

## EXECUTIVE SUMMARY

### TRADE POLICY COMMITMENTS AND CONTINGENCY MEASURES

*The World Trade Report 2009 focuses primarily on certain contingency measures available to WTO members in the import and export of goods. The legal framework for such measures is much less developed in services trade, although this is also discussed.*

The Report covers safeguard measures, anti-dumping, and countervailing duties. In order to appreciate better the trade-off among alternative policy instruments available to governments to address difficult economic situations, or situations in which a government decides to modify a policy stance, the Report also discusses a number of other mechanisms of flexibility available to WTO members. These include the renegotiation of tariff commitments, export taxes, and increases in tariffs up to the maximum ceiling that each WTO member has negotiated – known as tariff bindings.

Apart from the obvious relevance of contingency measures in relation to the integrity and durability of trade agreements, the topic of this Report merits attention as limited research has been undertaken in this area. Perhaps one reason for this is that contingency policy is an interdisciplinary field, requiring both legal and economic expertise. The Report seeks to fill a gap in the existing literature on the subject.

*Trade agreements define rules for the conduct of trade policy. These rules must strike a balance between commitments and flexibility. Too much flexibility may undermine the value of commitments, but too little flexibility may render the rules unsustainable.*

The tension between credible commitments and flexibility is often close to the surface during trade negotiations. For example, the question of a “special safeguard mechanism” (the extent to which developing countries would be allowed to protect farmers from import surges) was crucial in the discussions of the July 2008 mini-ministerial meeting, which sought to agree negotiating modalities – or a final blueprint – for agriculture and non-agricultural market access (NAMA).

Many of the kinds of flexibilities associated with trade agreements are generally referred to as escape

clauses, contingency measures, trade remedies or safety valves. The fundamental reason for incorporating such provisions into trade agreements is for governments to manage circumstances that cannot be anticipated prior to their occurrence. A trade agreement that offers such possibilities without unduly weakening existing contractual commitments has a better chance of remaining robust than an agreement that results in regular non-compliance.

### FLEXIBILITY IN TRADE AGREEMENTS

*Governments have good reasons for signing trade agreements, but effective agreements must strike an appropriate balance between flexibility and commitments.*

Economic theory offers two main explanations why governments sign trade agreements. First, they allow parties to escape from mutually destructive beggar-thy-neighbour behaviour – or terms-of-trade conflicts – where trade restrictions may be used to change the prices of imports or exports in favour of the trade-restricting country. Second, trade agreements may also allow governments to confer greater credibility on their trade policies in the eyes of stakeholders.

If a trade agreement allows too much leeway to modify obligations, the underlying value of the agreement is reduced. But if flexibility provisions are too restrictive, an agreement will be less stable because signatories may be more inclined to renege on their commitments. Flexibilities are not costless in relation to the benefits of an agreement, since they undo part of what the agreement achieves in terms of trade cooperation. Moreover, relaxing trade commitments may harm a government’s credibility and result in a reduction of global welfare. The presence of these “costs from flexibility” opens the question of why contingent measures are introduced in the multilateral trading system.

*Two largely complementary arguments are put forward to rationalize flexibilities in trade agreements: the “benefit” approach and the “incomplete contract” approach.*

The “benefit” approach holds that the cost of flexibilities in trade agreements must be compared with the benefits of allowing some degree of discretion to participating governments in setting their trade policy. Within this framework, contingency measures may serve as a safety valve, an insurance mechanism, or an adjustment policy tool. They may also serve as a means to improve the rule of law in the trading system and to facilitate trade opening.

The “incomplete contract” approach stresses the fact that a trade agreement is a contract that does not specify rights and duties of all parties in all possible future states of the world. Trade agreements are incomplete by nature and flexibilities offer an avenue for dealing with difficulties arising from contractual incompleteness in an agreement. Contracts may also be incomplete by choice. Governments opt for flexibilities as a trade-off between the benefits of a more detailed agreement and the costs associated with writing such an agreement.

*Abstracting from terms-of-trade considerations, the economic case for employing measures of contingent protection rests on the emergence of market failures, such as negative external effects (externalities) or imperfect competition. Alternatively, political economy arguments may explain a willingness to contemplate an agreement that allows for the suspension of commitments.*

From an economic theory perspective, an import surge may provide a terms-of-trade argument for an increase in trade protection. Large countries might be tempted to suspend commitments in periods of high import volumes because they can extract a higher economic surplus from foreign exporters. If the costs of breaking the agreement are offset by the benefits, an increase in protection may be seen, in the absence of a credible retaliatory threat, as an optimal policy.

