

Trade Policy and WTO Accession for Economic Development:
Application to Russia and the CIS

Module 11

Antidumping and Other Measures of Contingent protection

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This module addresses the following main questions:

- What is contingent protection?
- What is anti-dumping?
- What are subsidies and countervailing measures?
- What are safeguard measures?
- What are their effects on welfare? How are they regulated by WTO?

It derives the following main lessons:

Lesson 1: measures of contingent protection, meant for corrective purposes, are now being increasingly used for legitimizing selective, unilateral protection.

Lesson 2: anti dumping actions concern developed, developing and transition countries alike. Large developing and transition countries are the most likely targets of actions carried out by developed or other developing countries.

Lesson 3: the negative welfare effects induced by dumping are unlikely to arise and they are very difficult to prove. Antidumping actions are rarely initiated to challenge effective predatory pricing behaviour, and therefore they often constitute a form of hidden, discriminatory and unjustified protection.

Lesson 4: the GATT's definition and regulation of dumping is vague and the procedures are loose and full of loopholes. This has allowed a number of WTO members to act unilaterally and impose antidumping duties based on a very weak evidence of anti-competitive behaviour and it has made the case of any country which is challenged by an antidumping action extremely weak.

Lesson 5: Countervailing duties are not an effective mean to discourage the use of export subsidies. They are most likely used as an indirect way of protecting specific interest groups

Lesson 6: Being non discriminatory and costly for the country applying them, safeguards are less likely than other measures of contingent protection to be applied to satisfy the hidden protectionist agenda of specific interest groups.

1. Contingent Protection: General Principles

1.1 Contingent protection: what is it?

The fundamental principles of the GATT/WTO system are reciprocity and nondiscrimination. However, a number of exceptions to GATT's nondiscrimination rule exist, like contingent protection, government procurement, and regional trading agreements. This module deals with contingent protection and government procurement.

The term *contingent protection* refers to trade restrictions, that can be introduced under specific circumstances, providing protection from imports beyond the protection granted by the tariff schedules negotiated as part of GATT. Contingent protection thus represents an exception to the GATT/WTO fundamental principles of reciprocity and nondiscrimination¹.

¹ Regional trade agreements also represent exceptions to the principle of nondiscrimination.

Table 1.1. summarises the measures of contingent protection regulated by the WTO and their purposes. They can be divided into two categories. The first one regards *temporary* provisions that can be used when a predefined set of circumstances legitimize temporary increases in import barriers. The second one includes *permanent* exceptions to the general obligations.

Temporary restrictions allowed by the WTO are *anti-dumping duties, countervailing duties, and safeguard measures*, (tariffs to assist with balance of payments problems, tariffs to protect infant industries, or tariffs for emergency protection). Permanent exceptions are general waivers from binding obligations, which –in contrast with the other mechanisms – must be formally approved by the WTO Council.

Countervailing duties and anti-dumping duties are special offsetting import taxes allowed by the WTO under specific circumstances of *unfair* competition (export subsidies or dumping on the part of trading partners), conditional on a detailed investigation showing that the domestic industry is being hurt. These are discriminatory measures, in that they are just applied against one trading partner. *Safeguard measures* are temporary trade restrictions protecting an industry from *fair* competition, beyond the protection afforded by tariffs negotiated as part of GATT. They are non discriminatory measures as they are applied to all trade partners.

TABLE 1.1. CONTINGENT PROTECTION	
<i>Measures</i>	<i>What are they for?</i>
Temporary Measures	
Antidumping actions	Duties to offset <i>unfair competition</i> from foreign exporters, only applied to dumping firms <i>Discriminatory measure</i>
Countervailing duties	Duties to offset export subsidies granted by the government of an exporting country <i>Discriminatory measure</i>
Safeguards	Tariffs or quota to offset <i>fair competition</i> from imports causing damages to the domestic industry <i>Non discriminatory measure</i>
Permanent Measures	
Waivers from binding obligations	Long term waivers from binding obligations within the WTO granted to individual countries

1.2 What is the scope for contingent protection?

Lesson 1: *measures of contingent protection, meant for corrective purposes, are now being increasingly used for legitimizing selective, unilateral protection.*

The two arguments used to justify contingent measures are a strategic one and a political economy one. The *strategic* one is that measures of contingent protection, especially temporary ones, as far as they are credible threats, may discourage the introduction of distortive trade practices, like subsidies or dumping actions. The *political economy* one is that contingent protection working as both an insurance mechanisms and a safety valve, may help reducing the resistance of protectionist groups to broader trade liberalisation agreements.

