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THE GATT PROVISIONS ON COMPENSATION AND RETALIATION

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THE GATT PROVISIONS ON COMPENSATION AND RETALIATION

Introduction

Among the broad objectives of the General Agreement on Tariffs and Trade (GATT) is the expansion of trade among its contracting parties (hereinafter referred to as member countries) through the reduction of tariff and other trade barriers. To this end, the GATT was drafted to embody trade rules banning, as far as was then considered possible, nontariff barriers, with the goal of leaving tariffs as the only legitimate form of protection. The GATT also provides a means for the mutual reduction of tariffs. In adhering to the trade rules, GATT members have, in effect, agreed to an equivalence of commitment to specific obligations. In entering into multilateral tariff negotiations, member countries have had as a common objective the reduction of tariffs on a basis of reciprocity.

The uses of compensation and retaliation under the GATT have their roots in the overall balance of these reciprocal benefits and obligations. This paper examines how compensation or retaliation may be used to restore a balance of trade advantages when it has been upset. An unbalancing of trade advantages develops between members when a country takes an escape clause action under article XIX or when it withdraws tariff concessions under article XXVIII. The balance may also be disrupted through other actions, whether or not consistent with GATT, which undermine the value of a country's tariff concessions or their commitment to the rules. In these cases, the provisions of GATT articles XXII and XXIII apply.

Many factors in practice condition and complicate the carrying out of these GATT procedures. A quick settlement can be reached if a member country agrees to rescind an offending action. Whether as a temporary expedient or as a more permanent change, however, countries may attempt to justify their actions without regard to their consistency with GATT provisions. In some cases, efforts are made to legitimatize the action by seeking a waiver of their GATT obligations, by invoking exceptions provided for in GATT, such as those for national security, or by interpreting GATT provisions in a manner favorable to the case in point.

Considerations external to the immediate issue can also delay or frustrate the resolution of trade disputes. Overriding political or security requirements may complicate finding solutions to a particular trade problem. A member country may be inhibited from pressing for the settlement of a dispute arising from foreign practices because they are essentially similar to its own. Efforts to resolve some disputes may be deferred because raising them would likely jeopardize chances for settling other more important issues. Individual member countries also take into account the cost-benefit relationship in deciding on a course of action to correct an impairment or nullification of its GATT

rights. The resources required to rectify the balance of trade advantages in some cases might better be directed elsewhere, particularly when the benefits are inconsequential in trade terms, or when the political cost would outweigh the economic benefits.

The GATT sets forth broad procedures to be followed in settling disagreements. Underlying these is the principle of consultation. When informal consultations fail, the parties at issue may refer a problem to the GATT member countries acting jointly. The primary role of the other member countries is such cases, however, is to serve as a catalyst in facilitating the resolution of a dispute between the parties concerned. Safeguards are also built into the procedures to discourage intemperate actions, reflecting the strong desire of the GATT drafters to avoid the trade retaliation and counterretaliation which contributed to the sharp decline in world trade in the period before World War II.

Articles XIX and XXVIII—Maintaining the Balance of Tariff Concessions

Article XIX authorizes member countries to suspend obligations or withdraw tariff concessions when unforeseen developments consequent to these obligations or concessions lead to an increase in imports that cause or threaten to cause serious injury to domestic producers. Though these actions are to be taken on a nondiscriminatory basis, the impact of the restrictive measures falls most heavily on principal suppliers of affected products. A country taking emergency action under this article is required to afford countries having a substantial export interest in the products concerned an opportunity to consult. Ordinarily, the consultations take place after, rather than before, the action is taken. No express provision is made in the GATT for payment of compensation, although in practice compensation has been used to reestablish the balance of concessions.

The United States, for example, consulted with Canada during June 1971 after a temporary surtax was imposed on imports of frozen and fresh strawberries into that country. Canada justified its action under article XIX as necessary to meet the "threat of serious injury to growers from imports at disruptively low prices." During the consultations, Canada agreed to remove the levy on fresh and processed strawberries by certain dates acceptable to the United States. Canada also offered certain compensatory concessions which the United States accepted. This issue is now considered closed.