In general, economic theory provides a strong argument for non-intervention in a perfectly competitive environment. When markets are not functioning well, however, measures of protection can be justified in terms of a “second-best” argument. Suppose that an independent external event, such as the introduction of a successful technological innovation abroad, induces a sharp contraction of a sector. If the sector is large, its down-sizing may negatively affect other sectors and generate

lay-offs. A second-best argument for trade policy intervention can be made in these circumstances to slow down the restructuring of the sector.

In the absence of market failures or a terms-of-trade consideration, political economy arguments may explain the willingness of a government to suspend commitments. This could be the case, for example, when some external factor alters the distribution of income in such a way that influential groups or the median voter lose out. Political economy arguments can also explain the temptation to increase protection after a political event, such as a government change, or in response to a subsidy in a foreign country that would otherwise lower prices to consumers in the domestic market.

*A categorization of the circumstances that might justify government intervention can be made on the basis of the type of external event (shock) and its sectoral/country coverage.*

Three types of shocks may hit an economy: economic, non-economic and policy-related shocks. Economic shocks are changes in the economic environment in which economic agents operate. Examples of non-economic shocks include situations of environmental or health emergencies as well as political economy shocks. Examples of policy changes are the reduction of a tariff or the provision of a subsidy by a foreign country.

Economic shocks can be further divided into industry-specific, country-specific or global shocks. Four types of industry-specific shocks can be identified: changes in preferences, technological innovation, changes in factor endowments and changes in market structure. Country-specific shocks are changes in the state of nature that affect all sectors at the same time. They can originate in changes in aggregate demand or supply.

All these circumstances give rise to possible economic or non-economic motivations for government intervention.

*Broadly defined, flexibilities can take many forms...*

Flexibilities can include anything that redefines or reverses a commitment under an agreement. They can also include actions that take advantage of a gap between commitments and policies actually applied, or simply involve measures not covered by an agreement but which have implications in policy

areas relevant to the agreement. Some flexibilities may be of a nature that provokes retaliation from trading partners. Some even argue that the violation of a commitment or non-compliance with a dispute settlement finding may be regarded as a form of flexibility, although the robustness of agreements would determine the extent to which flexibility can be defined in these terms.

## ECONOMICS, DISCIPLINES AND PRACTICES

### SAFEGUARDS

*Safeguards in the WTO enhance the willingness of governments to undertake commitments, but the temporary nature of such measures is crucial to the attainment of their objectives.*

Safeguard provisions allow policy-makers to agree to higher levels of commitments than would be forthcoming in the absence of such flexibility. At the time a trade agreement is concluded, governments cannot foresee all future events that may lead to an intensification of competitive pressure from imports. Such pressure may make protection desirable for certain industries, whether to lessen income loss, facilitate adjustment or serve political objectives.

A distinguishing feature of WTO safeguards is their strictly temporary nature backed up by a credible threat of retaliation from trading partners. A number of studies have shown that this feature is crucial if safeguards are to achieve their objective, whether in terms of technological catch-up, a reduction in the speed of an industry's decline, or to avoid congestion in the labour market.

*WTO rules seek to strike a balance between a party's need for flexibility and the interest of trading partners in minimizing the impact of safeguards.*

A number of WTO members have used safeguards over the years, but none of those challenged in dispute settlement were able to justify the measure. Issues have arisen in regard to the establishment of a causal link between imports and injury, and distinguishing among the sources of injury. Economists have cautioned against excessive reliance on a correlation between imports and injury in the causality analysis and, at the same time, struggled with the conception of imports as an external

(exogenous) variable that could “cause” injury in the domestic economy to such variables as domestic production. Members are free in their choice of methodology to carry out this type of analysis, and the suggestion by economists that econometric models might help to separate the contribution of relevant factors has largely been ignored.

One of the reasons for this may be that legal issues in respect of which such quantification could matter – notably the determination of the tariff rate that corresponds to the share of injury attributed to imports – have never been tested in dispute settlement. This is because governments imposing safeguards have been unable to meet the causation standard for attributing injury to increased imports.

