

## MEMORANDUM

January 24, 2002

TO: Calman Cohen  
President  
Emergency Committee for American Trade

FROM: Warren H. Maruyama

RE: **WTO Compensation Requirements for U.S. Steel Safeguard**

Under the World Trade Organization (WTO) Agreement on Safeguards, the United States would immediately owe billions of dollars in compensation to our WTO trading partners if 20 to 40% duties are imposed under Section 201<sup>1</sup> on imported steel, as recommended by the U.S. International Trade Commission (USITC). While the WTO Safeguards Agreement provides a 3-year grace period on compensation, this grace period does not apply to key product categories, *e.g.* flat-rolled steel, because U.S. import volumes have declined in absolute terms. While the WTO does not provide a specific methodology for calculating compensation, the Hufbauer/Goodrich estimate of roughly \$2.12 to \$3.88 billion per year in U.S. compensation provides reasonable parameters for the Bragg-Devaney recommendation.

If the U.S. fails to provide acceptable compensation, Article 8:2 of the Safeguard Agreement authorizes steel-exporting WTO Members to impose retaliatory tariffs or restrictions on a "substantially equivalent" amount of U.S. manufactured and/or farm exports. These retaliatory duties could go into effect in 120 days after the President imposes restrictions on imported steel under Section 201. While the U.S. could challenge such retaliation under the WTO's Dispute Settlement Understanding (DSU), such a dispute would take a minimum of 2 1/2 years (or probably more) to resolve. During this period, retaliatory duties on U.S. exports would remain in effect. Regardless, our trading partners would have a right to retaliate for the full amount of trade damage if U.S. steel safeguards are extended beyond 3 years as recommended by some USITC Commissioners. Thus, the level of foreign retaliation against U.S. exports would balloon sharply under both the Bragg-Devaney and USITC majority recommendations in

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<sup>1</sup> 19 U.S.C. 2251 *et seq.*

July 2005. Such retaliation would likely be targeted against leading U.S. exports – major U.S. industries or farm products -- in order to maximize the political pressure on the Administration to phase out Section 201 steel import relief.

**1. The United States Would Owe Billions of Dollars in Compensation for Steel Import Restrictions Under WTO Rules.**

Under GATT 1994 Article XIX, also known as the "escape clause," WTO Members are permitted to impose safeguard measures "[i]f, as a result of unforeseen developments . . . any product is being imported into the territory of that contracting party in such increased quantities and under such circumstances as to cause or threaten serious injury to domestic producers in that territory of like or directly competitive products. . . ." <sup>2</sup> Thus, under the GATT 1994, a WTO Member has a right to impose safeguard duties or quotas on imported steel as long as the action complies with the criteria set out in Article XIX. Article XIX, however, also requires that a WTO Member compensate its trading partners for any trade damage arising from such import restrictions. If a mutually-acceptable compensation package cannot be worked out, these exporters are entitled to "suspend" substantially equivalent concessions, *i.e.* retaliate by imposing equivalent restrictions on the party taking the safeguard action. These compensation and retaliation rights are spelled out in Article XIX:3(a):

If agreement among the contracting parties with respect to the action is not reached, the contracting party which proposes to take or continue the action shall, nevertheless, be free to do so, and if such action is taken or continued, the affected contracting parties shall then be free, not later than 90 days after such action is taken, to suspend, upon the expiration of 30 days . . . the application to the trade of the contracting party taking such action . . . of substantially equivalent concessions or other obligations under this Agreement the suspension of which the Contracting Parties do not disapprove.<sup>3</sup>

As Professor Jackson explains in World Trade and the Law of GATT:<sup>4</sup>

The escape clause action, taken by the party claiming injury from imports, authorizes a retaliatory response from other contracting parties under Article XIX, paragraph 3 . . . If no agreement [on compensation] is reached, however, the invoking country [i.e. the U.S.] has the right to proceed with its withdrawal privileges under Article XIX and the exporting country is given a right to respond in kind.

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<sup>2</sup> General Agreement on Tariffs and Trade, Article XIX:1, BISD, Vol. IV (1969).

<sup>3</sup> Id. at Paragraph 3(a) (emphasis added).

<sup>4</sup> Jackson, World Trade and the Law of GATT, p. 565-66 (1969).

In the Uruguay Round, the WTO adopted a Multilateral Agreement on Safeguards,<sup>5</sup> which clarifies and expands "escape clause" rights and obligations under GATT Article XIX. Specifically, the Safeguard Agreement provides a 3-year grace period on compensation for a valid safeguard measure.<sup>6</sup> While this 3-year grace period is a major breakthrough and has helped revive Article XIX, it is limited to situations in which there has been an absolute increase in imports and the underlying safeguard measure conforms to WTO obligations. Article 8:3 of the Safeguards Agreement provides:

The right of suspension referred to in paragraph 2 shall not be exercised for the first three years that a safeguard measure is in effect, provided that the safeguard measure has been taken as a result of an absolute increase in imports and that such a measure conforms to the provisions of this Agreement.<sup>7</sup>

While the WTO does not specify how an "absolute increase in imports" would be measured,<sup>8</sup> other provisions of the WTO Agreement refer to a "prior representative period" for assessing serious injury and determining the minimum quantity of imports permitted under a quota:

If a quantitative restriction is used, such a measure shall not reduce the quantity of imports below the level of a recent period which shall be the average of imports in the last three representative years for which statistics are available, unless clear

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<sup>5</sup> Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations, Agreement on Safeguards (Marrakesh, 15 April 1994).

