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Law and Economics
of Contingent
Protection
in International
Trade

EDITED BY
Kyle W. Bagwell,
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and Petros C. Mavroidis

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Law and Economics of Contingent Protection in International Trade

This book discusses the regulatory framework of contingent protection in the World Trade Organization (WTO) – antidumping, countervailing duties, and safeguards – as well as an economic analysis of these instruments. The book's various chapters illuminate the basic functioning of all three protections.

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Introduction

This is the third volume in the series *Columbia Studies on WTO Law and Policy*. Our focus this time is on the *Law and Economics of Contingent Protection*. Our invited authors contributed chapters on antidumping, subsidies and countervailing measures, and safeguards.

Wouters and Coppens provide insight into the World Trade Organization (WTO) multilateral disciplines on subsidies and on measures taken to respond to subsidies (i.e., countervailing duties [CVDs]). These disciplines are articulated in the *GATT 1994*, the *Agreement on Subsidies and Countervailing Duties (SCM Agreement)*, as well as the *Agreement on Agriculture (AoA)*. After an overview of the historical and legal context of the *SCM Agreement*, the authors provide a systematic legal analysis of its main provisions, integrating the substantial amount of relevant case law. Finally, the specific disciplines for agricultural subsidies, as spelled out in the *AoA* in interaction with the *SCM Agreement*, are clarified.

Howse takes issue with the decision of the WTO Membership to abandon the so-called *nonactionable subsidies*, that is, subsidies against which no reaction by affected Members was permissible. These subsidies lapsed in 2001. Howse takes the view that this decision was not well thought out, and claims that developing countries might be the losers here. He offers arguments in favor of reinstating this category in the current *SCM Agreement*.

Francois provides an economist's reaction to the current regulatory framework regarding the calculation of benefit stemming from the payment of subsidy. This issue rose to prominence during the *Softwood Lumber* litigation between the United States and Canada. There, it was made clear to the WTO adjudicating bodies that the existing regulatory framework is ill-equipped to deal with "unusual" cases, such as the Canadian market for timber. Francois offers insights from economic theory on how to deal with similar concerns.

Green and Trebilcock examine in their chapter the WTO rules and decisions concerning export subsidies in the nonagricultural context to determine why these disputes are so prevalent and contentious, and whether the rules or their interpretation should be altered. They discuss the basic economic case against

export subsidies and political economy explanations for their continued use. They then review two central concerns about the WTO rules on export subsidies. First, they examine issues surrounding identification of export subsidies, including defining what constitutes a subsidy, distinguishing export subsidies from other types of subsidies, and how closely the WTO should review domestic policies for potential (rather than actual) export subsidies. Second, they discuss the difficulty the WTO has had in finding an appropriate remedy for violations of the prohibition against export subsidies. They argue that existing WTO rules do not adequately address either set of issues. In particular, in their view, Panels and the Appellate Body should adopt a more appropriate level of penalty for the use of export subsidies, such as tying the level of penalty to the adverse trade effects from the subsidy.

In their short reaction chapter, **Bagwell** and **Mavroidis** advance some preliminary thoughts on the level of pitching in the WTO SCM Agreement. The existing regime goes, to their mind, too far toward disciplining subsidies, in particular through the absolute prohibition on use of export subsidies. In contrast, trading partners might lose the incentive to continue negotiating trade liberalization if recourse to subsidies is not regulated at all: Through subsidies, trading nations might undo the benefit granted to their trading partners in the form of tariff concessions. Something needs to be done, but what is being done is inappropriate. A legislative amendment is, to their mind, warranted, and the remaining question is whether, from a policy perspective, this is the most appropriate moment in time to start advancing thoughts in this context.

We then move to discuss a high-profile litigation in this field: The *Boeing – Airbus* dispute fits very well here. **Slot** makes the point that WTO rules do not require that local remedies be exhausted before a complaint can be brought before the *Dispute Settlement Body* (DSB). Nevertheless, it may be interesting to ponder whether it would be possible, or have been possible at an appropriate moment, for *Boeing*, or one of its subsidiaries, to bring a complaint before the European Community (EC) Commission alleging the granting of incompatible state aid by EC Member States. To answer this question, it is necessary to discuss the relevant EC state aid rules. In addition, it will be interesting to see whether the EC Commission has ever taken any action against individual state measures granting aid to the *Airbus* companies or one of their subsidiaries or suppliers.

