

# CRS Report for Congress

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## Trade Retaliation: The “Carousel” Approach

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### Summary

Section 407 of the Trade and Development Act of 2000 (P.L. 106-200) requires the U.S. Trade Representative (USTR) to periodically revise the list of products subject to retaliation when another country fails to implement a World Trade Organization (WTO) dispute decision. This periodic revision of the product list has become known as “carousel retaliation.” The intent of switching products is to exert more pressure on a trading partner to comply with a WTO ruling. The impetus for more pressure came principally from U.S. banana and livestock exporters, who had become frustrated with the European Union (EU) and its repeated postponement of compliance with WTO dispute rulings. To date, the USTR has not revised a product list under Section 407, but credits the threat of action under carousel authority with helping to resolve the banana case, and says that carousel authority might be used as leverage in the future. An EU challenge of U.S. carousel retaliation still stands in the WTO dispute process.

### Setting the Stage: The WTO Banana and Beef Disputes

Many U.S. policymakers have expressed concern over the effectiveness of the WTO dispute resolution process to convince other countries to remove various trade barriers. Two WTO dispute cases were especially exasperating to U.S. exporters because of the length of time to decide the cases and the improbability that the losing party would change its practices. These involved banana and beef trade disputes with the European Union (EU).<sup>1</sup> They were the main reason that Congress considered alternative ways to pressure a trading partner to implement a WTO dispute decision.

All WTO disputes follow a procedure that normally takes about 2-3 years from start to finish. Disputes are administered by the WTO members, who act as the Dispute Settlement Body (DSB). Parties to the dispute first engage in consultations. If a satisfactory solution is not reached, the complainant may request a panel to hear the

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<sup>1</sup> For more information on these cases, see CRS Report RS20130, *The U.S.-European Union Banana Dispute* and CRS Report RS20142, *The U.S.-European Meat Hormone Dispute*, both by Charles E. Hanrahan..

dispute. Once a panel report is issued, it will be adopted by the DSB, unless a party to the dispute appeals it or all DSB members vote not to adopt it. If the report is appealed, the Appellate Body submits its findings, along with the panel's report as modified by the appeal, to the DSB, which will adopt the reports unless all DSB members vote not to do so. If the complaining party prevails, the losing party is given a "reasonable period of time" for implementation; an arbitrator might decide that time. The original panel can be called on to decide whether or not the losing party has implemented the decision. If a country does not implement the decision within the agreed upon time period, there are two possible alternatives for the complaining party. One is compensation, which is negotiated between the disputing parties. The other is suspension of concessions, or stated simply, retaliation. The complainant estimates its loss, the losing party can request arbitration on the level of the loss, and the DSB approves the final level.<sup>2</sup>

**Banana Case.** The WTO banana dispute began in 1995, the WTO's first year, but challenges of the EU banana regime had begun earlier.<sup>3</sup> The EU had a complicated import regime that gave preferences to banana imports from its former colonies and preferential licenses to European banana importers. In September 1995, the United States, Guatemala, Mexico, and Honduras requested consultations with the EU. Ecuador later joined the request. A panel was established and issued a report finding that the EU banana import regime violated certain WTO rules. The EU appealed the report. The Appellate Body upheld the panel's principal findings, and the DSU adopted the Appellate report. An arbitrator set a "reasonable time" for EU implementation at 15 months, or by January 1999. The EU argued that it came into compliance during the 15 months, but special panels to examine the question did not agree. The United States asked to suspend \$520 million in trade concessions. The EU requested arbitration. The arbitrators decided the amount should be \$191.4 million, and the DSB authorized the United States to suspend concessions in that amount.<sup>4</sup> On April 19, 1999, the United States imposed 100% tariffs on a list of eight items representing \$191.4 million in imports from the EU. [This case was resolved in April 2001. See **Recent Developments** below.]