<sup>6</sup> The steep decline in use of global safeguard measures in recent decades, and accompanying increase in antidumping (AD) and countervailing duty (CVD) measures under GATT Article VI, was often attributed to Article XIX's compensation requirement. Under GATT Article VI, no compensation is required for an AD/CVD measure. By deferring compensation for 3 years, the WTO sought to revive the use of legitimate global safeguards under GATT Article XIX to promote positive adjustment.

<sup>7</sup> WTO Agreement on Safeguards, Article 8:3 (1994) (emphasis added).

<sup>8</sup> It is clear, however, that a relative increase in imports would be insufficient for purposes of Article 8:3. Uruguay Round Agreements, Texts of Agreements, Implementing Bill, Statement of Administrative Action, and Required Supporting Statements, *Message from the President of the United States, Statement of Administrative Action*, 103<sup>rd</sup> Cong. 2d Sess., House Report No. 103-316, Vol. 1, p. 958 (1994) ("This provision does not apply when the increase in imports is relative, rather than absolute.") (hereinafter cited as "URAA Agreements").

justification is given that a different level is necessary to prevent or remedy serious injury.<sup>9</sup>

In short, steel-exporting WTO Members would likely rely on a prior representative period consisting of the last 3 years – the period from 1998 to 2000 – to determine whether the U.S. owes them compensation. The USITC's report shows that import volumes declined from 1998-2000 in key product categories, particularly flat-rolled. If so, the United States would immediately owe billions of dollars in compensation under the WTO Safeguard Agreement since we cannot invoke the 3-year safe harbor of Article 8:3.

**2. The United States Must Provide Compensation or Face WTO-Sanctioned Retaliation Against Several Billions Dollars of U.S. Exports.**

If our WTO trading partners find that any compensation offered by the United States is inadequate, they have a right unilaterally to retaliate against U.S. exports by suspending substantially equivalent concessions. This right is set out in Article 8:2 of the WTO Safeguards Agreement, which provides:

If no agreement [on compensation] is reached within 30 days in the consultations under paragraph 3 of Article 12, then the affected exporting Members shall be free, not later than 90 days after the measure is applied, to suspend, upon the expiration of 30 days from the day on which written notice of such suspension is received by the Council for Trade in Goods, the application of substantially equivalent concessions or other obligations under GATT 1994, to the trade of the Member applying the safeguard measure [i.e. the United States], the suspension of which the Council for Trade in Goods does not disapprove.<sup>10</sup>

As explained in the U.S. Statement of Administrative Action for the Uruguay Round Agreements, "Article 8.2 reaffirms the right of WTO members that export to retaliate against a WTO member taking safeguards measures against their products."<sup>11</sup> This right is self-executing. It is not subject to prior WTO approval nor does it require completion of WTO dispute settlement proceedings.

While WTO "compensation" would normally takes the form of U.S. tariff reductions on an equivalent amount of other non-steel products, such compensation could prove

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<sup>9</sup> WTO Safeguards Agreement at Article 5:1 (emphasis added).

<sup>10</sup> Id. at Article 8:2 (emphasis added).

<sup>11</sup> URAA Agreements, *Message from the President of the United States, Statement of Administrative Action*, 103<sup>rd</sup> Cong. 2d Sess., House Report No. 103-316, Vol. 1, p. 958 (1994).

extremely difficult to negotiate. Our trading partners must accept any U.S. compensation proposal as sufficient to offset their losses in steel. We cannot force them to accept a U.S. proposal. The key difficulty is that U.S. tariffs on most products have been eliminated or cut to *de minimus* levels in previous GATT rounds, starting in 1947. Accordingly, the remaining high U.S. tariffs tend to cover import-sensitive products, such as textiles, sugar, citrus, and light trucks. An increase in import competition in these sectors would provoke vigorous objections from the U.S. industries involved and thus would carry a significant political cost, particularly since the U.S. tariff compensation (or foreign retaliation against U.S. exports) could go into effect shortly before a pivotal Congressional election and key votes on whether to give the President Trade Promotion Authority (TPA) to participate in a new round of WTO negotiations.

