

# Why are safeguards under the WTO so unpopular?

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**Abstract:** In recent years, more countries have increasingly turned to explicit, codified trade policy instruments of the international trading system such as antidumping measures. Countries have also increasingly participated in the institutions established to facilitate trade in the international system, such as the WTO's Dispute Settlement Understanding. Given these phenomena, a natural question to consider is why haven't countries resorted to the WTO's safeguards provisions at a similar pace? This paper focuses on the economic incentives generated by reforms in the Uruguay Round, and argues that in order to address the relative unpopularity of the application of safeguards measures, further reforms must be made to WTO's Antidumping Agreement and the rules of the Dispute Settlement Understanding.

## 1. Introduction

The recent trend toward the 'legalization' of the international trading system and the resulting shift from a 'diplomacy-based' toward a 'rules-based' system has been well-documented (Jackson, 1997; Trebilcock and Howse, 1999). Evidence of this trend includes both the increase in the use of many GATT/WTO-sanctioned trade policy instruments and more frequent reliance on the formal procedures of the multilateral institutions of the international trading system. The most obvious example of the first phenomenon is the wide proliferation of antidumping (AD) measures initiated by national governments, as documented by Miranda *et al.* (1998), while an example of the second is the increase in the recourse to the WTO's Dispute Settlement Understanding (DSU) (WTO, 2001a).

Given these phenomena, one important question is, why hasn't use of the WTO's formal *safeguards* provisions proceeded at a similar pace? From a historical perspective, countries have never found the safeguards provisions of the GATT/WTO system particularly appealing. As Table 1 indicates, the GATT's most prominent safeguards provision, Article XIX,<sup>1</sup> was used only 150 times between

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<sup>1</sup> While reference to the GATT 1947's safeguards typically means a referral to Article XIX, it should be noted that there were other ways for countries to escape from their obligations under the original GATT. For

Table 1. Historic Use of the GATT's Article XIX and the WTO's Agreement on Safeguards

Country	Number of <i>Article XIX</i> cases resulting in protection 1947–1994	Number of <i>Agreement on Safeguards</i> cases resulting in protection 1995–2000
Australia	38	0
EEC	26	0
US	25	5
Canada	22	0
Austria	8	0
South Africa	4	0
Chile	3	1
Finland	2	0
New Zealand	1	0
Norway	1	0
Czech Republic	1	1
India	0	6
Egypt	0	2
Korea	0	2
Latvia	0	1
Argentina	0	1
Brazil	0	1
<i>Other</i>	19	0
Total	150	20

Source: WTO (1995a), WTO (2000a).

1947 and 1994. To put this into context, Miranda *et al.* (1998) report that GATT Contracting Parties imposed 132 definitive AD measures in 1993 alone!

However, with the substantial reforms of the Uruguay Round<sup>2</sup> transforming Article XIX into the WTO's *Agreement on Safeguards* (AS),<sup>3</sup> it is perhaps surprising that the dramatic increase in the use of *other* GATT/WTO sanctioned instruments

example, countries could appeal to Article XXVIII for permanent protection, Articles XII or XXVIII:b for balance of payments problems, Article XXI or XX for national security or other general exceptions, and Article XXV for the granting of waivers. For a discussion, see Jackson (1993) or Finger (1998).

2 Jackson (1993, pp. 227–228) identifies the following as key areas of discussion with respect to safeguards leading up to the Uruguay Round 'the controversy about discriminatory application of safeguards measures, as well as difficulties about surveillance and dispute settlement, the definition of 'serious injury', and the broader issues of 'structural adjustment' ... [as well as] the question of how to bring some discipline to the burgeoning and chaotic use of export restraints ...'.

3 While the *Agreement on Safeguards* has taken over the role previously played by the GATT's Article XIX, safeguards activity under the WTO has not been entirely centralized. Areas such as textiles, agriculture, and services have safeguards provisions written into their own agreements. Our focus will rest primarily on the *Agreement on Safeguards*, though obviously many of the points made will apply to all of the WTO's safeguards provisions. For a discussion of safeguards under the *Agreement on Textiles and Clothing* (Article 6), see Reinert (2000). For other sectors, see also the *Agreement on Agriculture*, Article 5, and the *General Agreement on Trade in Services* (GATS), Article X.

has not carried over to the use of safeguards as well. Relative to the GATT's Article XIX, the AS established in the Uruguay Round contains substantial rules changes, many of which appear to make use of the safeguards provisions more appealing. One example is the reduction in the amount of compensation that a protection-affording country is required to yield to affected trading partners when it uses this new escape clause to protect a domestic industry. Therefore, the AS might have been expected to become a *much more* popular policy choice relative to its predecessor, given that protection-imposing countries would face a reduced compensation hurdle. This has not been the case, and the escape clause remains a relatively unpopular and even arguably underutilized instrument. Table 1 indicates that only 20 safeguards measures were undertaken in the first five years of the AS, while Miranda *et al.* (1998) report that 333 definitive AD measures were imposed between 1995 and 1997 alone. Our intent here is to identify and analyze some of the economic incentives that make the AS so relatively unpopular.

