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Report on U.S. Obligations under GATT

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**American Bar Association
Section of International Law
and Practice
Report to the House of Delegates**

**Report on U.S. Obligations under
GATT***

RECOMMENDATION

BE IT RESOLVED, That the American Bar Association urges the Government of the United States to avoid actions, either administrative or legislative, that are inconsistent with its obligations under the General Agreement on Tariffs and Trade;

BE IT RESOLVED, That the American Bar Association (a) urges that the section of the Superfund Amendments and Reauthorization Act of 1986 (I.R.C. § 4611 (1986)), which imposed a tax on petroleum products with a higher rate of tax on imported petroleum products than on domestic crude oil, thereby discriminating against imports in contravention of Article III of the General Agreement on Tariffs and Trade, should be repealed or amended to avoid such discrimination;

(b) urges that the tax on imports of certain chemical derivatives of feedstocks (I.R.C. § 4671 (1986))—as distinguished from petroleum products—under the Superfund program be administered in conformity with the General Agreement on Tariffs and Trade, including the principle of national treatment in Article III; and

BE IT FURTHER RESOLVED, That the American Bar Association expresses serious concern about actions of retaliation by the Government of the United States which may be inconsistent with obligations under and procedures of the General Agreement on Tariffs and Trade, such as those directed towards Japan in regard to the semiconductor agreement.

*This report and recommendation was prepared by Frank Schuchat of the Section's Committee on International Trade.

REPORT

Introduction

Current global economic conditions have placed unusual strain on the world trading system. In light of the attention being paid to legislative measures to enhance United States competitiveness, and recognizing the ongoing efforts of the United States Government to persuade governments of other nations to eliminate, or at least reduce, barriers to open and nondiscriminatory world trade, it is important that the United States observe and be perceived to observe the obligations it undertakes in multilateral and bilateral trade agreements, and in particular, the provisions of the General Agreement on Tariffs and Trade ("GATT").

Part I

In October 1986, the United States Congress adopted and the President signed the Superfund Amendment and Reauthorization Act of 1986, Pub. L. No. 99-199, 100 Stat. 1613 (1986) (the "Act"), which amended the Comprehensive Environmental Response, Compensation, and Liability Act of 1980, 42 U.S.C. sec. 9601 *et seq.*, and authorized the continuation of the large-scale program commenced in 1980 to address certain environmental problems, in particular the clean-up of hazardous waste disposal sites.

The legislation passed by the Senate on October 3, 1986, and by the House of Representatives on October 8, 1986, reflected more than one year of work by a Conference Committee (House Conference Report No. 99-962, October 3, 1986 [to accompany H. R. 2005]). The principal controversy in Conference was the means for raising revenue for the Hazardous Substance Response Trust Fund ("Superfund"). Proposals for a broad-based tax were resisted by the Executive Branch. The concept of a waste-end tax, with a formula similar to a value-added tax, was also considered but rejected. The method for funding ultimately adopted by the Conference Committee draws from several sources including, *inter alia*, an increased tax on petroleum products (including crude oil), continuation of the existing tax on chemical feedstocks, and a new tax on imported chemical derivatives.

Petroleum Products Tax

The tax on domestic petroleum products, contained in Section 512 of the Act, is imposed under the Internal Revenue Code of 1954, Section 4611, and is generally set at a rate of 8.2 cents per barrel; however, the

rate of tax on imported petroleum products is 11.7 cents per barrel. The statements of Members of Congress during the floor debate on the Conference Report demonstrate that the purpose of enacting the 3.5 cents per barrel differential was to protect the domestic petroleum industry which, under the Act, will provide a significant portion of the \$8.5 billion needed to fund the Superfund program over a five-year period.

The Senate conferees were concerned about imposing a substantially increased tax burden on the domestic petroleum industry at a time when it was contending with the consequences of a significant decline in the world price of oil. Some conferees feared that this tax would exacerbate the economic problems of the oil industry, as well as encourage movement offshore by industries that consume the petroleum products subject to the tax.