Safeguard measures can take different forms, such as tariffs, quotas or tariff-rate quotas (TRQs). While in many circumstances tariffs may be preferable to quotas for reasons of transparency and efficiency, some arguments in favour of quotas can be made on political grounds, or in the presence of changing factors not taken account of by prices in the market (dynamic externalities) and “menu costs” (costly changes in trade policy).

A range of disciplines governs the application of safeguard measures. Among other things, safeguards should generally be applied on an MFN basis and compensated through equivalent concessions in other sectors. They are time-limited, with “holiday” provisions preventing an immediate re-imposition. However, some of these provisions contain loopholes. Countries may circumvent the MFN requirement by “modulating” quotas – that is, attributing lower shares to countries with disproportionate increases in imports. Also, compensation (for which agreement may be difficult to reach in any event) does not become due for the first three years during which a safeguard is imposed if the measure responds to an absolute increase in imports. An evaluation of safeguard disciplines obviously involves a comparison with other forms of contingent protection.

## DUMPING AND ANTI-DUMPING MEASURES

*In economics only “predatory” dumping results unambiguously in welfare-reducing effects for the importing country.*

Dumping can arise from price discrimination by firms with market power in international markets. It can also arise from cyclical shifts in demand coupled with an inability by firms to adjust production capacity over the course of the business cycle. Predation – the strategic firm objective of forcing competing producers to exit the market – cannot be ruled out as a motive for dumping. But the difficulty involved in successfully carrying out predation on international markets discounts this as an important explanation for practicing price discrimination in different markets.

*There are costs and benefits associated with anti-dumping.*

Economic theory suggests that in the first instance, with the possible exception of predatory dumping, all dumping either increases, or at worst, has an ambiguous effect on the economic welfare of the importing country. This is because dumped imports lower the cost of the good in the importing country. Further, if dumping increases the productivity of the foreign firm, the welfare benefits for the importing country may increase over time.

Many countries rely on antidumping law to counteract dumping. Antidumping law may be seen as a form of *ex ante* flexibility required in a trade agreement so that countries can make deeper market access commitments. Antidumping measures can act like a safety valve to let off protectionist steam which might otherwise threaten a government's programme of trade reform.

There are also *ex post* benefits from antidumping measures. Antidumping law can lead domestic firms to behave in a way that is beneficial for consumers. Domestic firms may expand production in the hope of sufficiently depressing prices in order to trigger an antidumping investigation. The growing number of countries adopting antidumping statutes may increase consumer welfare across the board if it succeeds in reducing or preventing international price discrimination.

But there are *ex post* costs from antidumping measures. An antidumping duty raises the price that both domestic and foreign firms will charge in the domestic market, penalizing domestic consumers. If the reason for dumping is the need of the foreign firm to maintain production capacity during periods of slack demand, antidumping can lead to a significant reduction in trade volumes. There

is a possibility that the provision of contingent protection to an upstream industry will incite demand for contingent protection in downstream industries. If firms compete not only on price but also on the basis of the quality of the product, antidumping may adversely affect the fortunes of the domestic firm in the long-run if this leads the foreign firm to upgrade the quality of its product. Penalizing foreign firms through antidumping can make it more difficult for firms from technologically backward countries to catch up and it can prevent firms from undertaking productivity enhancing activities. Finally, antidumping can facilitate collusive behaviour between domestic and foreign firms.

*GATT/WTO rules appear to give members a significant degree of flexibility in the use of the measure, since some dumping can be welfare-improving.*

GATT Article VI and the Agreement on Antidumping (formally the Agreement on Implementation of Article VI of GATT 1994) provide internationally agreed rules on the conduct of antidumping investigations and the application of antidumping measures. What triggers an anti-dumping investigation is the allegation that an exporter is causing injurious dumping to domestic industry. The definition of dumping in the Agreement does not distinguish the nature of the dumping, whether it is predatory or cyclical, the motivation, or the likely duration. A given proportion of domestic industry must support the request for initiation of the antidumping investigation. There must be evidence that the domestic industry has suffered material injury or the threat thereof as a result of dumped imports. Antidumping measures cannot exceed the dumping margin. The measures cannot be permanent and can be extended only if a subsequent review determines that the expiry of a measure would likely lead to continuation or recurrence of dumping and injury.

