

Working Party on GATS Rules

EXAMPLES OF SITUATIONS IN WHICH EMERGENCY
SAFEGUARD ACTION MAY BE TAKEN

Note by the Secretariat

I. INTRODUCTION

1. In order to assist the Working Party on GATS Rules in its deliberations on an emergency safeguard mechanism under Article X of the GATS, the Secretariat was asked to provide hypothetical or, if available, empirical examples of situations pertaining to services trade in which emergency safeguard action may be taken.

2. In responding to the Working Party's request, the Secretariat was confronted with a problem. To establish whether a situation, hypothetical or real, qualifies as one in which safeguard action should or may be taken, it is necessary to have certain criteria. However, it is in order to determine what such criteria may be that examples have been sought by the Working Party. To overcome this problem of circularity, and so as not to preempt the result of further discussions, the Secretariat took a pragmatic approach which is not based on any particular *a priori* definition of safeguard situations. Rather, the following examples seek to capture a wide-range of situations, *other than those covered by existing GATS provisions dealing with exceptional circumstances*,¹ which might be potential candidates for emergency safeguard action.

3. There seems to be a certain degree of agreement that safeguard measures should be taken only if, as a result of *unforeseen developments* and of the effect of the obligations incurred by a Member under the GATS, imports of services take place in such increased quantities and under such conditions as to cause or threaten serious injury to national/domestic suppliers of like or directly competitive services. Furthermore, there seems to be agreement that measures should be *temporary*.

4. The Informal Note by the Chairman of 3 June 1997 identified four key questions concerning a possible emergency safeguard mechanism. As requested by the Working Party, this note focuses only on the second question, concerning the circumstances in which safeguard action could be taken. One of the other questions that the Working Party needs to deal with concerns on whose behalf safeguard action could be taken, i.e. domestic suppliers, regardless of nationality, or only national suppliers.² This issue, and the related issue of how like or directly competitive services and service suppliers would be defined, is not discussed in this paper, and the term "domestic industry" is used to refer to the intended beneficiaries of safeguard action. The paper also does not discuss the approach that could be adopted (conceptual and empirical) to demonstrate injury/adverse effects, and to establish a causal

¹These include Articles III bis, XII, XIV, XIV bis and Paragraph 2 of the Annex on Financial Services.

²A distinction can be made between "domestic" suppliers, which would include all suppliers *located in a Member's territory*, and "national" suppliers who are *either themselves nationals or owned by nationals of the Member concerned*.

link with increases in imports attributable to GATS commitments. The final question pertaining to remedies is only addressed to the extent that seemed directly relevant to the circumstances in which safeguard action could be taken.

5. The next Section provides examples of circumstances in which domestic industry may suffer injury. It illustrates the difficulty in establishing a causal link with increased imports when other contributing factors are present, and also raises the question of whether the nature of underlying factors should be relevant in determining the permissibility and the form of safeguard action. Section III takes a closer look at the notion of unforeseen developments and asks how far it is possible to make the notion legally meaningful. Section IV provides examples of the possible grounds for, and forms of, safeguard action and discusses the possibility of incorporating certain economic criteria in these determinations. Finally, Section V illustrates the distinction between government objectives which could be foreseen, and therefore seem to be candidates for *ex ante* scheduling, and those which seem more appropriately to be the basis for *ex post* safeguard action.

II. CIRCUMSTANCES IN WHICH DOMESTIC INDUSTRY MAY SUFFER INJURY

6. At one level, it is easy to construct examples. One could pick any industry, say the domestic basic telecommunications sector, and consider a large increase in imports of foreign services (say, call-back services) which cause injury, reflected in significantly reduced profits, output and employment. Similar examples could be constructed for other industries but this would probably not help greatly to advance the current discussion. In order to create more illuminating examples, it may be necessary to look deeper at the reasons for the increase in imports.

7. For expositional purposes it may be useful to distinguish between:

- developments which are primarily domestic in origin; and
- developments which are primarily foreign in origin.