However, the validity of both arguments rests strictly on two conditions that, as we will see below when discussing specific measures, rarely hold. The first one is that the measure against which contingent protection is raised must be effectively damaging to the welfare of the country concerned. As we will see this is often not the case and even when it is so, the damage is difficult to prove. Second, the procedures through which these measures are raised must ensure that specific interests are not protected at the expenses of the overall national economy. Again, often these measures, especially anti-dumping and countervailing duties, are applied through administrative procedures, without taking into account the overall economic context of the country applying them.

For these reasons the fact that the use of contingent protection measures is increasing raises many concerns that regulations that were meant for a corrective purpose are now being increasingly used for legitimizing selective, unilateral protection. As we will see, at present the WTO agreement leaves relatively large room for the introduction of measures that are often little justified on the ground of safeguarding national economies.

1.3 How does the WTO regulate contingent protection?

Anti-dumping and safeguards are disciplined by GATT 1994 Article VI and by the Agreement on Implementation of Article VI of GATT 1994 (known as the Anti-Dumping Agreement). Subsidies and countervailing duties are disciplined by the Agreement on Subsidies and Countervailing Measures of GATT 1994, by the Agreement on Agriculture and Textiles and Clothing and only partly by the General Agreement on Trade in Services. These agreements, as the GATT and the GATS, are –for the most part– subscribed by all WTO members.

In what follows we examine first antidumping. We will discuss its economic effects and how it is regulated by the GATT. We then move on to examine subsidies and under what circumstances they can be offset by countervailing measures. Finally, we look at safeguards.

2. Anti-Dumping

- *Key questions.*
What is antidumping?
What are the economic effects of antidumping?
How does the WTO regulates antidumping actions?

2.1 Anti-dumping duties: what are they?

Anti-dumping duties are tariffs imposed by an importing country on imports of a product that has been dumped into its domestic market by some exporting firms. Such tariffs are supplementary to those agreed within the GATT and only applied to dumping firms; they thus represent an exception to the WTO fundamental principle of non-discrimination. Notice that they retaliate against actions carried out by individual firms rather than countries, contrary to the case of countervailing duties that we will discuss in the following section.

In very general terms, *dumping* is the practice of selling exports at an ‘unfairly’ low price, that is a situation where an exporting firm sells its production in the importing country at a price below those applied to identical or ‘like’ products² in the country of the exporter. Specifically, if the firm sells in the importing country at an average price below a benchmark related to either the price or the average costs of production in the home country, the exported product is said to be ‘dumped’. In principle, antidumping measures are measures against *unfair* competition.

Lesson 2: *anti dumping actions concern developed, developing and transition countries alike. Large developing and transition countries are the most likely targets of actions carried out by developed or other developing countries.*

Anti-Dumping is by far the most prevalent instrument for imposing new import restrictions. In the 1980s anti-dumping was used almost exclusively by a handful of industrial countries. Since the WTO agreements went into effect in 1995 1,979 actions had been undertaken by 1999. The largest number of actions have been initiated by the European Union and the US; however the US and the EU also account for the largest share of world trade flows. Finger, Ng and Wangchuk (2001) show that if these numbers are normalized by the volume of imports, than also developing countries are very active in carrying out antidumping actions. With Argentina South Africa and Peru leading the group. On the other side large developing economies and transition countries (China, India, Korea, Russia and other CIS countries) are the most likely targets of antidumping actions, both measured by absolute numbers or with

² A ‘like’ product is defined in the 1994 GATT Anti-Dumping Agreement as ‘a product which is identical, i.e. alike in all respects to the product under consideration or, in the absence of such a product, another product which, although not alike in all respects, has characteristics closely resembling those of the product under consideration’.

respect to their exports. Thus, antidumping is a measure which is of major importance and concern for developed, developing and transition countries alike.