If no agreement can be reached during consultations with respect to the action taken under article XIX, countries which have a substantial interest in the products concerned are free to suspend substantially equivalent concessions or other obligations (the suspension of which the member countries do not disapprove) with respect "to the trade of the contracting party taking such action," that is, to suspend concessions only with respect to the offending party. The European Communities (EC) in taking action in 1962 against the United States provides an example of the use of this provision. The United States increased its customs duties on imports of sheet glass and Wilton carpets under article XIX. The EC consulted with the United States on this action, but no satisfactory settlement materialized. The EC then retaliated by raising its customs duties on imports from the

United States of polyethylene, polystyrene and its copolymers; woven fabrics of synthetic fibers; woven fabrics of artificial fibers, varnishes, lacquers and an assortment of other paints and enamels. The EC also withheld Kennedy Round tariff cuts on imports from the United States of the affected items, thereby increasing the severity of its retaliatory action. Subsequently the EC reduced the duty rates on these items coming from the United States as a counterpart to the restoration by the United States of customs duties in effect prior to the escape clause action for some of the products covered in its article XIX action.

Article XXVIII allows member countries to withdraw or modify tariff rates bound in the GATT schedules at agreed 3-year intervals (so-called "open season") and at other times under specified special circumstances. Negotiations to effect these changes are normally held at the beginning of each 3-year period with countries having a substantial interest in the tariff concession. The "renegotiation" sessions concern essentially the replacement of concessions withdrawn or modified with concessions of equivalent value so that the general level of reciprocal tariff concessions which existed prior to the negotiations is maintained. A party whose trade is adversely affected may find, however, that the compensatory offer is unacceptable. When this happens, the original modifications in the tariff schedules are allowed to stand, but the parties affected by this action are then free to withdraw or modify equivalent concessions in their own tariff schedules to restore the balance of concessions. Such changes are generalized under the GATT's MFN principle and thus affect the trade of all member countries of GATT and not just the offending party.

In the so-called chicken war, the United States suspended tariff concessions thereby raising its tariff on selected items of trade interest to the EC under article XXVIII in reaction to a Community action. The Community announced in 1960 its plan to apply variable levies in place of the separate tariff schedules of the member states to imports of poultry—among other agricultural products. The United States had further talks with the Community after the common agricultural policy for poultry went into effect in July 1962, but these efforts to reach an acceptable solution also failed. The United States then announced its intention to suspend equivalent concessions negotiated with the Community. However, parties at interest were far apart in the estimates of trade impaired. Consequently, a special GATT panel met and decided that the value of the tariff unbindings resulting from the CAP on poultry was $26 million, a judgment which both the United States and the Community accepted. In December 1963, the United States announced the suspension of trade agreement rates and the return to higher statutory rates, effective January 7, 1964, for trucks valued over $1,000, brandy valued over $9 per gallon, potato starch, and dextrine.

Articles XXII and XXIII—Resolving Trade Disputes

Article XXII provides for consultation on any matter affecting the operation of GATT and for each member country to give sympathetic consideration to such representation as other countries may make. The article also provides that the member countries acting jointly may,

at the request of any country, consult with any contracting party or parties regarding any matter not satisfactorily resolved between the parties to a dispute.

Recourse to article XXIII represents a more serious step. A country may resort to this procedure when (1) benefits accruing to it under the agreement are nullified or impaired or (2) the attainment of an objective of the agreement is impeded. Such impediments may arise from various situations, including the failure of another country to carry out its obligations under the agreement, or as a result of an action by that country, whether or not it conflicts with the provisions of the agreement. The first step in article XXIII actions is essentially the same as that in article XXII. At this stage (article XXIII:1), consultations are held directly between the concerned parties with a view to the satisfactory adjustment of the matter, but based on written representations or proposals from the aggrieved party.

If the consultations do not lead to a satisfactory adjustment between the parties concerned within a reasonable period, the problem may be referred under article XXIII:2 to the member countries acting jointly for investigation and appropriate recommendation or ruling. The term "ruling" in this context refers to determinations regarding differences on points of interpretation of GATT provisions or facts. (An immediate move from article XXII to article XXIII:2 is permitted because consultations under article XXII are considered as fulfilling the requirements of article XXIII:1.)