In selecting items for the retaliation list, U.S. officials wanted to increase tariffs on items from EU countries that supported the banana regime. The higher tariffs would increase the total cost of the items and hurt EU exporters. To illustrate, U.S. officials selected "bath preparations, other than bath salts" as one of the items on the U.S. list. Before the increase in tariffs, the U.S. duty on imports of these items from the EU was 4.9% ad valorem. That rate rose to 100% in April 1999. The two leading EU exporters of bath preparations in 1998 were the United Kingdom and France. These countries not coincidentally were also the leading supporters of the EU banana regime. In the four quarters before the 100% tariffs were imposed, the United States imported \$7.6 billion in bath preparations from the United Kingdom and \$7.5 billion from France. In the four

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<sup>2</sup> For further information on the WTO dispute process, see CRS Report RS20088, *Dispute Settlement in the World Trade Organization: An Overview*, by Jeanne J. Grimmer.

<sup>3</sup> Several countries in Central and South America requested action on the EU banana regime in the early 1990s under the General Agreement on Tariffs and Trade (GATT), which was predecessor to the WTO. Those panel reports were not adopted.

<sup>4</sup> The DSB also authorized Ecuador to suspend concessions in the amount of \$201.6 million.

quarters after the imposition of 100% tariffs, U.S. imports fell to \$1.3 billion (83% decline) and \$4.1 billion (45% decline) respectively.

**Hormone Case.** In January 1996, the United States requested consultations with the EU on its directive on the use of hormones in livestock. The directive restricted imports of meat produced with hormones. The United States requested a dispute panel. (Canada also challenged the EU practice.) The panels reported that the EU ban was inconsistent with the WTO Sanitary and Phytosanitary Agreement. The EU appealed, and the Appellate Body upheld some of the panels' findings but reversed others. The DSB adopted the Appellate Body report and the panels' reports as modified. An arbitrator set a reasonable time for implementation at 15 months, or by May 1999. A month before the time expired, the EU said it may not be able to comply with the DSB ruling and would consider offering compensation by the deadline. The United States requested authorization for suspension of concessions of \$202 million. The EU requested arbitration, and arbitrators set the level at \$116.8 million. The DSB authorized suspension of concessions in that amount. On July 27, 1999, the USTR announced duties in the amount authorized by the DSB. The time from consultation to retaliation in both the banana and hormone cases was about three and a half years.

## The Congressional Response to Non-Compliance

On September 22, 1999, two months after the USTR increased tariffs in the hormone dispute, Senator Mike DeWine, on behalf of nine other Senators, introduced S. 1619, the Carousel Retaliation Act of 1999.<sup>5</sup> The bill proposed an amendment to the "section 301" trade program to require the USTR to "carousel," or rotate, a retaliation list when a country does not implement a WTO dispute settlement. It would have required the USTR to rotate items 120 days after the first list of items and every 180 days thereafter. The USTR would not be required to rotate the list if compliance was imminent, or if both the USTR and the petitioners agreed that rotating was not necessary in that particular case.

The legislation attempted to more effectively place pressure on foreign governments, through their domestic exporters, to change their position on the disputed practice. In his statement introducing S. 1619, Senator DeWine said that "...some [WTO] member nations are simply undermining this entire [dispute] process by refusing to comply with the final dispute settlement decision, even after losing their cases on appeal."<sup>6</sup> He said that the EU had ignored WTO rulings, ignored the U.S. retaliation, and now was preparing to subsidize the products that had been identified for U.S. retaliation. Farm and cattle groups and the Hawaii Banana Industry Association supported the bill.

The Senate approved the language of S. 1619 as an amendment to H.R. 434, a broader bill that also dealt with trade with the Caribbean and with Africa, on November 3, 1999. The House-approved version of H.R. 434 had not included a carousel provision. Section 407 of the conference report included the carousel provisions of the Senate bill and added a section on including reciprocal goods on the retaliation list. The conference

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<sup>5</sup> On October 1, 1999, Representative Larry Combest introduced identical bill H.R. 2991 with 12 original cosponsors.

<sup>6</sup> Congressional Record, Sept. 22, 1999, p. S11260.

report was released on May 3, 2000. The same day, a European spokesperson was quoted as saying that the carousel approach was a “very dangerous game” and that “the United States has to realize that one day this can be used against them.”<sup>7</sup> The House and Senate approved the conference report, and the President signed the measure on May 18, 2000 (The Trade and Development Act of 2000; P.L. 106-200).