2.2 What are the welfare effects of anti-dumping duties?

Lesson 3. *The negative welfare effects induced by dumping are unlikely to arise and they are very difficult to prove. Antidumping actions are rarely initiated to challenge effective predatory pricing behaviour, and therefore constitute a form of hidden, discriminatory and unjustified protection.*

There is dumping when products are sold in a given market below their 'normal value' in broad terms, their prices in the home market or their average costs of production (see below on the GATT's definition of 'normal value'). What is the welfare impact of these practices in the country of destination? The effect is ambiguous. From the point of view of consumers dumping is welfare improving (the effect is similar to the one of export subsidies analysed in Module 1) as it reduces final prices. From the point of view of producers the question is more complex. Of course, local producers suffer losses, as foreign exporters bite into their market shares. However, it is not obvious that dumping results from an anticompetitive behaviour. First, it is necessary to prove that prices are effectively dumped, lower than prices or production costs at home. As we will discuss below it is actually very difficult to reach firm conclusions on this ground. Second, even if this is proven, it does not necessarily imply that exporters are undertaking predatory pricing practices rather than fair price discrimination.

Predatory pricing takes place when firms set unduly low prices in order to drive competitors out of business. In the long run this can have indeed negative effects on the total welfare of the importing country, even of consumers. In fact, if efficient domestic producers go out of business and the dumping firm becomes a monopolist, it will then increase output prices. Thus, in principle, anti-dumping rules are an international projection of anti-trust laws, with the official aim of preventing predatory pricing.

However, firms rarely carry out predatory pricing. Indeed this is a long a process with uncertain outcomes. Firms would indeed take losses for a relatively long period of time (until their competitors are driven out of business) that will be recouped only by large profits in the future. The outcome of the game is uncertain: it is not sure competitors are driven out of business and that market conditions remain stable. Moreover, in order for predatory pricing to be successful, three further conditions must hold. *First*, market must be effectively segmented, otherwise dumped products get re-exported to other markets. *Second* dumping firms must have deep pockets to fund their initial losses, i.e. large market power in one or more markets. *Third*, the price elasticity of demand must be higher in the export market than at home or in other markets, in order to rapidly acquire large market shares and increase volumes (Krishna, Finger, 1993)

Also, there may be other reasons why firms set different prices in different markets, which have little to do with predatory behaviour and which are totally legitimate. According to the

classical analysis of Jacob Viner (1923), dumping is defined as price discrimination between national markets³. Indeed, if the export market is imperfectly competitive, dumping can be seen as a standard practice of price discrimination. The monopolist raises its profits by applying different prices at home and in the international market and it improves consumers' welfare in the importing country (Dixit, 1988). If instead export markets are perfectly competitive but the domestic market is imperfectly competitive, firms may benefit from dumping in periods of sluggish world demand. If the exporter is a monopolist in its own market, and the export market is in perfect competition, then the monopolist will benefit from exporting its excess capacity at a price below average total costs in order to protect its monopoly profits in the domestic market.

Therefore it is very unlikely that a case really justifying the application of antidumping duties emerge in the real world. In fact studies of antidumping actions in the US and in Europe(Lindsey 1999, Lindsay and Ikenson 2002, Finger, Ng and Wangchuk, 2001, Messerlin and Reed, 1995) show that most antidumping actions are undertaken on the basis of very negligible evidence that in general does not prove the presence of effective antidumping practices. Moreover, according to the Oecd which reviewed antidumping cases in Australia, Canada, the EU and the US, 90 per cent of the instances of import sales found unfair under antidumping rules would have never been challenged under national competition law (Oecd, 1996, Finger, Ng and Wangchuk, 2001) .

Finally (as we will see below) The assessment of anti-dumping cases is based on a purely administrative procedure carried out in the challenging country, without taking into account the overall national costs and benefits resulting from the actions. In other words if other instances are damaged by the action this damage is not taken into account in the administrative procedure

2.3 What does the Anti-Dumping Agreement say?

Lesson 4. *The GATT's definition and regulation of dumping is vague and the procedures are loose and full of loopholes. This has allowed a number of WTO members to act unilaterally and impose antidumping duties based on a very weak ground and made the case of any country which is challenged by an antidumping action extremely weak.*

Article VI of GATT 1994 explicitly authorizes the imposition of a specific anti-dumping duty on imports from a particular source, in excess of bound rates, when dumping causes or threatens injury to a domestic industry, or materially retards the establishment of a domestic industry.