The member countries acting jointly, for example, may rule that a particular measure at issue is inconsistent with GATT and recommend its removal. If the situation is considered serious enough to justify such action, the member countries may authorize one party to suspend the application to any other party—and that party alone—of such concessions or obligations under the agreement as the member countries jointly determine to be appropriate.

Use of Articles XXII and XXIII

By Other Countries

GATT member countries have agreed only once to the use of the authorization contained in article XXIII:2 to suspend concessions or obligations. Although the measure was not actually implemented, the Netherlands was authorized in 1953 to impose a specific import quota on U.S. wheat flour to offset the harmful effects on Dutch exports of dairy products resulting from U.S. restrictions on cheese imports under the Defense Production Act. Notwithstanding the fact that a formal authorization has been granted only one time, foreign governments have on a number of occasions openly declared their intention of having recourse to article XXIII to underscore their concern over particular actions by another country or to mount pressures on the offending country for an accommodating response.

Recourse to these procedures by foreign governments has generally fallen short, in practice, of seeking authorization to suspend concessions or obligations. For example, at the request of Malawi, the United States in 1967 consulted under article XXII:1 and XXII:2 with respect to a U.S. subsidy of 5 cents per pound on exports of unmanufactured tobacco. Malawi and other countries with a trade

interest, however, were unable to demonstrate conclusively that the U.S. subsidy had adversely affected their trade. The United States also agreed to consult in 1968 and 1969 with the EC, first under article XXII and subsequently under article XXIII:1, on the alleged impairment of U.S. tariff concessions to the EC arising from legislative changes affecting the U.S. duty on imports of reprocessed wool fabric. Settlement of this issue is still pending.

The United States agreed to hold initial consultations with the EC in April 1970 and with Spain in February 1971 under article XXIII:1 on the U.S. import prohibition applicable to all firearms "not suitable for sporting purposes" under the U.S. Gun Control Act of 1968 and its implementing regulations Spain and the EC noted that the U.S. action nullified a U.S. tariff concession to that country. The case is still pending. Meanwhile, the U.S. Government has been studying results of tests to establish objective standards for firearms preparatory to submitting legislative proposals applicable to both the importation and interstate sales of guns.

At the request of the European Communities, the United States in July 1972 consulted under article XXIII:1 regarding the EC allegation that the Domestic International Sales Corporation (DISC) provisions of the Internal Revenue Code of 1954, as amended, are in violation of the GATT and damage EC interests. The United States maintained that the DISC is not a prohibited subsidy under the terms of GATT article XVI and, in fact, yields less benefits to exporters than the tax practices of our major trading partners. The 1972 consultations failed to resolve the issue. (See below, U.S. request for consultation on certain tax practices of three EC countries.) With respect to the trade effects of income tax systems, the United States has taken the position that existing GATT rules are not adequate, and a negotiating forum should be established to arrive at new rules rather than attempting to extend the old rules to cover the DISC.

By the United States

To date the United States has not suspended concessions or obligations with respect to any country under article XXIII. However, the United States has invoked article XXIII on a number of occasions to dissuade other countries from imposing new import restrictions or to obtain removal of existing restrictions that are inconsistent with the GATT. The concern of foreign governments over the consequences to their trade should the United States retaliate in accordance with article XXIII:2 has no doubt been a major factor contributing to the settlement of trade disputes on which the United States has consulted with other countries under article XXII or XXIII:1. Article XXIII has also served as a deterrant to new restrictions. This occurred when the EC Commission proposed a tax on oilseeds, including soybeans and soybean products. This measure, if implemented, would have cut back imports of these products from the United States. The United States warned publicly that the proposed measure, if carried out would bring swift retaliatory action against EC products. Similar warnings have been conveyed privately to head off anticipated EC restrictions on other U.S. exports.

Following article XXII consultations with Norway several years ago, that country reduced or removed a number of restrictions which were burdensome to selected U.S. agricultural exports. Austria re-

duced sharply the number of items subject to quantitative import restrictions after a series of article XXII consultations held during 1963–64 which the United States initiated.