Developments which are primarily domestic in origin

8. Consider the following examples of situations in each of which there is likely to be an increase in imports and injury to domestic industry, but the underlying factors differ. The examples are presented roughly in order of "increasing exogeneity", i.e. in order of diminishing responsibility of domestic industry and domestic government for the difficulties:

- (i) Management errors in, say, business services lead to significant increases in the costs of production and hence prices of services, as well as deterioration in their quality; or in the telecommunications or banking sector, firms fail to invest in new technologies, which hurts their competitiveness.
- (ii) Huge domestic wage increases outpace increases in labour productivity in a particular sector and push up production costs, and firms are not allowed to hire foreign workers.³ Or strikes disrupt production in a particular sector.

³Certain shocks may affect domestic firms more than foreign firms because inputs are non-tradable, either naturally or because of policy. Skis-slopes are an example of a naturally non-tradable input, while restrictions on international labour mobility are an example of policy-induced non-tradability.

- (iii) Government policies directly affect the competitiveness of firms: e.g. banks are forced to make bad or subsidised loans to failing industries or depressed regions; radio stations are induced to broadcast several hours of socially desirable but unpopular programmes, which do not interest advertisers.
- (iv) Government policies indirectly affect the competitiveness of firms: e.g. a sudden tightening of monetary policy leads to an increase in interest rates and appreciation of exchange rates.⁴
- (v) Domestic preferences shift towards foreign services or to services in which foreign service suppliers have a comparative advantage.⁵ There could, for instance, be an evaporation of trust in national educational institutions or national hospitals following certain isolated scandalous developments. Or there could be a sudden shift in preferences for foreign entertainers or audiovisual services.
- (vi) Adverse political or natural shocks affect firms: e.g. civil disorder or earthquakes lead to the damage of domestic industry; or, less dramatically, bad weather hurts the tourist industry.

9. Most negative domestic shocks are themselves responsible for injury to firms. But it could be argued in some cases that it is the surge in imports, consequent upon the worsened competitiveness of domestic firms, that is ultimately responsible for injury to the industry. For instance, increased wages may be the source of the problem for the domestic industry, but it is the ability of national consumers to substitute cheaper foreign services for more expensive domestic ones which ultimately leads to injury.

10. Notably, the Agreement on Safeguards, states in Article 4.2(b) that "When factors other than increased imports are causing injury to the domestic industry at the same time, such injury shall not be attributed to increased imports."⁶ The examples in this Section highlight the problems that may arise in establishing a causal link between injury to industry and increased imports even when the fact of such increase is not in dispute.

⁴See footnote 3 above. In this case, it is the segmentation of capital markets which makes domestic firms excessively vulnerable to domestic interest rate increases.

⁵It could also be that foreign preferences shift dramatically away from national suppliers.

⁶It may be relevant that the Agreement on Implementation of Article VI of GATT 1994, in Article 3.5 states that "The authorities shall also examine any known factors other than the dumped imports which at the same time are injuring the domestic industry, and the injury caused by these other factors may not be attributed to the dumped imports. Factors which may be relevant in this respect include, *inter alia*, the volume and prices of imports not sold at dumping prices, contraction in demand or changes in the patterns of consumption, trade-restrictive practices of and competition between the foreign and domestic producers, developments in technology and the export performance and productivity of the domestic industry."

11. Several further questions arise:

Should the reasons which contribute to the increase in imports be relevant in determining the permissibility or the form of safeguard action, or should attention be restricted to the increase in imports *per se* regardless of the underlying reasons?⁷

If the underlying reasons for increase in imports are deemed to be relevant, then further questions arise:

To what extent should safeguard action be used to remedy failings intrinsic to the domestic industry itself, such as poor management?

To what extent should governments be allowed to offset through safeguard action the adverse effects on domestic firms of direct and indirect policy interventions? Should they be required to modify the problem-causing policies themselves as a condition for safeguard action? In this context, should a distinction be made between policies which have economy-wide effects, and those which have industry-specific effects?

To what extent should governments be able to use safeguard action to insure domestic industry against the normal rough and tumble of free markets, caused by factors such as a shift in preferences or changes in the weather?

Developments which are primarily foreign in origin

12. In the above examples, increased imports were a consequence of certain domestic developments, and it was difficult to establish whether injury was attributable to increased imports alone. It is the foreign supplier performance-enhancing developments which may provide more straightforward examples. But there may be reason to distinguish between developments which are deemed "fair" and others which are not.