#### Summary of Section 407 of P.L. 106-200

In the event that the United States initiates a retaliation list or takes other action under section 301 of the Trade Act of 1974 because a country fails to implement the recommendations of a WTO dispute settlement proceeding, the USTR shall periodically revise the list or action to affect other goods of the foreign country. The USTR is not to revise the list or action if the USTR determines that the country is about to implement the recommendation or if the USTR and the petitioning party agree that it is unnecessary. The USTR must review and revise the list 120 days after the date of the retaliation list and every 180 days thereafter. The USTR is to revise the list in a way that is most likely to result in the country’s implementing the recommendation or in achieving a satisfactory solution. The USTR is to include on retaliation lists the reciprocal goods of the industries affected by the failure of the foreign country(ies) to implement the recommendation made in the dispute.

Although U.S. banana and meat producers clearly supported the carousel provision, other U.S. businesses did not. Many businesses claimed that the carousel approach would create confusion and cause hardship for retailers by continually raising and lowering tariffs. On May 17, 2000, the day before the President signed H.R. 434 into law, Representative Robert Menendez introduced H.R. 4478, the Small Business Trade Protection Act, for himself and six others. The purpose of H.R. 4478 was to exempt certain small businesses from the increased tariffs and other retaliatory measures imposed against EU products in response to the EU banana and beef hormone regimes. The bill would have exempted small importers (defined generally as those with fewer than 100 employees) from the higher tariffs. It capped the exemption at 125% of the amount of the product imported the prior year from the countries concerned. It also provided that small importers who lost 50% or more of their revenues as a result of higher tariffs in the disputes would be eligible for full rebates of those tariffs. In related legislation, Representative Maxine Waters introduced H.R. 1362, a bill to bar the imposition of increased tariffs or other retaliatory measures against EU products in response to the banana regime of the European Union.

## Recent Developments

On May 26, 2000, just 8 days after the President signed the Trade and Development Act of 2000, the USTR issued a press release calling for comments on modification of the retaliation lists in the banana and beef hormone cases.<sup>8</sup> The press release said that the USTR was particularly interested in comments from small- and medium-sized businesses.

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<sup>7</sup> Pruzin, Daniel. EU Warns US Against Africa-CBI Provision Adopting ‘Carousel’ Approach to Retaliation. Bureau of National Affairs, Inc. *Daily Report for Executives*, May 4, 2000.

<sup>8</sup> USTR. USTR Announces Procedures for Modifying Measures in EC Beef and Bananas Cases. Press Release 00-41. May 26, 2000.

On the same day that the USTR issued its press release, EU members authorized the EU Commission to seek consultations with the United States on the carousel measure under WTO dispute procedures. On June 5, 2000, the EU made a formal request for consultations. In its submission requesting consultations, the EU argued that the carousel approach violated the WTO Dispute Settlement Understanding because the carousel approach was a unilateral means to impose trade retaliation and had not been agreed to multilaterally. The EU also argued that continual switching on the retaliation list caused more harm than that allowed under WTO dispute procedures. Other countries wanted to join the EU complaint. According to one report, 10 other countries, including Japan and Australia, sided with the EU at the July 27, 2000 meeting of the Dispute Settlement Body.<sup>9</sup>

In its press release calling for comments, the USTR said that the Administration's goal was to announce modifications to the retaliation lists by June 19, 2000, which was the first business day that was 30 days after Section 407 entered into force.<sup>10</sup> That date passed without modifications. A reason for delay might have been many U.S. companies used possibly targeted products as inputs or sold such products, and did not want these products on the list. According to one report at the time, "Over 500 requests were received from US businesses and members of Congress looking to protect US firms that rely on EU imports from being unduly hurt by the 100 percent duties."<sup>11</sup>

To date, the USTR has not revised the lists of products for retaliation. A serious concern has been a link between carousel retaliation and the U.S.-EU dispute over U.S. tax benefits for foreign sales corporations (FSC). In that dispute, the EU brought and won a case against the U.S. practice, and the United States amended its law in November 2000. While a decision was pending in the WTO on whether or not the amended U.S. law was in compliance with WTO rules, the EU and the United States informally agreed that the EU would not seek sanctions in the FSC case. The EU warned, however, that if the United States revised its product lists under the carousel provisions, the EU would ignore the informal agreement and pursue sanctions. In July 2001, the WTO ruled that the U.S. amendment was not WTO-compliant. The United States appealed the ruling, but lost its appeal on January 14, 2002. The EU and the United States continue to discuss the FSC case.