At first glance, the infrequent appeal to the *safeguards* provisions looks like good news for proponents of liberal trade. Little use for the escape clause could mean that countries are finding it easier to live up to their trade liberalization commitments. However, the vast proliferation of AD measures shows that any such claims of success are unfortunately misguided. For the period of 1987–1994, while only 18 measures of protection were imposed under Article XIX (WTO, 1995a), over 700 definitive antidumping measures were imposed worldwide, after the initiation of 1586 AD investigations by GATT Contracting Parties (Miranda *et al.*, 1998). It is not that national governments have managed to fend off protectionist pressures or that they no longer seek an 'escape' from their GATT/WTO obligations, rather they are not doing so under the *safeguards* provisions – instead, they are avoiding use of the escape clause and instead choosing instruments like AD measures to relieve this pressure.

This paper starts under the assumption that we are considering a 'second-best' world where countries inevitably face some pressure to protect domestic constituencies between negotiating rounds. Therefore, trade policy adjustments will need to be made and the issue is then the least costly way to implement the adjustments. While we review below some of the reasons why economists prefer that protection-receiving industries use the safeguards provisions instead of AD measures and other 'unfair trade' laws, we generally assume that an MFN-based escape clause is preferable to the alternatives.

We explain the under-utilization of the safeguards provisions in two ways. First, we appeal to the relationship between safeguards and AD measures and the rules of retaliation and compensation under the WTO's DSU. Focusing on the dispute settlement provisions as a legal process, we argue that the DSU's rules and procedures of compensation in trade disputes make the imposition of even a (statutorily) dubious AD measure that is certain to result in a formal trade dispute preferable to utilization of the safeguards provisions. Second, we argue that countries wishing to 'manage trade' prefer other measures to the safeguards

provisions. While the AS distanced itself from voluntary export restraints (VERs) and managing trade, we argue that other provisions of the WTO have both implicitly and explicitly sanctioned this phenomenon. In fact, for countries looking to manage trade, the WTO's antidumping provisions and the process by which disputes relating to AD measures are settled favor the same sort of managed trade outcomes that the AS has explicitly attempted to prohibit.<sup>4</sup>

The assessment of the WTO's safeguards provisions and the relationships among safeguards, antidumping, and dispute settlement we present here are important, given the calls for reform of the *Agreement on Safeguards* (see, for example, Messerlin, 2000), and its potential as a topic of discussion in the next negotiating round. Finger (1998) proposes some procedural elements for reform that complement the main ideas discussed here, which focus on restructuring the economic incentives in a way that makes the safeguards provisions relatively more attractive. Our arguments suggest that changes designed to affect either the frequency of safeguard use or the 'type' of countries which appeal to the *Agreement on Safeguards* must be coordinated with reforms to the WTO's rules on antidumping, dispute settlement, and retaliation and compensation.

The rest of this paper proceeds as follows. In section 2, we briefly review some of the economic arguments favoring use of safeguards provisions over the most common 'unfair trade' alternatives. Section 3 discusses the reforms contained in the Uruguay Round Agreements and in particular the changes to the safeguards, antidumping and dispute settlement provisions that may explain the relative unpopularity of the AS from an economic incentive perspective. In section 4 we address a set of proposals for consideration in the next negotiating round, discussing how the economic incentives generated by these potential reforms may influence the relative popularity of the AS, the reliance on ADDs, and the recourse available under the DSU. Section 5 concludes.

## 2. Safeguards instead of 'unfair trade' laws

Why do economists typically prefer that a country resort to the safeguards provisions of an agreement in lieu of the 'unfair trade' provisions such as AD measures? There are several economic and political reasons, which we review here, to clarify the importance of this topic and to motivate the subsequent analysis.