Wu, commenting on **Slot's** chapter, notes that it highlights several advantages for companies in bringing a complaint before the European Commission under its state aid laws rather than nudging their government to pursue a subsidies violation case before the WTO. **Slot's** chapter raises, in his view, an interesting question: Why haven't foreign multinationals been more aggressive in bringing forward complaints before the Commission on issues of state aid? In **Wu's** view, *Boeing's* decision was nonetheless rational, and does not reflect either a systematic bias against choosing a European forum or a lack of awareness of how European state aid law operates. In discussing potential explanations for

Boeing's action, the author illuminates some of the inherent difficulties that multinationals face in adjudication before the European Commission, despite the advantages of the EC's state aid rules.

The next topic discussed in this volume is antidumping. This part kicks off with a contribution by **Stewart** and **Dwyer**. Their chapter provides an overview of the WTO Anti-Dumping Agreement. In 1994, WTO Members adopted the WTO Anti-Dumping Agreement as part of a package of multilateral trade agreements that resulted from the Uruguay Round of trade negotiations. The general overview of WTO Anti-Dumping Agreement provisions is followed by some concluding observations regarding the use of antidumping laws by WTO Members. Specifically, the authors, in the seventh section of their paper, begin by explaining that a number of the Agreement's provisions reflect the tension between the interests of exporters and importers; they then identify major users of antidumping laws over time and significant trends in WTO disputes challenging antidumping measures. To assist with further research efforts, the overview also identifies WTO Panel or Appellate Body decisions discussing particular Agreement provisions (see footnotes and Attachment 2), and contains a bibliography of books, articles, reports, and papers (Attachment 3).

In his comment to their chapter, **Gantz** asks the question, "What is the excuse for the protection thereby afforded to domestic industries, given the weak economic rationale for international antidumping rules that punish price determination?" He suggests in his commentary that the rationale is political and practical; many national governments would not agree to freer world trade without the safety valve of antidumping laws. However, despite the oversight of the WTO's DSB, the international regulatory process and implementation are deeply flawed, in large part because the WTO's Anti-Dumping Agreement fails to deal effectively with important issues such as non-market economy analysis and zeroing, or otherwise mitigate the inherent biases in the system against foreign producers. Although the number of new antidumping actions worldwide is declining, particularly among developed countries, any major future reductions in Most-Favored-Nation (MFN) tariff levels in the developing world will likely stimulate use of the antidumping remedy in the affected nations.

Prusa, who also comments on the same chapter, starts with the observation that antidumping is extremely prominent in trade law. The chapter by **Stewart** and **Dwyer** is, in his view, an excellent starting place for anyone interested in learning about the WTO Anti-Dumping Agreement. From an economic perspective, however, he considers that the chapter is severely lacking, in part because the statute itself lacks economic rationale. He also suggests that the chapter should note that pricing and sales decisions that are entirely consistent with basic economic theory are sanctionable under the Anti-Dumping Agreement.

Kovacic discusses the difference across trade and antitrust statutes in treating price differentiation. His chapter describes the original overlap of how

antidumping and competition law treated price discrimination, and how the two areas diverged, with competition law encouraging price competition and antidumping (dealing only with foreign sellers) using more restrictive tests, particularly with respect to different views of what is "predatory" pricing. The first section of his chapter examines the elements that give agencies discretion to determine the impact of statutory commands. The second section describes how antitrust has adjusted controls on price differentiation. The third section considers how antitrust and antidumping treatment accords with the views of business schools and economists about how firms should make pricing decisions.

One of the thorniest issues in antidumping is that of rules of origin. This is the reason we welcomed two contributions in this area. **Vermulst** examines the role of origin rules in antidumping law and practice, with focus on the European Union (EU) system. He analyzes the use of such rules as an operative tool during the investigative process and as an enforcement mechanism once antidumping measures are imposed. He concludes that harmonization of nonpreferential origin rules remains desirable, but that such harmonization realistically should go hand in hand with the establishment of third country anticircumvention legislation.