The Agreement on Implementation of Article VI of GATT 1994, commonly known as the Anti-Dumping Agreement, further elaborates on the principles established in Article VI, to

³ Also Dixit (1988) and Krugman Obstfeld (2003) use this definition.

govern the investigation, determination, and application, of anti-dumping duties.

Previous Agreements. The possibility of imposing tariffs additional to the negotiated ones was available even in the 1947 GATT agreement: each country had an automatic right to renegotiate any of its reductions after three years. In the 1950s the GATT was amended to add more elaborate renegotiation provisions. By the 1960s formal use of Article XIX and of the renegotiations process began to wane. Big problems such as textile and apparel imports were handled through the negotiation of voluntary export restraint agreements. The Uruguay Round agreement on safeguards subsequently banned VERs; at that time antidumping was a secondary instrument and it was included with little controversy. By the 1990s, though, antidumping had become the developed countries' major safeguard instrument.

Present agreement. The Anti-Dumping Agreement establishes detailed procedural rules for the initiation and conduct of anti-dumping actions: the investigations, the imposition of measures, and the duration and review of measures. It defines dumping as the introduction of a product into the commerce of another country at a price below its 'normal value'. Normal value is defined as the comparable profitable domestic price, adjusted to an ex-factory level. If a domestic price is not available, or is not representative, the costs of production (plus a reasonable margin for sales, expenses and profit) or comparable export prices to third countries (adjusted to an ex-factory level) can be taken as the normal value.

When it has been established that the export price is less than the normal value, dumping has occurred. However, according to the Anti-Dumping Agreement, before being allowed to impose an anti-dumping duty the importing country has also to:

- calculate the extent of the 'dumping margin', that is by how much the exporter's domestic price exceeds the export price, and which is used as a base to compute the rate of anti-dumping duty;
- demonstrate that dumping is causing material injury in the domestic market.

Disputes in the anti-dumping area are subject to binding dispute settlement before the Dispute Settlement Body of the WTO. All WTO Members are required to bring their anti-dumping legislation into conformity with the Anti-Dumping Agreement, and to notify that legislation to the Committee on Anti-Dumping Practices. In addition, members are required to notify the Committee twice a year about all anti-dumping investigations, measures, and actions taken. Finally. Members are required to promptly notify the Committee of preliminary and final anti-dumping actions taken.

Antidumping duties are also subject to "sunset reviews" every five years. During a sunset review, a duty is removed unless there is evidence that the targeted country continues to dump and this dumping is hurting domestic firms in the importing country.

It is widely recognized that the WTO definition and regulation of dumping is vague and that the procedures are loose and full of loopholes, making the case of any country which is challenged by an antidumping action extremely weak. Problems arise about the very

definition of dumping, the criteria for establishing 'normal value', and about ascertaining the injuries caused by dumping. As argued above, this has allowed a number of WTO members to act unilaterally and impose antidumping duties based on a very weak ground.

The definition of the normal value of a product is very difficult to determine. Products are not always fully similar. Prices may differ just because market conditions are different in the two countries. Factors costs vary from country to country and it is hard to establish the full cost of production in the home country. Defendants have little opportunities to prove their case. Finally, the problem is even more complex when challenged WTO members are non-market economies, because the home market price is not set through the market. In this case, normal value is usually determined by looking at domestic prices, costs of production, and even third country export prices in an analogue market economy country. This explains the unduly large number of anti-dumping actions undertaken against transition economies and the resistance of western countries, particularly the EU, to China's request to the WTO of being granted a market economy status.

More problems arise in the calculation of the difference between normal value and the export price –the 'dumping margin' –and the calculation of anti-dumping duties to be imposed.

As far as injury determination is concerned, the procedure is riddled with ambiguity and loopholes. First of all, the Agreement's definition of 'like product' has proven to be too vague and has given place of unilateral interpretation. Secondly, the information gathered by the investigating authorities within the injury investigation cannot be disclosed to the opposing side to any meaningful extent; as a consequence, it is excessively difficult for the defendant to refute the evidence gathered by the investigators.

Even more problematic is proving the causal link between imports and injury. The determination of material injury relies mainly on economic evidence making it difficult to establish whether –and to what extent– injury was in fact caused by dumping rather than by other factors.