First, a country's use of the escape clause under the GATT/WTO system has generally required continued adherence to the rules of MFN. This requirement avoids the potential efficiency losses from trade diversion that occur when protection-affording countries discriminate between foreign exporters of the same product and shift imports from low-cost producers to less-efficient exporters.

<sup>4</sup> To avoid confusion, we should also identify some of the areas that will *not* be the focus of this paper. We will not consider the finer procedural elements of the safeguards and antidumping provisions that examine, say, the differences in satisfying the 'material injury' versus 'serious injury' criterion. For a discussion of many of the legal aspects of the escape clause as well as its historical evolution, see Jackson (1993).

The second reason is based on the fact that *any* unilateral act of protection undertaken by a sizable importing country imposes a negative externality on its trading partners. When an antidumping measure is imposed, this negative externality manifests itself *politically* as ‘blame shifting’ – the refusal to admit to even a temporary loss of competitiveness by the domestic industry and the explicit accusation of unfair trade (dumping) on the part of the foreign exporter.<sup>5</sup> The negative externality manifests itself *economically*, as part of the cost of protection is shifted on to the foreign exporter through a reduction in the exporter’s terms of trade. This negative economic externality is also present when a country resorts to the safeguards provisions, but, because there is no claim of unfair trade, the political cost is not. If the safeguards provisions include a *compensation* requirement, then a protection-affording country that resorts to the escape clause over AD measures is stating in effect that it is willing to internalize more of the *economic* costs of the protection.

### 3. Uruguay Round reforms, recent trade disputes, and economic incentives

This section reviews the Uruguay Round reforms, and recent activity under the WTO that relate to the safeguards, antidumping and dispute settlement provisions that affect the economic incentives confronting countries that are choosing among alternative trade policy instruments. These reforms are broadly captured in Table 2.

#### 3.1 *The agreement on safeguards: no compensation and no VERs*

From an economic incentive perspective, the safeguards provisions under the WTO were designed to be more attractive than their predecessor. As illustrated in Table 2, the *Agreement on Safeguards* in many instances does not require a country to compensate affected trading partners for the first three years that a safeguards measure is in place.<sup>6</sup> This is a distinct change from the escape clause of Article XIX, under which trading partners affected by a country’s increased protection were eligible for compensation. While this compensation preferably took the form of additional liberalization undertaken by the protection-affording country, additional liberalization that was mutually desirable was often difficult to identify. Often compensation took the form of the GATT-sanctioned withdrawal of ‘substantially equivalent concessions’, or an increase in a foreign tariff based on the rule of *reciprocity*.

A second major change that we focus on here is the explicit intent of the AS to end the frequent use of VERs that had been an increasingly frequent part of the landscape during the latter years of the GATT regime. Prior to the Uruguay Round, VERs were

<sup>5</sup> The ‘blame shifting’ through a dubious ADD may then also lead to a formal trade dispute, where it would impose further *economic* costs through the need for real resources required to prosecute, defend, and ultimately adjudicate the case.

<sup>6</sup> After the initial three years (or in the case that the ‘absolute increase in imports’ criterion was not satisfied), protection-affording countries are subject to compensation based on the *reciprocity* rule, just as was the case under Article XIX (see Table 2).

Table 2. Comparing key elements of the GATT 1947 and WTO systems

Area	GATT 1947	Uruguay Round Agreement
Safeguards (compensation)	<p><i>Article XIX:3(a)</i></p> <p>‘[i]f agreement among the interested contracting parties with respect to the action is not reached ... the affected contracting parties shall then be free ... to suspend ... such substantially equivalent concessions ... of which the CONTRACTING PARTIES do not disapprove.’</p>	<p><i>Agreement on Safeguards</i></p> <p>Article 8:3</p> <p>‘[t]he right of suspension [of concessions] 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 ... ’</p>
Safeguards (managing trade)	NA	<p><i>Agreement on Safeguards</i></p> <p>Article 11:1(b)</p> <p>‘ ... a Member shall not seek, take or maintain any voluntary export restraints, orderly marketing arrangements or any other similar measures on the export or import side.’</p>
Antidumping (managing trade)	NA	<p><i>Agreement on Antidumping</i></p> <p>Article 8.1</p> <p>‘[p]roceedings may be suspended or terminated without the imposition of provisional measures or antidumping duties upon receipt of satisfactory voluntary undertakings from any exporter to revise its prices or to cease exports to the area in question at dumped prices ... ’</p>
Dispute Settlement (compensation)	<p><i>Article XXIII:2</i></p> <p>‘[i]f the CONTRACTING PARTIES consider that the circumstances are serious enough to justify such action, they may authorize a contracting party or parties to suspend the application to any other contracting party or parties of such concessions or other obligations under this Agreement as they determine to be appropriate in the circumstances.’</p>	<p><i>Dispute Settlement Understanding</i></p> <p>Article 22:4</p> <p>‘[t]he level of the suspension of concessions or other obligations authorized by the DSB shall be equivalent to the level of the nullification or impairment [imposed by the original policy].’</p>