*Economists have also raised some questions about provisions dealing with material injury...*

The Antidumping Agreement allows the practice of cumulation, where imports of a product from more than one country are simultaneously subject to anti-dumping investigations and an injury determination may be the result of a finding of cumulated dumping from more than one national source. Cumulation increases the likelihood of a positive injury finding because it is much easier to

identify and establish material injury arising from a larger volume of imports than it is to establish a sufficient level of injury independently for smaller levels of imports from specific supplier countries. By cumulating exporters from different countries, there will be a lower incentive for each exporter to invest in its own defence, because it can free ride on the legal defence of other exporters. But by free riding, the consequence is a smaller than optimal cumulative effort in putting up a legal defence, thus increasing the possibility of a positive injury finding.

A second issue has to do with the list of factors that investigating authorities need to examine in considering material injury. It has been suggested that some of the injury factors listed in Article 3.4 of the Agreement may actually reflect a healthy evolution of the domestic industry. The reduction of employment, for instance, may be the result of improvements in technology. Technological change may also lead to wage reductions.

*...and suggested the use of economic concepts and models in the causality and non-attribution analyses.*

It has been argued that economic concepts and methods could be used in the causality and non-attribution analyses. Simulation or econometric models are able to determine the contribution of dumping to injury of a domestic industry and to distinguish that from the contribution of other factors. Another consideration has to do with the use to which the non-attribution test is put. Antidumping duties are imposed to counteract the dumping margin so long as there is evidence that the domestic industry's injury has been caused, either wholly or partly, by the dumped imports. Conceivably, the results of the non-attribution test could be used to quantify and deduct injury caused by factors other than dumped imports. Depending on the precision in which this analysis is undertaken, the results could also be used to adjust the magnitude of the antidumping duties, since the dumping margin may only be responsible for part of the material injury to domestic industry.

## SUBSIDIES AND COUNTERVAILING DUTIES

*Duties imposed to countervail subsidies will generally not raise aggregate welfare in the country that imposes them. Two exceptions are circumstances when a terms-*

*of-trade argument can be made and when markets fail. Political economy considerations help to explain why governments might use countervailing duties.*

Under the assumption that markets function perfectly, countervailing duties typically have a negative effect on aggregate welfare in the country imposing them. There are two main caveats to this proposition. First, in theory, countervailing duties can improve the importing country's terms-of-trade. If the terms-of-trade gain from the duty is larger than the efficiency loss, there may be an aggregate welfare argument for the government to countervail. Second, countervailing duties may deter subsidization altogether and thereby confer benefits to producers in the importing country who must compete with subsidized goods in their export markets.

When the assumption of perfect markets is dropped, further aggregate welfare-based arguments may be made for using countervailing duties. With rigidities in the labour market, for example, a subsidy can harm the importing country. Similarly, under imperfect competition in product markets, countervailing duties can be used to appropriate some of the economic rents that accrue to factors of production.

The principal beneficiaries of countervailing duties are producers competing with subsidized imports. If, as suggested in the political economy literature, governments do not necessarily maximize national welfare but rather pursue policies that benefit certain constituencies, they may indeed use countervailing duties to help producers harmed by foreign subsidies.

*Countervailing duties can serve two main purposes in trade agreements. First, they may be used by governments to neutralize negative external effects (externalities) arising from subsidies. Second, the prospect that countervailing duties might be used could deter the use of subsidies in the first place.*

If the rationale of a trade agreement is to eliminate reciprocally policies that impose negative effects (externalities) on trading partners, countervailing duties may serve this objective. The government of an importing country can set countervailing duties so as to restore the price prevailing in the absence of the subsidy, thereby leaving domestic consumers and producers unaffected by the subsidy. In the process, the government collects tariff

revenue which makes it better off than before the subsidy. In this particular case, however, the negative externality imposed by the subsidy does not necessarily correspond to a loss of aggregate economic welfare for the importing country. This means that the rationale for countervailing duty law could be seen as protecting an entitlement of domestic producers to be shielded from the harmful effects of foreign subsidies rather than as an instrument to promote global efficiency.

The possibility of imposing countervailing duties may also be seen as part of a larger multilateral system aimed at discouraging trade distorting subsidies and facilitating trade policy commitments. A system of constraints upon subsidies can only be effective if it is properly enforced and countervailing duties may be part of the enforcement mechanism. While, in a narrow sense, countervailing duties might be deemed detrimental to national economic welfare, there might nevertheless be systemic gains from the existence of credible countervailing duty provisions in all countries. The threat of countervailing duties may allow governments to resist political pressures for wasteful subsidization at home and also deter subsidies that would otherwise injure each nation's exporters in their overseas markets.