In a separate chapter, **Inama** and **Vermulst** examine the efforts made at the multilateral level to establish disciplines on rules of origin and the various techniques that may be used in drafting rules of origin. They then discuss the role of origin rules in antidumping law and practice, with a focus on the EU system. They analyze the use of such rules as an operative tool during the investigative process and as an enforcement mechanism once antidumping measures are imposed. They conclude with an overview of the status of the Harmonization Work Programme (HWP) under the WTO Agreement on rules of origin and the recent proposals on anticircumvention made in the negotiating group on rules. Although the use of harmonized nonpreferential origin rules in the context of antidumping proceedings remains a desirable goal, it should realistically go, in the authors' view, hand in hand with the establishment of third-country anticircumvention legislation.

Eeckhout, commenting on both chapters, introduces a couple of general observations concerning the difficulties, in a globalized economy, of devising rules of origin that are appropriate for antidumping proceedings. He questions the utility and feasibility of such an exercise, in particular because the rationale for antidumping policy itself is contested.

During the Uruguay Round, the conclusion of *sunset clauses* was hailed as a major achievement in the effort to constrain abuses in antidumping practice. **Dordi** examines the Appellate Body case law in this area and notes that, in all decisions, the Appellate Body decided not to apply the same provisions regulating original investigations to the sunset review. This is a remarkable deviation, in the author's view, from the usual textual interpretation of the WTO contract that the Appellate Body follows. As a result, what was supposed to be a constraining

factor ended up being a rather loose test, which essentially makes it easy for investigating authorities to keep duties in place after five years.

Prusa comments on Dordi's chapter as well, noting that it highlights a key lesson for trade negotiators. Namely, the same agreement might mean something very different to different parties. In terms of sunset rules, the agreement implied that antidumping orders would be terminated unless it could be shown that injurious dumping would be resumed. In the United States, however, a review of sunset decisions reveals that the U.S. Department of Commerce has never determined that dumping would not resume. After seeing what the United States does with sunset reviews, one wonders what trading partners will assume any new WTO agreement will mean. Clearly, the sunset provisions have shown that one must be very careful with what one negotiates with the United States.

The third and last part of this volume concerns safeguards. **Wauters** provides an overview of the disciplines imposed on WTO Members by the WTO Agreement on Safeguards. He puts safeguard measures in the broader context of the WTO system, in general, and other WTO trade remedies such as antidumping and countervailing measures in particular. The chapter examines the conditions for the imposition of safeguard measures, and addresses some specific issues relating to the application of safeguard measures such as the MFN requirements and the obligation to offer compensation. By providing an overview of the provisions of the Agreement on Safeguards and their interpretation by WTO Panels and the Appellate Body, the chapter shows that this Agreement has certain shortcomings and that, unfortunately, the Appellate Body's jurisprudence has not contributed much to rectifying these shortcomings – quite to the contrary.

Bronckers, commenting on Wauters, considers that the arguments that have traditionally been advanced in favor of a nondiscriminatory application of safeguard measures are not convincing within the regime of the WTO Safeguards Agreement. Furthermore, if selective safeguards were plainly accepted in this Agreement, it would no longer be necessary to design country-specific mechanisms, such as the China-specific safeguard clause. In the 1970s and 1980s, the EC was a major proponent of selective safeguards. However, with the advent of the WTO Safeguards Agreement, the EC seems to have lost interest in taking safeguards itself. This may change as of 2009, when the EU Reform Treaty is expected to enter into force, and the European Parliament for the first time will obtain important powers in EU trade policy.

Saggi, also commenting on Wauters, argues that whereas the economic rationale underlying the Safeguards Agreement is sound, the same cannot be said about the structure of the agreement and its subsequent interpretation by the Appellate Body. In fact, the Safeguards Agreement appears to be fraught with ambiguity, and its insistence that safeguards be used when imports are an unforeseen cause of injury to domestic industry appears to be misguided in two key respects. First, at a conceptual level, it seems difficult to see how one could ever convincingly establish that a given surge in imports was unforeseen in the

past. Second, the notion of a causal link between imports and injury is devoid of economic logic: Domestic production and imports of like goods are jointly determined in the marketplace, and it makes little sense to attribute a reduction in domestic output to an increase in imports.