Article III of the GATT provides that a Contracting Party must provide national treatment with respect to internal taxation and regulation for products of other Contracting Parties imported into its territory. (See Appendix.) The imposition of the tax on petroleum products, with one rate for domestic products, and a higher rate for imported products, is a violation of Article III of GATT.

Section 512 of the Act imposes an internal tax on imported and domestic products in such a way as to afford protection to domestic production, in violation of Article III:1. The imposition of the tax on imported petroleum products at a rate in excess of that applied to like domestic products is inconsistent with Article III:2. Section 512 is also inconsistent with the principle of national treatment expressed in Article III:4.

Compared to the daily fluctuations in the benchmark prices for a barrel of oil, the 3.5 cents per barrel differential may not be considered meaningful. Nonetheless, given the obligation of the United States under the GATT to provide national treatment to the products of other contracting parties, the enactment of the differential tax is a most troubling development because it disregards fundamental international legal obligations of the United States.

Section 512 of the Act cannot be justified under the rules governing international trade and a consequence of its passage will be to undermine the stature of the United States as a leader among nations in the defense of GATT and in the promotion of a fair and open world trading system. This will, in turn, impair the effectiveness of our trade negotiators in their efforts to dissuade other nations from violating the rules of GATT and the principles of international trade law.

The legality of the Superfund petroleum product import tax under GATT was challenged in GATT in February 1987 by Canada, Mexico and the European Economic Community ("EEC"). This issue is now before a dispute resolution panel convened on the basis of the complaints of those

Contracting Parties. The ultimate result of the GATT dispute resolution proceeding could be a recommendation by the GATT Contracting Parties that the United States conform its law to the national treatment requirements of GATT Article III or provide compensation, in the form of reduced tariffs, for a violation of Article III. In the latter case, some sector of the U.S. economy unrelated to petroleum products may have to suffer the cost of this measure. This unfortunate effect of an ill-conceived statutory provision could have been avoided had the obligations of the United States under GATT been more carefully considered in enacting this import tax.

Chemical Derivatives Tax

In addition to imposing a discriminatory tax on petroleum product imports under Section 512, Section 515 of the Act imposed a tax on imported chemical derivatives (I.R.C. § 4671 (1986)) at a rate equivalent to the amount of the tax which would have been imposed on the taxable chemicals used as materials in the manufacture or production of the derivative, i.e., the feedstock, if the feedstock had been sold in the United States for use in the manufacture or production of the chemical derivative.

Under the prior law, although crude oil, certain petroleum products or taxable feedstock chemicals imported into the United States were subject to the petroleum or feedstock tax, no tax was imposed on imports of products derived from those materials. The economic effect of a tax discriminating against domestic products is obvious. Section 515 is an effort to ensure that products of the domestic chemical industry are treated no less favorably than imports for tax purposes.

However, under the Act, if an importer of a chemical derivative does not furnish sufficient information about the product he imports to permit the Treasury to determine the appropriate tax, then the amount of tax imposed on the imported chemical derivative is 5 percent of the customs value of the imported chemical derivative.

The EEC contends that the tax on imported chemical derivatives as well as the tax on petroleum products—is in contravention of Article III of the GATT. The EEC complains that, rather than stating a clear tax level, Section 515 shifts to the importer the burden of proof in establishing the proper level. The EEC alleges that this procedure may cause administrative problems, including delays, and result in a loss of confidentiality concerning the manufacturing process of derivatives. Finally, the EEC asserts that the 5 percent rate applied in the absence of satisfactory documentation is higher than the tax imposed on equivalent domestic chemical derivatives.

The legality under GATT of Section 515 of the Act presents a more complicated question than does Section 512. The manner in which Section 515 is administered will determine whether or not it is consistent with the GATT obligation to accord national treatment to the products of other contracting parties. It should be noted that this provision of the legislation does not take effect until January 1, 1989. The legislation directs the Secretary of the Treasury to conduct a study of issues related to implementation, in consultation with both the Administrator of the Environmental Protection Agency and the International Trade Commission, to be submitted to Congress no later than January 1, 1988. There is sufficient time to accomplish the objective of the Congress in adopting Section 515 without violating GATT rules, either by administrative action or technical corrections legislation. It is important that this result be achieved.