"Fair" trading developments

- (i) *Foreign technological innovations* make newer, better or cheaper foreign services available. For instance a foreign supplier provides new patented telecommunication services which affects the profitability of domestic suppliers. If the innovation will eventually become nationally available, then the difficulties are temporary. If however, the innovation will not be accessible for the economically meaningful future, then domestic industry may cease to be viable.
- (ii) Foreign service suppliers have exclusive access to *inputs which become cheaper*. Or foreign service suppliers in a sector benefit from improvements in complementary infrastructure, such as better road access to tourist resorts, or enhanced airport or port capacity facilitating multi-modal transport.
- (iii) Effective advertising by foreign service suppliers induces large *shifts in demand* towards their services. This could happen in any sector. e.g. audiovisual, tourism or financial services.

⁷In the goods context, the question of establishing a causal link between injury and increase in imports in the presence of other contributing factors has been addressed, but no further distinction has been made between the underlying causes for the increase in imports.

Some questions mirror the ones raised in the previous section:

To what extent should governments be able to use safeguard action to insure domestic industry from the uncertainty inherent in free markets, caused by factors such as a changes in technology, input prices and consumer preferences?

To what extent should governments be able to use safeguard action to protect domestic industry from the adverse consequences of restrictions which deprive it of access to cheaper foreign inputs?

"Unfair" trading developments

- (iv) *Foreign governments provide assistance* to foreign suppliers who sell to the domestic market. This could most explicitly take the form of new subsidies or tax exemptions by another Member.

Should issues which relate to the appropriateness of countervailing measures be taken up under Article XV or can they also provide a case for safeguard action - at least while Article XV disciplines are being developed?

- (v) Foreign service suppliers indulge in *anti-competitive practices*. For instance, they use profits from protected domestic markets to finance an expansion in low-priced exports.

Certain practices of monopoly and exclusive service suppliers can already be addressed under Article VIII of the GATS. Should other issues which relate to anti-competitive practices be dealt with, for instance, by strengthening Article IX of GATS which deals with business practices, or can they also provide a case for safeguard action?

More fundamentally, should Article X deal, as does GATT Article XIX, with fair trading practices to which there must be an MFN-based response (already built into Article X), or should its scope be expanded to deal with unfair trading practices to which there may be a non-MFN response?

III. UNFORESEEN DEVELOPMENTS

13. It may not be easy to determine what could constitute unforeseen developments. In the area of goods, this term has been interpreted (though without consensus) to mean "developments after the negotiation of a tariff concession which it would not be reasonable to expect that the negotiators of the country making the concession could and should have foreseen at the time when the concession was negotiated."⁸ Unfortunately, the only recorded application of this interpretation did not lead to a clear result.⁹ The interpretation has also been characterised as unduly widening the scope of the

⁸See page 4 of the Report of the Intersessional Working Party on the Complaint of Czechoslovakia Concerning the Withdrawal by the United States of a Concession under the Terms of Article XIX (GATT/CP/106, 27 March 1951).

⁹The same Working Party, except the representative of the United States, first "agreed with the Czechoslovak representative that the fact that hat styles had changed did not constitute an 'unforeseen development' within the meaning of Article XIX" (page 5). But then the Working Party, with the exception of the Czechoslovak (continued...)

escape clause and rendering tariff concessions less stable.¹⁰ The need for follow up review of Article XIX language with a view to obtaining greater stability of trade concessions was noted in a 1963 GATT report.¹¹ It is notable that the Agreement on Safeguards, while defining in Article 1 safeguard measures as those provided for in Article XIX of GATT 1994, does not contain any mention of the term "unforeseen developments."

14. One argument could be that it is unduly difficult and not particularly fruitful to try and verify that a development was indeed foreseen. The question is:

Is it feasible to develop criteria to determine whether circumstances were in some objective sense foreseeable? Is the notion to be a permissive one in which all benefit of doubt goes to the party invoking it or is it possible to make judgements on what could reasonably have been foreseen?