The thoughtful chapter by **Crowley** deals with the question of why safeguards are needed in a trade agreement. It reviews the theoretical and empirical literature on their use, and then analyzes the available data to examine two hypotheses in the economics literature, namely, that safeguards improve welfare by facilitating tariff reductions, and that safeguards improve welfare by providing insurance against adverse economic shocks. She finds that countries that undertook larger tariff reductions during the Uruguay Round conducted more safeguards investigations after the WTO was established. This finding suggests that the presence of a safeguard clause in the WTO agreement may have facilitated greater tariff reductions during the Uruguay Round. She finds no evidence that safeguards are used more intensively by countries exposed to more aggregate economic uncertainty. It thus seems unlikely that safeguards provide insurance against aggregate economic shocks.

In his comments on the Crowley paper, **Dunoff** considers whether framing an inquiry into the purpose of the safeguards mechanism in this form is likely to generate fruitful insights, or whether asking this question may instead be more likely to lead us astray. This exploration raises larger methodological questions concerning whether right now there are limits to what either legal or economic analysis can add to current understandings about the purpose and function of safeguards.

1 An Overview of the Agreement on Subsidies and Countervailing Measures – Including a Discussion of the Agreement on Agriculture

Introduction

The present contribution aims to provide an insight into the World Trade Organization's (WTO's) multilateral disciplines on subsidies related to trade in goods and on unilateral measures to respond to these subsidies, in other words, countervailing duties (CVDs). In our discussion, we focus on the legal analysis and thus leave the economic analysis to other contributions in this book. As such, we offer only one part of the introduction to the Agreement on Subsidies and Countervailing Measures ("SCM Agreement"), which should be complemented with the economic analysis to evaluate the subsidy and CVD disciplines from a normative point of view.

Our legal analysis is structured around six parts. After a short overview of the legal and historical context, we clarify the object and purpose of the SCM Agreement and examine the various aspects of the definition of "a subsidy" included in the SCM Agreement. When a specific subsidy is deemed to exist under the SCM Agreement, a traffic light metaphor can be made when categorizing subsidies. Some types of subsidies are prohibited (red light), whereas all other specific subsidies are allowed as long as they do not cause adverse effects (yellow light). At present, no type of subsidy gets the green light under the SCM Agreement. Later in this chapter, we look at how WTO Members may respond to subsidies provided by other WTO Members. WTO Members can challenge red light and yellow light subsidies before the WTO adjudicating bodies (multilateral remedy), or in case subsidized imports cause injury to their domestic industry, they can opt for the imposition of CVDs (unilateral remedy). However, not all WTO Members and types of subsidies are treated equally. Therefore, in the final part of this chapter, we study the special and differential treatment provided to developing countries and the different treatment of agricultural subsidies under the Agreement on Agriculture ("AoA").

The authors would like to thank Clarisse Morgan for her helpful comments on a previous version of this paper. All views and errors are ours.

Historical and Legal Context

Originally, the General Agreement on Tariffs and Trade (GATT) 1947 was very lenient toward subsidies provided by GATT Contracting Parties. Article XVI of the GATT merely required Contracting Parties to notify subsidies that were export stimulating or import reducing and, upon request, to discuss the limitation of these subsidies if they caused or threatened to cause serious prejudice to other Contracting Parties.¹ This should be read together with Article III:8(b) of the GATT, which exempts the payment of subsidies exclusively to domestic producers from the national treatment discipline.² In contrast, Contracting Parties whose industry was injured by subsidized imports were allowed to impose CVDs up to the amount of the subsidy (Article VI:3 of the GATT).³ This right was made subject to the determination by the countervailing country that the subsidy caused (or threatened to cause) material injury to its domestic industry; however, the exact procedural and substantive obligations were not spelled out.⁴

In 1955, a Review Session of the GATT included the first substantive obligations on subsidies (Section B of Article XVI of the GATT).⁵ From 1958 or “the earliest practicable date thereafter,” Contracting Parties had to cease to grant export subsidies on nonprimary products when they resulted in a sale at a price for export lower than that for the domestic market (bilevel pricing test) (Article XVI:4 of the GATT).⁶ Only in 1960, Contracting Parties could agree on a Declaration Giving Effect to the Provisions of Article XVI:4 (“1960 Declaration”)

¹ The original Article XVI was limited to paragraph 1 of the current Article XVI of the GATT. All Contracting Parties were bound by this obligation. For an elaboration of the discussions during the GATT preparatory work on subsidy disciplines, see J.H. Jackson, *World Trade and the Law of GATT – A Legal Analysis of the General Agreement on Tariffs and Trade* (Indianapolis, The Bobbs-Merrill Company, 1969), 948 pp., 368–371.