Japan has long maintained import quotas on some of our exports. These restrictions were carried over into the GATT by Japan at the time of its accession in 1955 and became illegal under that GATT during 1963 when it renounced the balance of payments justification for their retention. In 1968 bilateral representations, the United States gave clear indication to Japan of our intention to press article XXIII:2 action against it in GATT unless the pace of its liberalization program was accelerated. Subsequently, Japan reduced the number of its illegal quotas and announced a schedule for the elimination of additional restrictions. More recently, the United States has continued to press Japan to remove unjustifiable import restrictions, particularly in the wake of the large deficit in U.S. trade with that country. In response to representations from the United States and from other countries, Japan reduced the number of items subject to residual import restrictions from 120 in April 1969 to 90 at the end of 1970 to 40 at the end of 1971 and to 33 as of April 1973. The United States is continuing to press Japan on further reducing its import restrictions.

In late 1970, the United States consulted with Denmark under article XXIII concerning an embargo on corn imports announced for the 1970–71 season. Denmark agreed to eliminate the restriction and gave assurances that no new measures would be adopted during the crop year. The United States accordingly agreed to drop its GATT case.

Directly following the July 1972 consultations with the EC on DISC (noted above) consultations under article XXIII:1 were held at U.S. request with France, Belgium, and the Netherlands regarding certain of their tax practices and the relationship of such practices to exports. These countries denied the U.S. claim that their tax systems result in prohibited subsidies. Since no agreement was reached, the United States has kept under consideration what future action may be appropriate.

In the past year, the United States has used article XXIII:2 procedures in three cases. These are with respect to certain quota restrictions maintained by France, with respect to quotas maintained by the United Kingdom on certain products from dollar area countries; and with respect to compensatory taxes charged by the European Community in excess of GATT bindings.

In the case of the United Kingdom: The United Kingdom continues to apply quotas on certain products imported from 18 so-called dollar area countries, primarily Caribbean countries. Following unsatisfactory conclusion of article XXIII:1 bilateral consultations, the United States requested the GATT Council to consider the problem under article XXIII:2, to rule on the legality of the quotas, to recommend their removal, and to authorize U.S. withdrawal of concessions on products of United Kingdom origin. An impartial panel was formed to consider the matter under article XXIII:2. The panel issued an interim report to the contracting parties and recommended that the United States and the United Kingdom consult bilaterally once more in an effort to resolve the matter. It promised to issue a final recom-

mendation within 30 days if bilateral agreement on a solution could not be reached.[1]

In the case of France: In September 1972, the United States referred to the GATT Council, under article XXIII: 2, the matter of quota restrictions applied against U.S. products in contravention of the general agreement. The United States requested authorization to withdraw concessions on products of French origin. Following U.S. referral of the problem to the GATT, France entered bilateral consultations concerning the amount of withdrawals to be made. During the course of these consultations, the United States was able to negotiate an agreement with the Government of France to phase out quota restrictions on all but one of the products on which we desired solutions. On six products liberalization will occur on January 1, 1975. One other product will be liberalized on January 1, 1978. During the interim period, quotas will be increased by 35 percent each year. Each yearly increase will be based on the previous year's enlarged quota. Discussions continue on one remaining product. Since withdrawals do not help producers of items subject to quotas, the Government of France's agreement on liberalization is very important to U.S. exporters of the products in question.

In the case of the European Community: The European Community (EC) authorized the imposition of compensatory taxes on agricultural products to offset the effect of exchange rate changes, made by some of the member states, on the operation of the EC's common agricultural policy. In many cases the addition of a compensatory tax to the duty caused the charge collected on the import to exceed the bound rate. Informal representations to the EC by the United States and a formal written representation under article XXIII: 1 failed to resolve the problem. Thus the United States requested for contracting parties to investigate the matter and take appropriate action. Some $40 million of U.S. exports appeared to be affected. Following our request and before the contracting parties could consider the matter, the EC agreed to stop collecting the compensatory taxes on at least 98 percent of those products that the United States complained about. The EC also committed itself to rescind the remaining taxes as soon as feasible.

Conclusion

The GATT lays great stress on consultation and conciliation for the resolution of trade disputes. It does, however, envisage circumstances under which retaliation would be permitted. This gives force to the procedures for consultation to help solve bilateral trade problems and to keep at a minimum the instances when the injured country finds it necessary to resort to the sterner measures possible under article XXIII: 2 to protect its trade interests.

[1] Subsequent to the completion of this paper, the United States and United Kingdom reached agreement on a program for elimination of the quotas and the United States withdrew its complaint against the United Kingdom.