For instance, any of the examples cited above could be unforeseen either because of poor foresight or because they were genuinely impossible to foresee. However, it may be the case that certain changes in policy, such as a tightening of monetary policy, should have been foreseen, perhaps because it was known that the government would respond to inflationary problems. Or, it may be well known that certain markets, such as fashion designing, are characterised by high variations in demand conditions.

Would it be possible and useful to distinguish between sectors where significant variations in demand and supply are part of normal business conditions and others where they are not?

IV. EXAMPLES OF POSSIBLE GROUNDS FOR, AND FORMS OF, SAFEGUARD ACTION

15. The clearest case for safeguard action is based on the need to facilitate economic adjustment. Increased imports, even when they contribute to an increase in the aggregate welfare of the society, may adversely affect the interests of certain groups, such as those whose skills are specific to the import competing industry. The social costs of adjustment may be lower if the import-competing domestic firms are given time to adjust, either by improving their competitiveness or by moving resources into other areas of production. The role of safeguard action is thus to provide temporary relief in order to make possible gradual rather than abrupt adjustment.

⁹(...continued)

representative, agreed that "the degree to which the change in fashion affected the competitive situation, could not reasonably be expected to have been foreseen by the United States authorities in 1947, and that the conditions of Article XIX that the increase in imports must be due to unforeseen developments and to the effect of the tariff concession can therefore be considered to have been fulfilled" (page 6).

¹⁰One GATT expert writes, "As one reviews this remarkable GATT report on Article XIX, it appears quite clear that the result of the findings made was to greatly extend the scope of the escape clause and render it available for invocation in a wide variety of situations. It almost appears that a mere rapid increase in the proportion of imports to the domestic production would make invocation of Article XIX justifiable, especially when all benefit of doubt goes to the party invoking it. The net result is to render tariff concessions and other GATT obligations less stable." (See page 563 of J.H. Jackson, *World Trade and the Law of GATT*, Bobbs-Merrill Company, Inc., Indianapolis, Kansas City, New York, 1969.)

¹¹See page 3 of the Report of the Working Party on Procedures for Tariff Reductions (L/2002, 30 April 1963).

16. What are the circumstances which make safeguard action necessary and desirable? Even if the shock to domestic industry is temporary, private enterprises may still not be equipped to weather the storm. For instance, they could be subject to constraints which force them to behave myopically - for instance, capital market imperfections, which limit the ability of firms to borrow. If the shock is permanent, and domestic industry is no longer viable, there may still be a reason to ensure the continued operation of private enterprises for a certain period. That is, there may exist positive externalities, i.e. benefits for society which private firms do not take into account. An example could be the social benefits from preventing instantaneous layoffs of relatively immobile factors of production.

Is the fact of injury caused by increased imports a sufficient condition for safeguard action, or should there be additional conditions? For instance, should Members be required to demonstrate the existence of market imperfections and/or positive externalities which make safeguard action necessary and desirable?¹²

17. It is evident that services like transport, telecommunications and financial services play an important infrastructural role in the economy. For instance, the sudden availability of cheap imported transport services may provide a huge benefit to domestic consumers and goods exporters even as they injure the domestic transport industry. Even though the economy as a whole may benefit from cheaper imports, it is well-known that governments are subject to strong pressures for safeguard action from the injured industry, and that countervailing pressures from user industries or consumers tend to be relatively weak.¹³ The question arises whether there might be reason to create multilateral disciplines to ensure a more balanced appraisal of the case for safeguard action.

Should safeguard action be justified only by the need to protect a particular industry from injury, or should the justification be based on a wider view of national welfare? Should the inclusion of a "public-interest" clause be left to the discretion of individual Members?

18. Even though safeguard actions may be justified, restrictions on imports may not provide a solution in response to certain shocks, and may not be the most desirable instruments even when they do provide a solution. For instance, say the domestic health industry is in difficulty, direct support may be a more suitable instrument than import restrictions, provided that the necessary resources can be raised through non-distortionary means. While both measures may help the industry, import restrictions hurt consumers by leading to an increase in prices, which can be avoided through direct assistance. However, import restrictions may violate market access commitments while direct assistance may well be inconsistent with a Member's national treatment commitments.

¹²No such conditions are imposed in the goods context, but Members may not wish to limit themselves to the goods precedent.