Source: WTO (1995b).

a frequent means by which trading partners would arrange to compensate exporters in the many instances where trade policy adjustments – including resort to the escape clause – were deemed ‘necessary’. However, as Table 2 indicates, under the AS such VERs were prohibited.

Why might an exporter look to negotiate a VER as a way to obtain compensation for lost export sales? While VERs do have a negative impact on economic welfare, an argument can be made that in some escape clause cases, the VER served as a useful, and even a second-best way of compensating affected trading partners. If the alternative was a GATT-authorized tariff withdrawal (i.e. retaliation) by a trading partner as compensation, even if this tariff withdrawal were limited by the rule of reciprocity, an outcome given by a VER could be preferable on welfare grounds. A VER arrangement that served to share the rents associated with the original increase in protection under Article XIX would avoid the second set of economic costs generated by the tariff retaliation that was often the compensation alternative.<sup>7</sup>

To further understand the economic incentives facing a country considering an appeal to the safeguards provisions, we argue for the need to consider the escape clause both against the alternatives and within the confines of the WTO agreement. We thus turn to a discussion of the WTO's AD Agreement and the DSU in the next sections.

### 3.2 *The antidumping agreement and managing trade*

While the *Agreement on Safeguards* explicitly sought to reduce the frequency of countries managing trade through negotiated VERs, a different approach was taken with respect to the WTO's Antidumping Agreement. As Table 2 indicates, in the AD Agreement, managed trade agreements through voluntary *price undertakings* are statutorily acceptable and arguably statutorily embraced, relative to the imposition of antidumping duties.

Price undertakings refer to an agreement between the investigating AD authority and the foreign exporting firm that is the subject of the AD investigation. In this outcome, the firm agrees to raise its price to a level that eliminates the 'dumping margin' established by the investigating AD authority. In the absence of perfectly inelastic demand, such a price increase will inevitably decrease the imports of the good in question, leading to an outcome quite similar to that generated by a VER. That is, in economic models, a comparison of price undertakings and VER regimes yield outcomes that are similar in terms of the impact on welfare and the inefficiencies generated. In fact, Moore (2001) has actually found instances in which price undertakings can actually generate outcomes that are *worse*, in terms of lost economic welfare, than those generated by the imposition of VERs!

Nevertheless, to the extent that countries choosing among instruments of protection are looking to protect their domestic industry by managing trade – perhaps to directly compensate the affected foreign industry – the use of AD measures provides for a potential outcome that utilization of the AS, as it is currently constituted, can not.

<sup>7</sup> This is a point made by Ono (1991) amongst others.

### 3.3 *The DSU, AD disputes and ‘conditional VERs’*

An additional phenomenon related to the unpopularity of safeguards is the increase in formal GATT/WTO trade disputes in which countries are accused of abusing their AD provisions. Over 30 such disputes have been initiated since 1989, and almost 10 per cent of the formal disputes initiated since the WTO’s 1995 inception concerned allegations of misuse of domestic AD measures (Bown, 2001b). First, this signals that it is likely that countries are increasingly using the ‘unfair trade’ laws when it is inappropriate to do so, and when in fact they should be using the ‘fair trade’ laws of the safeguards provisions. Second, and as we discuss in detail next, the outcome of these disputes is sometimes an additional form of managed trade.

There are many instances of formal WTO trade disputes concerning dubious ADDs or AD investigations in which the defendant country has compensated the plaintiff country by terminating the AD measure under dispute and simply refunding the collected duties, in lieu of being subject to authorizable retaliation. As an example, in its dispute with Switzerland over *Coated Woodfree Paper Sheets* (WTO, 1998), Australia agreed to settle the case before the panel stage by terminating the provisional duties in place and refunding the duties already collected. The dispute settlement panel in *Mexico vs. US over Gray Portland Cement and Cement Clinker* (GATT, 1992) also formally recommended this form of settlement, and the refunding of duties has been a topic of discussion in many other reports.<sup>8</sup> In terms of the impact on economic welfare (at least under the conditions of perfect competition), this outcome might be considered a ‘Conditional VER’.<sup>9</sup> The transfer of tariff revenue from the defendant (ADD imposing country) as compensation to the plaintiff is equivalent to the ‘quota rents’ being shifted to the exporting country through a policy change from an import tariff to a foreign VER.

