that Brazil's acts, practices, and policies in informatics following the passage of the 1984 Informatics Law were actionable under section 301.¹⁴⁷ This quick determination forced Brazil to the negotiating table—a step Brazil had previously avoided taking.

Initially, Brazilian leaders refused to take the threat of section 301 action seriously, perhaps justifiably so given the paltry number of investigations previously conducted under that section. Once the United States took the step of actually determining Brazil's Law objectionable under the statute, however, Brazilian negotiators began to take notice. Subsequent to determining that Brazil's conduct was actionable, the Administration has proceeded with caution. There was no rush to impose sanctions on Brazil despite the protests from some sections of Congress and U.S. industry leaders. Instead, the threat of impending sanctions has been effectively used by the Administration to force Brazil to come to the bargaining table with serious, workable proposals.

In the numerous bilateral talks that have taken place as a result of the section 301 action, the United States has made real progress in moderating Brazil's restrictive stance. Large gains have been made in insuring the protection of U.S. industries' intellectual property. The enactment of the new software legislation by Brazil has the possibility of effectively protecting American interests if it is implemented as Brazil has indicated it will be. In addition the threat of sanctions was effective in overturning SEI's decision concerning the Microsoft software. That reversal could open the door for the entry of more American software. Although little progress has been made in allowing foreign investment in Brazil, on the whole the Administration has been effective thus far in utilizing section 301 as a powerful tool to open the closed Brazilian markets.

The ultimate question remains unresolved; that is, how much freedom should Brazil, as a developing nation, have to regulate imports into what it considers a developing market? Current international agreements have recognized the rights of developing nations to subsidize and restrict access to infant markets in order to promote the growth of domestic infant industries. That type of protection has not been allowed to the extent that it causes undue harm to other nations, however.¹⁴⁸ Brazil's position is that its informatics industry is still in the developmental stages and should have the right to restrict access to the market in order to allow the industry to mature.

In the realm of intellectual property the answer seems straightforward. Brazil has the right to place tariffs on the imported software processes, as any import may be taxed. That right should not extend to the point that a licensing process that in effect entails a relinquishment of any control over the technology is a

¹⁴⁷. See *White House Council Agrees to Pursue 301 Complaint with Brazil over Informatics*, *supra* note 102, and accompanying text.

¹⁴⁸. See Bello and Holmer, *supra* note 87, at 216.

mandatory prerequisite to importation. To the extent that Brazilian law forces the disclosure of technological secrets or fails to protect intellectual property so that they are easily pirated it should be curtailed. Otherwise, the Brazilian law expropriates for its domestic industry the legitimate work product of foreign companies without giving just compensation in return. The advances made through the section 301 investigation, if implemented under the new software law, should effectively alleviate this problem.

The question of Brazil's right to stipulate levels of foreign ownership, institute domestic component requirements, or completely reserve domestic markets is more problematic. The U.S. position is that as the sixth or seventh largest market in the world the Brazilian industry cannot be considered an infant one.¹⁴⁹ Perhaps this is a mischaracterization on the part of the United States because, regardless of the size of the market, Brazil's own industry may not be sufficiently mature to compete within it. Market size is not determinative of a domestic industry's maturity. For instance in the mainframe sector of the market, which is worth \$800 million, the Brazilian industry has yet to be born.¹⁵⁰ Conversely, the Brazilian microcomputer market has progressed to the point at which it can successfully compete with foreign multinationals, in some cases actually undercutting their prices or providing better technology.¹⁵¹ Given these facts there seem to be some inconsistencies in Brazil's rationale for her informatics policy. The current Brazilian Law closes the market in some sectors where Brazil has demonstrated an ability to compete while leaving the market open to foreigners where Brazilian industry is either nonexistent or truly in its formative stages.

On Brazil's behalf the argument can be made that the question is one of degree. Although under the protection of the 1984 Informatics Law domestic manufacturers are able to compete in the international market, they would be unable to do so if that protection, and consequently the domestic market base, were removed. Thus, they should be allowed to develop under the continued protection of that law until they have matured to the point where they can compete without it.

Where a Brazilian industry truly does not exist, such as in the mainframe market, a different argument could be postulated. There Brazil must leave the market open to satisfy its own rapidly increasing technological needs. To do otherwise would hinder the country's economic development. In so doing, however, Brazil precludes the development of its own domestic industry. This conclusion is illustrated by the fact that IBM continues to hold an 80 percent market share in the mainframe market.

149. *U.S. Settles Tobacco Dispute with Japan, No Deal Seen with Brazil on Informatics*, *supra* note 110, at 1215.

150. Botelho, *supra* note 2, at 41.

151. *Id.*

V. Conclusion

The right of Brazil to foster a growing domestic industry, even if it entails the use of some protectionistic measures, is undisputed. The problem lies with Brazil's methodology. The system of incentives for domestic investment, mandatory domestic control, and market reserve has worked for Brazil in the past.¹⁵² In the present context it is untenable. Not only is it depriving Brazil of much needed foreign capital, increasing consumer costs, and restricting access to foreign technology, but it is also unfairly infringing on other countries' rights of access to Brazil's informatics market. Just as Brazil has access to the world market in other areas, she must grant the world access to her informatics market.

Perhaps the answer is to restructure the law to encourage greater foreign capital participation, further protect foreign technological secrets, and provide export incentives. At the same time the domestic industry and economy could be fostered by restricting the removal of dividends and increasing the mandatory percentage of profits that each company must spend on research and development. Control need not be taken from the domestic industries; the foreign participation requirements need only be relaxed to the point where foreign participation is feasible.

One thing is clear: In the Brazil informatics case the Administration has been able to use its powers under section 301 to establish a greater fairness and equity in the international market. The case, though far from over, has demonstrated the effectiveness of section 301 as a market opening tool if wielded with caution and skill. Care must be taken not to implement sanctions rashly, for, as this case has demonstrated, the mere threat of sanctions can have beneficial results.

152. See generally Carl. *supra* note 7.