¹³In recognition of this problem, the Agreement on Safeguards, in Article 3:1 stipulates that the "investigation shall include reasonable public notice to all interested parties and public hearings or other appropriate means in which importers, exporters and other interested parties could present evidence and their views, including the opportunity to respond to the presentations of other parties and to submit their views, *inter alia*, as to whether or not the application of a safeguard measure would be in the public interest." However, in substantive terms, it is still injury to industry, rather than national welfare more generally, which would seem to be the basis for action.

Should there be a presumption in favour of economically superior instruments of safeguard action?¹⁴

V. EXAMPLES OF OBJECTIVES WHICH CAN BE REFLECTED IN SCHEDULES

19. It could be argued that even if the causes of injury cannot be anticipated, the negative effects that would prompt government intervention are sometimes known in advance. That is a government may be able to see what declines in output, or increases in unemployment would induce it to act. Now in the GATS there is significant scope for *ex ante* scheduling of limitations, in a way that there is not in the goods context. In the goods context, Members make commitments on a single dimension, i.e. the tariff, and there is no possibility of including, for instance, limitations relating to national share of output. But there is greater scope in the GATS for a Member to write into its schedule certain circumstances that would trigger government intervention. This is for instance what Mexico has done in the financial services chapter of NAFTA.¹⁵ Thus, the desire to maintain a certain national share of output, employment or assets in certain sensitive sectors would seem to be typical candidates for *ex ante* scheduling rather than *ex post* safeguard action. To not include such elements in schedules, but to invoke them as a basis for safeguard action, may have the effect of inflicting avoidable uncertainty on the market participants - the very thing that the GATS is designed to prevent.

20. It may, however, be the case that even though a Member is reconciled to reductions in national output and employment in a particular industry, the *speed* at which this is happening (due to a rapid increase in imports) imposes a high social cost. This could form the basis for temporary safeguard action to facilitate *more gradual adjustment*, as discussed in the previous section. Alternatively, a Member may change its mind, and decide after making a commitment that it would like to maintain a national share of output or employment. Even though this permanent change in policy would ideally take the form of a modification of commitments under Article XXI, emergency safeguard action may still be needed as an interim measure while the Article XXI-process is completed, for instance if there is a sudden flood of imports which threatens to drive domestic industry out of business.

21. If it is accepted that the only objective of safeguard action should be making more gradual adjustment possible, then ensuring that safeguard action is temporary may be the key discipline. This would ensure that intervention serves only to help industry deal with either temporary shocks, such as a brief surge in imports, or facilitates adjustment in response to permanent shocks, such as a fundamental shift in comparative advantage.

If it can be ensured that intervention is temporary and not (frequently) repeated, how much need is there to establish criteria which would be difficult to enforce, such as those which seek to establish whether or not events were foreseen?

¹⁴Article 5 of the Agreement on Safeguards stipulates that Members should choose measures most suitable for the achievement of objectives such as prevention or remedying serious injury and facilitation of adjustment.

¹⁵Thus, Annex 1413.6 Section B of NAFTA provides that if the sum of authorized capital of foreign commercial bank affiliates reaches 25 per cent of the aggregate capital of all commercial banks in Mexico, Mexico may request consultations with the other NAFTA parties on the potential adverse effects arising from the presence of commercial banks of other parties and the possible need for remedial action, including further temporary limitations on market participation.

22. Finally, the key question may be posed thus:

When should objectives be built *ex ante* into the schedules and not be the basis for safeguard action, and when should more liberal commitments be scheduled with the scope for *ex post* safeguard action?

The former option has the virtue of creating a more certain environment for both domestic and foreign suppliers, but the disadvantage of perhaps leading to excessively cautious, and therefore less liberal scheduling. The attractiveness of the latter option will depend strongly on the ability to devise adequate procedural disciplines which prevent abuse of the safeguard mechanism and ensure that the security created by GATS commitments is not undermined. On balance, Members may feel that motives for intervention in certain sectors (or certain modes) are more appropriately the subject of *ex ante* scheduling and that in certain sectors (or with respect to certain modes) there is greater scope for developing enforceable procedural disciplines on safeguard action - for instance, because of greater availability of statistics.