Finally, an antidumping action is essentially an administrative procedure started unilaterally by a given country. Given the weaknesses of the GATT regulation an initiating country is very likely to succeed in imposing the duties. Defendants are very unlikely to be able to challenge the action and to make a strong case that dumping was actually not in place. Moreover, the procedure generally does not take at all into account national interests of the initiating country, i.e. the overall costs and benefits of the policy at the national level. Consequently it can be easily used to protect specific interests, as national injured counterparts (e.g. consumers) have little margins to oppose the action.

Indeed, antidumping has become the most widely use defensive measure, because regulation within the WTO offers a number of advantages to protection-seeking industries:

- Protection can be offered to individual exporters because the Agreement does not require multilateral application.

- The action is unilateral: no compensation or renegotiation to other parties outside or within the country starting the action is required.
- The rhetoric of foreign unfairness provides an excuse for protection.
- Investigation in itself tends to curb imports, because exporters (or intermediaries in the importing country) bear significant legal and administrative costs and they face the uncertainty of having to pay backdated antidumping duties, once an investigation is completed.

3. Subsidies and Countervailing Measures

Key questions:

- *What are subsidies and countervailing duties?*
- *What are their economic effects?*
- *How does the WTO regulate them?*

3.1 Subsidies and countervailing duties: what are they?

Subsidies are implicit or explicit payments by a government to the private sector in return for some activity that it wants to reward, encourage or assist. Under WTO rules, subsidies may be prohibited.

Countervailing duties (CVDs) are tariffs applied to offset (countervail) the impact of export subsidies granted by the government of an exporting country. Supposedly, CVDs should level the playing field for international competition and mitigate distortions. It is possible, however, that such remedy for subsidies is more harmful than the subsidies themselves. CVDs are often applied to appease sectoral interests rather than discouraging or offsetting the threat or the implementation of subsidies.

Dumping and subsidies —together with anti-dumping measures and countervailing duties (CVD) —share a number of similarities. Many countries handle the two under a single law, apply a similar process to deal with them and give a single authority responsibility for investigations. Occasionally, the two WTO committees responsible for these issues meet jointly. The main difference between them is that dumping is an action carried out by a firm, while subsidies are actions undertaken by governments. Because the WTO is an organization of countries and it cannot regulate actions undertaken by firms —such as dumping— the Anti-Dumping Agreement only concerns the actions governments take against dumping — anti-dumping actions. The Subsidies Agreement, instead, disciplines both the granting of subsidies and the countervailing actions.

3.2 What are the welfare effects of subsidies and CVDs?

Lesson 5: *Countervailing duties are not an effective mean to discourage the use of export subsidies. They are most likely used as an indirect way of protecting specific interest groups*

Export subsidies, contingent in one way or another on the volume of exports, may take the simple form of a payment for every unit exported, or may take more subtle forms such as below-market export financing or insurance, tax benefits for exporters. Also subsidies to protect domestic production are sometimes used. These can provide the same sort of protection than tariffs, although they have different welfare effects.

Subsidies are clearly conflicting with the overall process of trade liberalization. They undermine market access commitments made by importing nations. Promises to reduce or eliminate the use of traditional instruments of protection can be worthless if other instruments protection are substituted for them. They divert customers from one exporting nation to another and thus threaten the benefits to exporters of market access commitments secured through international negotiations. They distort resource allocation by diverting resources from higher valued to lower valued uses. In other words, they can distort comparative advantage and produce a less efficient global division of labor, leading to lower economic welfare.

What are its effects in individual countries? As shown in module 1, when an export subsidy is introduced, the price of the good in the exporting country increases and the price in the importing country decreases. In the *exporting country* producers gain, while consumers loose and the usual dead weight losses arise. Furthermore, if the country is large, a subsidy worsens its terms of trade because it causes a reduction in the price of exports. As a consequence, the net welfare effect of an export subsidy in the exporting country is definitely negative. On the other hand, the *importing country* facing an export subsidy is unequivocally better off because of the subsidy. Consumers gain and domestic producers loose, but in competitive industries, the economic losses to import-competing domestic firms are generally outweighed by the gains to domestic consumers. Moreover, if the exporting country is large, the importing country improves its terms of trade.

Also in terms of world welfare the sum of the losses exceeds the sum of the gains, thus an export subsidy results in a reduction in world production and consumption efficiency.