Part II

On June 14, 1985, the Semiconductor Industry Association ("SIA") filed a petition with the United States Trade Representative ("USTR") seeking an investigation under Section 301 of the Trade Act of 1974 (19 U.S.C. 2411), with respect to acts, policies and practices of the Government of Japan which it alleged had severely injured the United States semiconductor industry. The USTR initiated an investigation under Section 301 of the Trade Act of 1974 on July 11, 1985, based on the SIA petition.

At about the same time, three separate investigations were initiated by the International Trade Administration of the Department of Commerce ("ITA"), and the United States International Trade Commission ("ITC"), concerning allegations of dumping with respect to imports of specific semiconductor products from Japan. These three investigations were: *64k Dynamic Random Access Memory Components from Japan* (ITC Investigation 731-TA-270, 50 Fed. Reg. 27498, July 3, 1983; ITA Investigation A-588-503, 50 Fed. Reg. 29458, July 19, 1985); *Erasable Programmable Read Only Memories from Japan* (ITC Investigation 731-TA-288, 50 Fed. Reg. 41230, October 9, 1985; ITA Investigation A-588-504, 50 Fed. Reg. 43603, October 28, 1985); *Dynamic Random Access Memory Semiconductor (DRAMs) of 256 Kilobits and above from Japan*, ITC Investigation 731-TA-300, (50 Fed. Reg. 51613, December 18, 1985; ITA Investigation A-588-505, 50 Fed. Reg. 51450, December 17, 1985). The first two of these investigations were initiated upon receipt of petitions from domestic producers, the last investigation was commenced by the ITA under statutory authority for self-initiations.

Following negotiations between the Government of the United States and the Government of Japan over a period of more than one year, an

Agreement Concerning Trade in Semiconductor Products ("the Arrangement") was concluded on September 2, 1986. In entering into the Arrangement, the Government of Japan joined with the Government of the United States in declaring "the desire to enhance free trade in semiconductors on the basis of market principles and the competitive positions of the semiconductor industries in both the United States and Japan." A commitment was made by the Government of Japan to impress upon semiconductor producers and users in Japan the need to provide increased market access opportunities in Japan for foreign-based semiconductor firms and to provide further support for expanded sales of foreign-produced semiconductors in Japan through establishment of a sales assistance organization and promotion of stable long-term relationships between Japanese purchasers and foreign-based semiconductor producers. In addition, the Government of Japan also committed to prevent sales of semiconductor products at less than fair value through monitoring of costs and prices for semiconductor products exported from Japan and to encourage Japanese semiconductor producers to conform to antidumping principles.

Sales at less than fair value were found in preliminary determinations in all three antidumping investigations and antidumping duties were imposed on imports of 64K DRAMs. At the time the Arrangement was concluded on September 2, 1986, the antidumping investigations of EPROMs and 256K and above DRAMs were suspended and no additional duties were imposed on imports of those products. A program of monitoring the foreign market value and the United States price of certain semiconductor imports, on a quarterly basis, was commenced by ITA, as a means for preventing further sales at less than fair value.

Allegations subsequently were made by U.S. producers and by SIA that the Arrangement was not being observed by Japan. On numerous occasions between September 1986 and April 1987 consultations were held between the Government of Japan and the Government of the United States in order to enforce U.S. rights under the Arrangement and to ensure that the Government of Japan would continue concerted efforts to fulfill its obligations.

On March 27, 1987, the President announced his intention to raise customs duties to a level of 100 percent *ad valorem* on as much as \$300,000,000 in Japanese imports to the United States in response to the lack of implementation or enforcement by the Government of Japan of major provisions of the Arrangement. The President also announced that the products against which retaliatory action would be taken would be selected after comment period ending April 14, 1987. The President stated that any sanctions taken would remain in effect until there is firm and continuing evidence that indicates that the Government of Japan is fully implementing and enforcing the Arrangement.