In short, given the political obstacles to a mutually-acceptable compensation package that would require sharply reducing existing levels of protection for import-sensitive U.S. industries and farm commodities, there is a high risk that our WTO trading partners would end up exercising their retaliatory rights under Article 8:2 of the WTO Safeguards Agreement and Article XIX:3(a) of GATT 1994. In practical terms, this means that key steel exporters, *e.g.* EU, Brazil, Japan, Korea, China, India, and South Africa, would impose restrictions on a substantially equivalent amount of U.S. manufactured or agricultural exports. While the precise amount of compensation/retaliation required under WTO rules may be open to interpretation, the Hufbauer/Goodrich figure of \$2.12 to \$3.88 billion in annual compensation for the Bragg-Devaney option provides a reasonable estimate of the likely parameters.<sup>12</sup> Under Article 8:2, these retaliatory duties could take effect 120 days after the President imposes safeguard restrictions on imported steel under Section 201, as recommended by the USITC.<sup>13</sup>

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<sup>12</sup> There are no WTO rules on how retaliatory measures should be structured. Typically, foreign governments seek either to protect import-sensitive domestic industries or farm commodities by restricting U.S. market access, or generate political pressure to phase out a safeguard measure as quickly as possible by targeting important U.S. industries. *See e.g. Proclamation to Terminate Temporary Duties on Imports of Broom Corn Brooms* (December 3, 1998)(Mexican retaliation for U.S. safeguard on broom corn brooms targeted U.S. high-fructose corn syrup, wood and paper products, and flat glass).

<sup>13</sup> Before the Uruguay Round, the U.S., European Union, and other powerful GATT Contracting Parties sometimes could avoid compensation by negotiating voluntary restraint agreements (VRAs) or orderly marketing arrangements (OMAs), in which foreign governments effectively waived their compensation rights under GATT Article XIX. This approach, however, was foreclosed by the WTO Safeguards Agreement, which strictly prohibits VRAs, OMAs, and other “gray area” measures. In effect, in the Uruguay Round, the U.S. and EU secured a 3-year grace period on compensation. In exchange, the developing countries secured a prohibition on VRAs. WTO Agreement on Safeguards, Article 11:1(b) (1994) (A WTO Member “shall not seek, take, or maintain any voluntary export restraints, orderly marketing arrangements or other similar measures on the export or import side. . .”).

**3. A WTO Dispute Settlement Challenge to Foreign Retaliation Against U.S. Exports Would Take a Minimum of 2 1/2 Years.**

Under Article 8.3 of the WTO Safeguards Agreement states, our trading partners can impose retaliatory restrictions 120 days after the U.S. safeguard goes into effect, unless disapproved by the WTO Council on Goods. Accordingly, the burden would be on USTR to persuade the WTO Council to block such retaliation. The prospects for persuading the WTO Council to disapprove such retaliation under Article 8:3 appear remote.<sup>14</sup> Key WTO Members, e.g. the EU, have already expressed strong objections to the USITC's recommendation. Since the GATT/WTO traditionally operates on the basis of consensus, objections from one or more WTO Members would likely sink any effort to block retaliation in the WTO Council. Since U.S. tariffs or quotas on imported steel would damage many key WTO Members, such a request is unlikely to engender much sympathy.

While the United States could also challenge such retaliation as unwarranted or excessive under the WTO Dispute Settlement Understanding (DSU), such a dispute would take a minimum of 2 1/2 years or more to resolve. During this period, the duties on U.S. exports would remain in effect.<sup>15</sup> Moreover, if U.S. duties on imported steel are imposed for 4 years, as recommended by Commissioners Bragg, Devaney, Miller, and Hillman, the U.S. would clearly owe additional compensation for the full amount of trade damage after the 3<sup>rd</sup> year and for any additional years such protection remains in effect. The WTO's grace period on compensation is limited to 3 years under the terms of Article 8:3. Thus, the amount of potential retaliation would balloon sharply in the 4<sup>th</sup> year, regardless of the outcome of a WTO dispute.

In contrast, ECAT's recommendation that the Administration and Congress work together on a bold, innovative bipartisan program to assist dislocated steel workers and retirees would avoid the need for compensation and the risk of retaliatory duties on billions of dollars of U.S. manufactured and farm exports. Such an approach would address the industry's legacy costs; facilitate a market-based consolidation and restructuring of the domestic steel industry; protect the pensions and health care benefits of dislocated steel workers and retirees; and avoid the high cost of import restrictions under Section 201 for U.S. exporters, downstream steel-consuming U.S. industries, U.S. workers and consumers.

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<sup>14</sup> The GATT/WTO traditionally has operated on the basis of consensus. *See e.g.* URAA Agreements, *Message from the President of the United States, supra* at p. 677 ("Article IX:1 of the WTO Agreement requires the WTO to continue the practice of decision-making by consensus followed under GATT 1947.")

<sup>15</sup> Under the DSU, it normally takes 15-18 months, and sometimes much longer, to complete Panel, Appellate Body, and Dispute Settlement Body (DSB) procedures. Thereafter, the losing party has a "reasonable" period of time – generally 15 months -- to comply under DSU Article 21. During this period, retaliatory duties on U.S. exports would remain in effect.