Does it make economic sense to use countervailing duties to offset the effects of subsidies? Marvel and Ray (1995) provide a useful analysis of the economic effects of countervailing duties. In general terms, as far as export subsidies generate a positive net welfare gain in the importing country, they do not make much sense. Countries importing lower-priced, subsidized goods are net economic beneficiaries; when they respond to subsidies with countervailing duties, they tend to reduce their economic well-being, other things being equal.

Thus, paradoxically, both subsidies in the exporting country and countervailing duties in the importing country are welfare worsening, and they only protect specific sectoral interests.

Still, export subsidies may harm producers in the importing country. As suggested by the literature on strategic trade policy, a foreign government may employ a subsidy to shift rents to firms in an industry earning better than competitive returns. A countervailing duty might be a rational response when domestic producers are seriously harmed by subsidised imports (the strategic trade policy argument above).

However, the industries to which the strategic trade framework can be applied are limited in number and the empirical studies of the use of countervailing duties suggest that they are used primarily in established and often declining industries. CVD have been mostly concentrated in agricultural products and raw material, industries that hardly justify the use of subsidies as part of strategic trade policy weapons.

Also, countervailing duties have not always been used to offset subsidies in an efficient way. Subsidies to be targeted are those that decrease the marginal costs of exporters, thereby stimulating export supply (as discussed in module 1). Subsidies should be immediately phased out, when matched by efficient CVDs. CVDs should therefore be short lived. Quite the contrary. CVDs are often long lived and they target subsidies the cost of which is sunk, once incurred, i.e. subsidies which have little to do with the material injury suffered by domestic producers.

Finally, the material injury standard for CVDs introduces an important protectionist element into the CVD process because it only considers the impact of imports on the firms with which imports compete. This means that like for anti-dumping duties, countervailing measures are introduced without taking into account total national interests. Those harmed by protection – consumers or downstream industries - do not take part in the decision process leading to the introduction of CVDs.

Therefore, there is a risk that countervailing duties are used to protect specific interest groups from fair rather than unfair competition and that anyway they are not an efficient mean to offset subsidies. This fear is strengthened by the evidence that countervailing duties have been growing in number and importance. This shows that either subsidies are growing or that CVDs are being used as ‘hidden’ protectionist measures.

3.3 What does the Agreement on Subsidies and Countervailing Measures say?

Subsidies which directly or indirectly affect trade flows are regulated by the WTO which defines what is a subsidy, which subsidies are forbidden and the countervailing measures to offset their effects.

From a rule making perspective, subsidies rise a number of issues. One is whether and which subsidies should be prohibited. Another is whether and how to define the criteria for intervention and how to choose the most effective remedy.

The Uruguay Round of GATT negotiations produced the Agreement on Subsidies and Countervailing Measures (“SCM”). It also established separate rules for agricultural subsidies

in the WTO Agreement on Agriculture, and took some minimal steps toward addressing subsidies issues in services industries within the General Agreement on Trade in Services (“GATS”).

The Agreement on Subsidies and Countervailing Measures disciplines the use of subsidies, and regulates the actions that countries can take to counter the effect of subsidies imposed by others. WTO disciplines relating to subsidies have a twofold objective:

- to establish rules that avoid or reduce adverse effects on members, and prevent the use of subsidies to nullify or impair concessions
- regulate the use of countervailing duties by members seeking to offset the injurious effects of foreign subsidization of products

The structure of the SCM Agreement is the following. Part I defines the coverage of the discipline and provides a definition of the term ‘subsidy’. Parts II, III and IV classify subsidies into categories and establish rules for dispute settlement and procedures. Part V establishes the substantive and procedural requirements that must be fulfilled for the application by a Member of a countervailing measure against subsidized imports. Parts VI and VII define the institutional structure and modalities for implementation of the Agreement. Part VIII establishes special treatment rules for developing country Members. Part IX contains transitional rules for developed country and economies in transition. Parts X and XI describe, respectively, a general dispute settlement provision and final provisions.

According to the Agreement’s definition, a subsidy entails a "financial contribution by a government," in the form of:

- a direct transfer of funds,
- a decision to forego revenue that is "otherwise due,"
- the provision of goods and services
- an income or price support scheme, if the financial contribution confers a "benefit."

The definition of subsidy as a financial contribution establishes that not all government programs are subsidies. Only contributions that distort the incentive to trade in a major way are regulated as subsidies by the WTO. If a government provides goods and services at market prices, for example, no benefit arises and thus no subsidy exists. Also, financial contributions that can be justified on market failure or non-economic grounds are unconstrained.