² For the exact scope of this exemption, see *infra*.

³ See also Article II:2(b) of the GATT. Also pertinent in this context is Article XXIII of the GATT on the prohibition of nullification or impairment [Article XXIII(b)], given that countries can nullify or impair benefits (e.g., tariff concessions) by the use of subsidies. Moreover, the “escape clause” in Article XIX of the GATT (and the Safeguard Agreement) could also be relevant to respond to subsidies that result in increased imports that cause or threaten to cause serious injury to domestic producers.

⁴ See Articles VI:3, VI:4, VI:5, and VI:6 of the GATT.

⁵ The amendments were clearly inspired by the provisions of the Havana Charter but were, at the same time, not as stringent as the Havana Charter with respect to agricultural export subsidies.

⁶ The second sentence of Article XVI:4 provided for a standstill obligation until the end of 1957. The expectancy was that the Contracting Parties would have agreed by that time to prohibit all nonprimary export subsidies, but an agreement was only reached in 1960 with the 1960 Declaration, which was not accepted by all Contracting Parties. Therefore, the standstill obligation was extended several times (for some Contracting Parties up to the end of 1967).

that elaborated a nonexhaustive list of export subsidies on nonprimary goods.⁷ Because of the different treatment between primary and nonprimary goods, many developing countries were unwilling to adopt the 1960 Declaration, which was in the end only accepted by 17 Contracting Parties.⁸ In contrast, regarding primary products,⁹ the 1955 amendment only provided for an obligation to “seek to avoid” the use of export subsidies and, if Contracting Parties did grant a subsidy that had the effect of increasing exports, it was subject to a highly ambiguous standard: It could not be used in a way that resulted in a “more than an equitable share of world export trade in that product” (Article XVI:3 of the GATT).¹⁰

It may be noted that the 1955 GATT amendment introduced two forms of distinctive treatment that are still present in the current multilateral system. First, the multilateral system primarily targets export subsidies, which are subsidies contingent upon export, because of their direct trade-distorting effect.¹¹ Disciplines on other subsidies, labeled domestic subsidies, are mostly less strict. Second, disciplines on agricultural subsidies are also less severe when compared with other subsidies.¹² The latter is a result of the negotiating power of some developed countries (mainly the European Community [EC], Japan, and the United States) resistant to cutting back their agricultural subsidies.

⁷ The 1960 Declaration became effective on November 14, 1962.

⁸ Contracting Parties that did not accept the 1960 Declaration were thus not subject to the obligation to cease export subsidies on nonprimary products (Article XVI:4, first sentence).

⁹ For the purpose of Article XVI, primary products are defined as “any product of farm, forest or fishery, or any mineral, in its natural form or which has undergone such processing as is customarily required to prepare it for marketing in substantial volume in international trade” (para. 2 of Ad Article XVI: Section B of the GATT).

¹⁰ All Contracting Parties that accepted the 1955 amendment to Parts II and III of the GATT were subject to this obligation. See J. Jackson, *loc. cit.*, *supra*, no. 1-376. To determine the “equitable share” of a Contracting Party, account will be taken of the shares in the product during a previous representative period and “any specific factor” affecting trade in the product (Article XVI:3 of the GATT). The fact that a Contracting Party has not exported the product in question during the previous representative period would not in itself preclude that party from establishing its right to obtain a share of the trade in the product concerned (para. 1 of Ad Article XVI:3 of the GATT). See also the exception for certain price stabilization schemes (para. 2 of Ad Article XVI:3 of the GATT).

¹¹ Interestingly, the “Suggested Charter for an International Trade Organization of the United Nations,” proposed by the United States in 1946, already included a prohibition of export subsidies subject to the bilevel pricing test (Article 25). This prohibition of export subsidies was carried into the Havana Charter (Article 26).

¹² In fact, a differential treatment of agricultural subsidies was already inscribed in the original GATT 1947 given that Article VI:7 of the GATT excludes the possibility to countervail certain agricultural subsidies where a domestic stabilization scheme exists. The Havana Charter also provided for a more flexible treatment of agricultural export subsidies (Articles 27–28), but this differential treatment was more limited than the one inscribed by the 1955 amendment in Article XVI of the GATT.