Careful inspection of such alternative settlement or compensation schemes indicates that managed trade-type outcomes can occur even when abuse of AD measures leads to a formal trade dispute. As well, this form of compensation has been used in both bilateral negotiations leading to pre-panel settlements (*Coated Woodfree Paper Sheets*) and it has also been recommended in panel reports. Therefore, even though the explicit use of VERs is ruled out by the *Agreement on Safeguards*, other provisions of the WTO seem to encourage VER-type outcomes. Thus if countries are interested in managing trade, it is not surprising that they prefer the AD instrument to the escape clause.

This, however, is not the most worrisome aspect of the way in which AD measures and the dispute settlement provisions interact. In these ADD refund cases,

<sup>8</sup> Mexico vs. US over *Grey Portland Cement and Cement Clinker* was a pre-WTO case in which the report was never adopted. The refunding of duties is also a topic of discussion in *US vs. Mexico over High-Fructose Corn Syrup* (WTO, 2000b) and the panel reports of *Mexico vs. Guatemala over Grey Portland Cement* (WTO, 2000c), and *Japan vs. US over Hot Rolled Steel* (WTO, 2001b).

<sup>9</sup> We thank Rachel McCulloch for coming up with this term. The VER outcome is conditional in the sense that the transfer of rents likely depends on the defendant country facing a sufficiently high probability that it would lose the case.

the plaintiff country does receive some compensation, so the size of the negative economic externality imposed on a trading partner by the act of protection is reduced. Even more troubling are the disputes not settled through the refunding of collected ADD revenue, to which we turn next.

### 3.4 *The DSU: limitations to compensation and the capacity for retaliation*

The last set of incentives that affect a country's decision relating to its use of the safeguards provisions result from the formal changes to the rules of dispute settlement negotiated during the Uruguay Round. In this section we assume a 'legalized' dispute settlement process, focusing again on the rules of compensation under the WTO.

In section 3.1 we argued that, when a country implemented protection under the AS, the compensation requirement had been relaxed, relative to the requirement under the GATT regime's Article XIX. We make a similar argument here with respect to the rules of compensation under the DSU, relative to the GATT regime's dispute settlement provisions of Article XXIII. See again the statutes presented in Table 2.

Under the dispute settlement provisions of the GATT regime, the level of permissible retaliation of 'such concessions' that would potentially serve as compensation in a lost trade dispute was ill-defined. Roessler *et al.* (forthcoming) argue that under the GATT regime, 'Article XXIII nominally put a constraint on the magnitude of "damages", [that is, retaliation,] but there was no satisfactory mechanism for reviewing them and thus nations aggrieved by violations could threaten or even impose damages *out of proportion* to the harm that they had suffered.' (emphasis added).

One important improvement under the DSU is that the statute now explicitly limits the level of retaliation. So what is the level of retaliation authorizable under the DSU? While the exact language regarding the compensation available under the DSU is different from the language under Article XIX (see again Table 2 for a comparison), the economic *interpretation* of this compensation appears to be quite similar, in both cases apparently based on the principle of *reciprocity*.<sup>10</sup> The levels of retaliation established by the interpretations of arbiters in the *Bananas* (WTO, 1999a) and *Beef Hormones* (WTO, 1999b) cases clearly now change the incentives facing countries that are making a decision as to how to impose protection.

Under the DSU, affected trading partners are no longer able to make threats of retaliation 'out of proportion' to the damage that they themselves have suffered, which will certainly affect the calculations made by a protection-affording country when deciding among policy instruments. Take as an example the extreme case in which a country wishes to offer protection to a domestic industry that was injured by imports, but there was no 'absolute surge in imports' to satisfy the AS no-compensation waiver. If the authorizable retaliation-as-compensation is *identical*

<sup>10</sup> For a discussion see Bown (2001a).

under both the DSU and the AS, what economic incentive would a country ever have to use the safeguards provisions? Even if the country were to impose a frivolous ADD and the affected trading partner filed a dispute, in the worst-case scenario that the protection-affording country lost the dispute, it would only have to yield the same compensation as it would have faced under the safeguards provisions! If there is any uncertainty in the dispute resolution process, then the country is clearly better off using the AD measure relative to the safeguards provisions, even when there is scant evidence of dumping or injury.