The Agreement distinguishes between two types of subsidies: prohibited and actionable.

Prohibited subsidies are those contingent, formally or in effect, on export performance or on the use of domestic over imported goods⁴. These subsidies are prohibited because they are specifically designed to distort international trade, and are therefore likely to hurt other countries’ trade. An illustrative list of export subsidies, attached to the Agreement, mentions

⁴ The Agreements grants an exception for least developed countries.

the provision of products or services (including transportation) for use in export production on terms more favorable than for domestically consumed goods. It also lists export credits and guarantees or insurance at a cost that does not cover long-term operating costs. All export subsidies are deemed specific, that is available only to an enterprise, industry or group of industries. Specific subsidies can be challenged in the WTO dispute settlement procedure where they are handled under an accelerated timetable; if the procedure confirms that the subsidy is prohibited, it must be withdrawn immediately. Otherwise, the complaining country can take counter measures. If domestic producers are hurt by imports of subsidized products, countervailing duty can be imposed.

Actionable subsidies are measures that are permitted but may give rise to a consultation or to the imposition of countervailing duties if the complaining country can demonstrate that the subsidy has damaged its interests. The agreement defines three types of damage:

- damage to a domestic industry in an importing country;
- damage to rival exporters from another country when the two compete in third markets;
- damage to exporters trying to compete in the subsidizing country's domestic market.

Three types of adverse effects can be challenged multilaterally:

- Injury to domestic industry.
- Serious prejudice. This type of adverse effect can arise when a subsidy causes: 1) displacement of exports, even in a third country market; 2) significant price reductions or lost sales; 3) an increase in the subsidizing member's share of world market
- Nullification or impairment of benefits accruing under the GATT 1994⁵.

Part V of the SCM Agreement establishes detailed rules regarding the initiation and conduct of countervailing investigations, the imposition of preliminary and final measures, and the duration of measures. Most of the procedural rules of the SCM Agreement are the same as those in the Anti-Dumping Agreement.

If the Dispute Settlement Body rules that the subsidy does have an adverse effect, the subsidy must be withdrawn or its adverse effect must be removed immediately. Again, if domestic producers are hurt by imports of subsidized products, countervailing duty can be imposed provided that the importing country proves that the import subsidy exists, that the domestic industry has been injured and that there is a causal link between the two. The subsidized exporter may agree to raise its export prices as an alternative to being charged countervailing duties on its exports.

WTO members are required to notify their subsidy programs to the WTO secretariat each year, giving information on the type of subsidy, the amounts involved, duration, their policy objective as well as statistics allowing their trade effect to be determined.

With regard to countervailing measures, members are required to report legislation and regulations, all actions taken as well as competent authorities and domestic procedures.

⁵ Typically, when a bound tariff reduction is undercut by subsidization

Members must also submit semi-annual reports on countervailing duty actions taken.

Special exemptions were granted to developing countries and economies in transition. Least-developed countries and developing countries with less than \$1,000 per capita GNP are exempted from disciplines on prohibited export subsidies; other developing countries had to remove export subsidies by 2003. Import-substitution subsidies⁶ had to be eliminated by 2003 in least-developed countries and by 2000 in other developing countries. Transition economies had to phase out subsidies by 2002.

4. Safeguards

Key questions:

- *What are safeguards?*
- *What are their economic effects?*
- *How does the WTO regulate them?*

4.1 Safeguards: what are they ?

A **safeguard measure** is a temporary tariff or quota used to protect a domestic industry from foreign exporters. WTO allows, through its safeguard clause, to impose temporary and nondiscriminatory safeguard measures on imports that are causing injury. The difference between anti-dumping duties and safeguard measures is that the former may only be imposed when foreign exporters are engaged in anti-competitive practices while the latter may be imposed on exporters that have a *'fair'* competitive advantage. Not also that safeguards are non-discriminatory measures, as they are equally all applied towards all trade partners

4.2 What are the welfare effects of safeguard measures?

Lesson 6: *Being non discriminatory and costly for the country applying them, safeguards are less likely than other measures of contingent protection to be applied to satisfy the hidden protectionist agenda of specific interest groups.*

The economics literature provides several motivations for the inclusion of safeguards in the WTO agreements.