In April 2001, the United States and the EU reached an agreement in the banana dispute. As part of the agreement, the United States agreed to suspend its retaliatory tariffs from July 1, 2001. Revision of the retaliation list in this case then will no longer be an issue. In the hormone case, however, retaliatory tariffs remain in place. European officials have mentioned possible compensation in the form of increased market access for U.S. hormone-free beef, but nothing has been decided. In a hearing before the House Agriculture Committee on May 23, 2001, U.S. Trade Representative Zoellick reportedly

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<sup>9</sup> U.S. Faces EU on 'Carousel' and Bananas. Trade Reports international Group. *Washington Trade Daily*. July 28, 2000.

<sup>10</sup> The conference report to accompany H.R. 434 (H.Rept. 106-606) stated that for cases in which the USTR had already taken a retaliatory measure and the initial statutory deadline had already passed, conferees expected the USTR to take initial action no later than 30 days after enactment.

<sup>11</sup> 'Carousel' List Still Held Up. Trade Reports International Group. *Washington Trade Daily*. Aug. 2, 2000.

said that the carousel authority had been used successfully as a tool in the banana case, and that it might be used in other disputes in the future.<sup>12</sup>

## Policy Considerations

There are at least three policies to consider in relation to the question of non-compliance with a WTO dispute decision. One policy is acceptance of non-compliance under the current WTO dispute procedures. The General Accounting Office (GAO) has found that a majority of WTO disputes involving the United States have resulted in greater market access or more protection of intellectual property rights.<sup>13</sup> So, the WTO dispute process generally has benefitted U.S. interests. However, in a few cases, the outcome has not been greater market access. As the banana and hormone cases showed, a WTO dispute decision against a country does not necessarily result in the timely removal of its trade-restrictive practice. In those instances, the losing country may face higher tariffs or pay compensation, neither of which is a goal of dispute settlement.

A second policy is to seek further reform of multilateral dispute settlement procedures to increase the likelihood of compliance. If WTO Members find that retaliatory measures do not always effectively induce compliance and that this situation poses significant challenges to the overall effectiveness of the WTO dispute settlement system, Members may seek to revisit existing dispute remedies. The United States has already proposed in the current WTO dispute settlement review that the dispute procedures provide for the carouselling of retaliation lists. Some commentators have also suggested more aggressive monitoring of a defending party's compliance activities during the implementation period, especially where the period is long; automatic authorization of compensation for prevailing parties; and remedies for past damage resulting from violations of WTO obligations.

A third policy for consideration is unilateral action in an attempt to increase the chance of compliance. Unilateral action such as carousel retaliation might or might not improve compliance with WTO dispute decisions. If unilateral action is successful, the domestic industry is better off because it faces a less restrictive foreign market. If not successful, the domestic industry still faces the restrictive foreign market, U.S. consumers of imported goods on the retaliation list have to pay higher prices, and foreign exporters lose sales. In any case, continuous changes in retaliation lists could hurt some U.S. companies, especially small and medium-sized businesses and importers of items on the lists. The EU challenge in the WTO also could have international consequences. For example, if the U.S. practice is upheld, will other countries impose similar measures? Depending upon the point of view, carousel retaliation promotes the WTO by strengthening the dispute process, or undermines the multilateral system through unilateral action.

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<sup>12</sup> Yerkey, Gary G. U.S. Will Use 'Carousel' Law as 'Leverage' to Open Foreign Markets, USTR Zoellick Says. Bureau of National Affairs, Inc. *International Trade Reporter*. May 31, 2001.

<sup>13</sup> U.S. General Accounting Office. World Trade Organization: Issues in Dispute Settlement. Report to the Chairman, Committee on Ways and Means, House of Representatives. August 2000. GAO/NSIAD-00-210. P. 8