Moreover, even in protection-affording cases that would be eligible for the three-year, no-compensation waiver under the AS, countries may still prefer alternatives to the safeguards provisions, including alternatives that violate the country's WTO obligations. Regardless of the *level* of permissible retaliation authorizable under the WTO regime, the retaliation-as-compensation approach requires that affected trading partners have the *capacity* to retaliate.

A key determinant of the capacity to retaliate is whether the retaliating country accounts for a substantial share of its affected trading partner's exports in a particularly (politically or economically) important industry. Working from the perspective that retaliation is used only as a threat and that negotiators use this threat as a 'benchmark' to establish parameters from which to negotiate an efficiency-enhancing, non-retaliatory outcome,<sup>11</sup> the factors that affect the retaliation's impact on this welfare benchmark are critical. A retaliating country can improve upon its threat point in two ways: by making credible threats that would (i) lead to substantial welfare gains for itself, and/or (ii) lead to substantial welfare losses for its trading partner. In a simple economic model with only two countries and two traded goods, Bown (2001a) has shown that the capacity to retaliate is determined by the retaliating country's ability to affect its terms of trade. This is particularly effective in a two-country situation because the welfare *impact* of a single 'optimal' retaliatory policy like a tariff is, in a sense, doubled: the retaliation both worsens the welfare of the trading partner (through its terms of trade loss) and improves the welfare of the retaliating country (through its terms of trade gain).

In a more general multi-country and multi-product framework, the capacity for retaliation to affect welfare also depends on the characteristics of the markets available for retaliation.<sup>12</sup> For example, the impact of a tariff on the retaliating country's own welfare will be different if there are alternative export sources of substitutes for the product under retaliation, relative to instances in which there are no close substitutes. On the other hand, the impact on the affected country's welfare

11 Out of over 400 formal GATT and WTO trade disputes to date, authorized retaliation has only taken place in the *Bananas* and *Beef Hormones* cases. Non-retaliatory outcomes have included (i) removal of the contentious policy, (ii) partial removal of the contentious policy, (iii) restructuring of the original contentious policy to some sort of rent-sharing (VER-type outcome) agreement, or (iv) failure to remove the contentious policy but compensation through additional liberalization in some mutually agreeable sector.

12 In such a circumstance, a retaliatory policy's impact on the terms of trade is more likely to be muted, given that the terms of trade are no longer determined solely by the two countries involved in the dispute, but also determined by the imports and exports of third countries. See also Bown (2001b).

will also differ according to the availability of alternative export outlets facing its industries. For both countries, adjustment costs and the potential for trade diversion are additional factors affecting welfare and thus the ‘benchmark’ threat point.<sup>13</sup>

Empirical investigations in this area have provided initial evidence to suggest that the threat of retaliation may be serving to influence policy decisions by protection-affording governments. Bown (2000), for example, finds evidence consistent with the theory that under the GATT regime, the capacity for retaliation has had an influence on countries’ choices between affording import protection through the safeguards provisions versus through measures that would ultimately lead to a trade dispute. In looking at US antidumping cases between 1980 and 1998, Blonigen and Bown (2001) also find evidence that the threat of retaliation through potential GATT/WTO trade disputes affects the US AD authority in its ADD decisions.<sup>14</sup>

The implication of this work for our purposes is to suggest that if a protection-affording country’s potentially affected trading partners are *not* equipped with the capacity to make credible retaliatory threats, the current rules of dispute settlement provide little recourse to discourage behavior inconsistent with a country’s GATT/WTO obligations. With respect to policy adjustments that then impact only a country’s ‘small’ trading partners, the rules therefore create little economic incentive for the country to implement protection through safeguards measures, when the alternative is so attractive.

#### 4. Proposals for reform: popularizing safeguards

What can be done to make the use of safeguards more attractive? First we should note that it serves little purpose for the AS to ban VERs while the managed trade outcome is prevalent both explicitly and implicitly in other WTO provisions. We make a first argument therefore that the WTO take an *internally consistent* stance toward managed trade. Then, given that managed trade has efficiency-enhancing characteristics in certain compensatory situations and that the managed trade outcome seems to manifest itself even where it is not explicitly encouraged, it may be less costly for the WTO to simply repeal the AS ban on VERs as opposed to an attempt for the WTO to prohibit managed trade throughout the entire agreement.