One of the most commonly mentioned reasons is that the existence of safeguards, offering an escape valve for periods when domestic producers are pressured by import competition, can

⁶ Subsidies designed to help domestic production and avoid importing.

encourage greater tariff reduction during negotiations. Because the gains from permanent tariff reductions are larger than the costs of imposing temporary safeguards in a few sectors, the aggregate welfare effect of inclusion of safeguards in a trade agreement is positive, even when they are not actually used .

Another economic argument in favor of safeguards is that they act as a form of insurance against fluctuations in the terms of trade. If a good is typically subject to substantial fluctuations of price, countries importing that product may want to recede from trade agreements when the economic environment changes dramatically. In the absence of a safeguard clause, large countries would not be able to sustain cooperation and would engage in a trade war with high levels of tariff retaliation⁷. Even small countries, which cannot affect world prices by imposing a safeguard, can use safeguards to insure themselves against international price shocks⁸.

In general terms the political economy argument, that the inclusion of safeguards in the GATT agreement strengthens support for the whole process of trade liberalization is stronger for safeguards than for other measures of contingent protection. This is because, as we will see below, safeguard procedures make their misuse less likely.

4.3 What does the Agreement on Safeguards say?

Safeguard protection is an Import protection provided under the Safeguards Clause, that is Article XIX of the GATT. This article permits countries to restrict imports causing injury through temporary and nondiscriminatory restrictions. The Agreement on Safeguards ("SG Agreement") illustrates the rules for application of safeguard measures relative to Article XIX of GATT 1994.

The WTO Agreement defines safeguard measures as "emergency " actions with respect to increased imports of particular products, when such imports have caused or threaten to cause serious injury to the importing Member's domestic industry. Such measures can consist of quantitative import restrictions or of duty increases to rates higher than those agreed within the WTO.

The guiding principles of the Agreement are that

- measures must be temporary;
- they may be imposed only when a surge in imports⁹ is found to cause or threaten serious

⁷ Bagwell, K., Staiger, R., 1990. "A theory of managed trade," *American Economic Review*, Vol. 80, pp. 779–795.

⁸ Fischer, R., Prusa, T., 1999. „Contingent protection as better insurance," National Bureau of Economic Research, working paper, No. 6933.

⁹ An import "surge" justifying safeguard action can be a real increase in imports or it can be an increase in the

- injury to a competing domestic industry;
- that they (generally) be applied on a non-discriminatory way;
- and that the Member imposing them (generally) must pay compensation to the Members whose trade is affected.

The agreement sets out criteria for assessing whether “serious injury” is being caused or threatened, and the factors which must be considered in determining the impact of imports on the domestic industry. GATT rules establish that safeguards should only be used when imports increase unexpectedly. The WTO’s Safeguards Committee oversees the operation of the Agreement.

A safeguard measure should not last more than four years, even though it can be extended up to eight years, subject to a determination by competent national authorities that the measure is needed and that there is evidence the industry is adjusting. Measures imposed for more than a year must be progressively liberalized.

Thus, safeguard measures, unlike anti-dumping measures:

- do not require finding evidence of "unfair" practices;
- generally must be non discriminatory;
- generally must be "paid for" by the Member applying them.

Because they are non discriminatory, and they are costly for the country applying them, they are safeguards are generally less distortive than other contingent measures and when applied their effects on the whole national economy is generally taken into account.

To some extent developing countries’ exports are shielded from safeguard actions because importing countries can apply safeguard measure to a product from a developing country if the developing country is supplying a significant share of the imports of that product.

The use of safeguards first began in the 1940s when the U.S. began to pursue a liberal trade agenda. Fearing that the lowering of a tariff on some particular good as part of a trade agreement could result in a larger than expected import surge that would hurt domestic firms, the U.S. government insisted that a safeguard provision be part of every trade treaty that it signed.

Prior to the Uruguay Round’s revisions to the safeguard rules in 1994, the use of a safeguard measure was subject to measured retaliation. As part of the Uruguay Round reforms, the safeguard rules changed so that safeguards are no longer subject to retaliation for the first three years they are in effect. This modification was intended to make nondiscriminatory safeguards more attractive for protection- seeking governments relative to discriminatory antidumping duties.

imports’ share of a shrinking market.

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