Following public hearings before an interagency group convened by the USTR between April 13-14, 1987 (52 Fed. Reg. 10275, March 31, 1987), the President issued a Proclamation 5631 of April 17, 1987 (52 Fed. Reg. 12412, April 22, 1987), setting forth an increase in the rates of duties for certain designated articles from Japan to 100 percent *ad valorem*. The President stated this action was based on his determination pursuant to Section 301 of the Trade Act of 1974 that implementation and enforcement of major provisions of the Arrangement was inadequate and inconsistent with the provisions of, or otherwise denied benefits to the United States under, a trade agreement and was unjustifiable and unreasonable and constituted a burden or restriction on United States commerce.

By its action of April 17, 1987 in raising customs duties unilaterally, the United States Government acted inconsistently with Article I (the MFN obligation) and Article II (the binding of customs duties obligation) of the General Agreement of Tariffs and Trade ("GATT"). Unless some exception authorizes this unilateral action, it can be contended that the United States has violated Articles I and II of the GATT.

Article XXIII of the GATT, concerning nullification or impairment of benefits under the GATT, permits a Contracting Party to suspend the application to any other Contracting Party of concessions or other obligations under GATT to respond to a failure to carry out obligations under GATT or to the existence of "any other situation." However, Article XXIII provides that the Contracting Party which believes that a benefit accruing to it directly or indirectly under the GATT is being nullified or impaired or impeded as a result of failure of another Contracting Party to carry out its obligations, should first make representations or proposals to the other Contracting Party, which must be given "sympathetic consideration."

If no satisfactory adjustment is effected between the Contracting Parties within a reasonable time, the matter may be referred to the Contracting Parties of the GATT, normally by submitting the dispute to a panel of experts. The Government of the United States, in seeking to enforce its rights under the Arrangement on semiconductors, did discuss compliance with the Arrangement with the Government of Japan before retaliation, arguably satisfying the requirement of representations. However, following the unsatisfactory outcome of these discussions, the United States did not commence in the GATT, pursuant to Article XXIII, the process which might have authorized the suspension of tariff concessions to Japan.

If the action of the Government of the United States in raising tariffs on Japanese goods unilaterally is not permitted under any exception to the rules of the GATT, then the action is of questionable authority. The decision of the Government of the United States to take this unilateral action without proper resort to applicable GATT procedures is not con-

sistent with the stature of the United States as a supporter of and adherent to GATT principles. Further, the decision to not articulate a basis consistent with GATT for the retaliation weakens the substantive position of the Government of the United States that the failure of the Government of Japan to honor its commitments under the Arrangement is inconsistent with the principles of international trade contained in the GATT.

Respectfully submitted,

Joseph P. Griffin
Chairman
February 1988

Appendix

Article III of the General Agreement on Tariffs and Trade *National Treatment on Internal Taxation and Regulations*:

1. The contracting parties recognize that internal taxes and other internal charges, and laws, regulations and requirements affecting the internal sale, offering for sale, purchase, transportation, distribution or use of products, and internal quantitative regulations requiring the mixture, processing or use of products in specified amounts or proportions, should not be applied to imported or domestic products so as to afford protection to domestic production.

2. The products of the territory of any contracting party imported into the territory of any other contracting party shall not be subject, directly or indirectly, to internal taxes or other internal charges of any kind in excess of those applied, directly or indirectly, to like domestic products. Moreover, no contracting party shall otherwise apply internal taxes or other internal charges to imported or domestic products in a manner contrary to the principles set forth in paragraph 1.

* * * * *

4. The products of the territory of any contracting party imported into the territory of any other contracting party shall be accorded treatment no less favorable than that accorded to like products of national origin in respect of all laws, regulations and requirements affecting their internal