<sup>13</sup> Early anecdotal evidence from the *Bananas* and *Beef Hormones* cases suggests that governments may not be responding with ‘optimal’ tariffs that would serve to generate maximum domestic economic welfare gains through a shift in the terms of trade. Instead, the USTR has chosen what are likely prohibitive (100 per cent) tariffs on targeted imports, perhaps with the intent of generating large welfare losses for foreign exporters. In *Bananas* (USTR, 1999a), the USTR chose a strategy of targeting ‘luxury’ items such as Italian handbags, or products where the European exporters may face substantial adjustment costs of seeking out alternative markets. In *Beef Hormones* (USTR, 1999b), the USTR did choose to target imports from Europe of beef, pork and other agricultural products, likely with the intent of generating large welfare losses in the same European industries that stand to gain from the import ban on hormone-treated US beef. Note, however, that also included on the *Beef Hormones* retaliation list were such luxury items as Roquefort cheese, foie gras, and truffles.

<sup>14</sup> In both papers, the authors use the protection-affording country’s exports to the affected foreign trading partner as a share of the protection-affording country’s total exports to measure the capacity for foreign retaliation.

Next we consider proposals to reform three distinct areas in turn: the safeguards agreement itself, the antidumping provisions, and the dispute settlement provisions.

#### 4.1 *Reforms to the agreement on safeguards*

What reforms to the economic incentives under the *Agreement on Safeguards* could make utilization of the provisions more attractive? Unfortunately, very little. Since compensation has already been reduced to zero for the first three years that a safeguards measure is in place, a direct measure to increase its popularity would require the removal of compensation entirely and then perhaps a shift toward the WTO actually *compensating* countries for use of the safeguards provisions. This would involve providing transfers to compensate countries with senescent industries, establishing a fund available for retraining, relocation, and adjustment assistance.<sup>15</sup> While theoretically possible, such a proposal is likely to be politically unacceptable and prohibitively costly to implement and monitor. As well, we have identified the benefits to a system where some compensation is due, as it forces the protection-affording country to internalize more of the economic costs of the negative externality that it is imposing on its partners. Therefore, if the intent is to make utilization of the safeguards provisions more attractive, the necessary approach is to make the alternatives *less* attractive.

#### 4.2 *Reforms to the AD Agreement*

Before proposing a complete overhaul of the AD Agreement, we find it useful to take a step back before recommending drastic reforms – such as, say, the complete abolition of AD measures. Given the ingenuity of policymakers, drastic reform will simply shift protection to some yet-to-be-dreamed-up alternative that will likely be even worse than AD measures. While economists are concerned with the proliferation of AD measures, in the second-best world that we have been considering, there are some appealing features to antidumping duties, at least relative to the alternatives. For example, it is preferable that these AD measures come in the form of *tariffs*, as opposed to protection in the form of import quotas, technical, standards, or other non-tariff barriers to trade. Tariffs are relatively transparent and there is arguably less rent-seeking activity associated with them. Therefore, we consider first reforms that build from the attractive economic characteristics of AD duties.

Suppose the WTO restructured its AD Agreement to require countries that impose disputed provisional or definitive duties to deposit all tariff revenue into an escrow account. The distribution of funds within the account would then be determined by the WTO, based on the statutory acceptability of the AD measure imposed. Suppose further that the first line of compensation for any formal dispute over allegations of a WTO-unacceptable AD measure would be a *mandatory* refunding of the duties. As we have noted earlier, such an outcome works similar –

<sup>15</sup> For a discussion of adjustment assistance and the escape clause, see Corden (1997).

in terms of the welfare effects involved – to a voluntary export restraint. This proposal would essentially turn a method of compensation that some countries have been using informally into a formal DSU procedure.

This potential compensation policy would be attractive for a variety of reasons. First, it would help to eliminate any terms of trade motivation for the initial protection and thus the negative externality. It would also offer protection to the domestic industry in a way that imposed costs on the domestic economy, thus generating a more prominent incentive to *remove* the measure. The more tariff revenue that is collected, the bigger the potential loss for the ADD-imposing country. Therefore, policymakers may be more hesitant to impose frivolous ADDs under the expectation that they may suffer these losses, and they may therefore find the safeguards provisions relatively more attractive.

As we noted in section 3.3, the ADD-refund serves as a built-in compensation mechanism that does not induce additional inefficiencies into the trading system through retaliation. This means of settlement would also be an effective form of compensation to ‘small’ countries who do not have the capacity to threaten retaliation. Finally, the ADD-refund could be given directly to the foreign exporting industry that was targeted by the ADD, thereby compensating the economic actor that was directly injured by the initial act of protection. Targeting this assistance to the affected exporting industry is much more difficult and often impossible when retaliation is the compensation mechanism.

Under a scheme of fully refunding the ADDs collected, *both* parties should also desire an expeditious panel procedure, which is not otherwise the case. Historically, the dispute settlement system has been biased against trade in perishable goods. For example, countries could impose temporary measures that violated their GATT/WTO obligations and protected domestic industries, knowing that the protection received by the seasonal sector would be removed before the completion of the lengthy panel process and before any retaliation or other compensation would be authorizable. This scheme would remove the incentive to temporarily protect perishable goods through frivolous ADDs, as the country would face the risk of the lost tariff revenue.

Also, while the outcome is similar in terms of the welfare effects to a voluntary export restraint, there are some features that are clearly preferable to the VERs of the past. First, a trading partner is not being pressured by a more powerful, protection-imposing country into accepting this outcome, as was usually the case under the VERs of the 1980s. Instead, the compensation would be automatic and not subject to power-driven negotiations. Also, as there are no negotiations over any actual VERs, there is no scope for widening the problem by introducing the opportunity for collusion between foreign exporters and the domestic import-competing industry.

While such a system would make ADDs less attractive and thus safeguards measures relatively more attractive, would such a scheme also make non-tariff barriers more attractive than they have been? This is a possibility; but since tariff revenue is also not collected with the imposition of NTBs, they should not be more

attractive than previously, especially if there is some positive probability that the defendant country who imposed the ADD will win the WTO dispute and be authorized to retain the revenue.

### 4.3 Reforms to the DSU

In lieu of refunding AD revenue as compensation in disputes, an alternative approach to consider is a further increase in the level of permissible retaliation under the DSU.<sup>16</sup> Suppose retaliation were not limited by reciprocity, this would likely increase the attractiveness of the safeguards provisions with respect to protected sectors that compete with exporters from ‘large’ countries that have the capacity to affect the terms of trade with respect to the export markets of the protection-imposing country. However, this proposal would do virtually nothing to assist the ‘small’ countries that would still remain unable to make credible threats of retaliation. And since empirical evidence suggests that national AD authorities are biased in their decisions against exporters from these small countries, such a change in the rules may have little real impact on trade policy choices.<sup>17</sup>

A final alternative would be to allow for ‘retaliation-sharing’ as compensation in trade disputes. If a plaintiff is too small to adequately affect the terms of trade and obtain compensation in a case that it has won, it could turn to another WTO member that was sufficiently large and ask that member to retaliate on its behalf.<sup>18</sup> In one sense countries may already be turning to this alternative as well, through their formation of preferential trading agreements with common external trade policies.

## Conclusion

This paper addresses two questions as they relate to safeguards provisions: why are they so under-utilized, and what can be done about it. We have suggested that this low rate of utilization may be largely due to two factors: the weak rules of compensation facing countries that avoid safeguards provisions by violating their GATT/WTO obligations, and countries’ desire to manage trade, which is implicitly encouraged when a country imposes AD measures but prohibited when a country relies on the *Agreement on Safeguards*. We have also presented proposals for reform that target the WTO’s AD Agreement and the DSU, in order to make the safeguards *alternatives* relatively less attractive.

Finally, we note again that we do not consider the question of whether safeguards measures are desirable at all. Rather, we assume a second-best world throughout, where trade policy adjustments are inevitable, and we then focus on the least costly

<sup>16</sup> To a certain extent we have already seen something similar to this, or alternatively, an increase in the *scope* of retaliation, as Ecuador has been authorized in its dispute with the EU over the EU’s *Banana Regime* to retaliate by withdrawing TRIPs commitments (WTO, 2001a, p.6). However, the economic implications of retaliation through such non-tariff barriers have yet to be formally investigated.

<sup>17</sup> See Blonigen and Bown (2001).

<sup>18</sup> Maggi (1999) investigates this power sharing in a related context.

way that these adjustments can be made. We have not attempted to address the costs of safeguards themselves, in the sense that the inclusion of an escape clause into a trade agreement may lead to higher equilibrium tariffs than would be obtainable if no such clause were included.<sup>19</sup>

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<sup>19</sup> Therefore we ignore the time consistency problems introduced by the existence of discretion initially identified by Staiger and Tabellini (1987). See also Kohler and Moore (2001).

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