*Legal provisions in the Agreement on Subsidies and Countervailing Measures support the idea that governments need countervailing duties to help domestic producers. However, they do not lend much support to the idea that in the WTO system countervailing duties serve the purpose of discouraging subsidies.*

If the possibility of applying countervailing duties were conceived as a means of neutralizing or deterring subsidies that inflict a welfare loss on trading partners, their application should be sanctioned only for cases in which a subsidy can be shown to have this sort of negative effect. The Subsidies and Countervailing Measures Agreement, however, confines the use of countervailing duties to situations where the importing country can provide evidence that an industry has been injured by subsidized imports. This lends support to the idea that the main rationale for countervailing duty law is to protect an entitlement of domestic producers to be insulated from the harmful effects of foreign subsidies rather than to promote global efficiency.

There are reasons to doubt that the threat of countervailing duties within the WTO system does much to discourage subsidies. First, countervailing

duties have been used infrequently and only by a small number of nations. Part of the reason for this is the injury test, which restricts the number of countries that can countervail to those with an import competing industry. Moreover, uncoordinated and unilateral countervailing actions may only divert subsidies towards non-countervailing markets. Second, countervailing duties will only be employed against subsidy programs if and when those become known to trading partners. If detection takes time, the beneficiaries of the subsidy may derive considerable benefit before the duty is applied.

*The economic discussion of WTO disciplines on countervailing duties has focused on two features of the provisions – the rationale of a unilateral as opposed to multilateral track for addressing subsidies, and the nature of the injury test.*

The WTO rules provide a multilateral and a unilateral track for addressing subsidies. Under the first of these, a member who considers that its interests are being harmed by subsidies provided by another member may challenge the measure under the dispute settlement system. The unilateral track entails the possibility of applying countervailing duties against injurious subsidies. Analysis of the rationale for having two tracks relies on both theoretical and practical considerations.

On the question of the injury test, a suggestion in the literature is that this test might be replaced by an aggregate economic welfare test in order to determine the desirability of applying countervailing duties. This suggestion follows from the proposition that the injury test is not consistent with the promotion of global economic efficiency.

## RENEGOTIATION OF COMMITMENTS

*Provisions in the WTO for renegotiating commitments determining the conditions of access to the market are not intended to permit temporary remedial measures, but rather to secure a more permanent adjustment of commitments.*

Commitments under the WTO can be renegotiated under Article XXVIII GATT and Article XXI GATS. These provisions define conditions under which members are allowed to withdraw commitments (bound tariff reductions or specific commitments) in exchange for other commitments to compensate members whose trade interests are affected by the withdrawal.

Like other flexibility provisions, the possibility of renegotiating commitments may act as a safety valve that facilitates the achievement of deeper commitments in the presence of uncertainty about future developments. Renegotiation also allows “efficient breach” under a trade agreement – that is, deviations from commitments that may be mutually beneficial to signatories.

*Institutional factors and administrative costs may explain why some countries appear to use the renegotiation of commitments as a form of contingent protection.*

In general, it would not make sense to change commitments on a permanent basis in response to a temporary change in economic and political conditions. However, this temporal consideration may be blunted when the right of renegotiation is deployed as a form of contingent protection.

Some aspects of the legal text may induce countries to prefer the use of renegotiation relative to other trade remedies. One consideration relates to the “reputation” costs (i.e. a loss of credibility with respect to trading partners) of different measures. As renegotiation requires compensation, it has a small reputation cost and may be favoured relative to other trade remedies. In addition, countries may be induced by institutional factors (such as the lack of domestic institutional capacity to administer an antidumping statute) to revert to renegotiation as a form of contingent protection.

## THE MARGIN BETWEEN COMMITMENTS AND APPLIED MEASURES

*The legal consolidation (binding) of tariffs in goods markets and market access and national treatment commitments in services markets constitute the backbone of trade agreements. But some commitments reflect less than applied policies (the binding “overhang”).*

In the trade policy debate it is often argued that the binding of trade policy commitments above the level of the corresponding applied measures increases policy stability and reduces the uncertainty confronting exporters in foreign markets. Economists have given surprisingly little attention to this question. A small number of recent theoretical contributions link the use of weak bindings (i.e. bindings that specify the

maximum level at which a government commits to set its applied tariff rather than a precise level) to contracting costs, privately observed political pressure, or continuing contributions from lobbies. Work is even more sparse on the quantification of benefits of tariff bindings or of the value to be given to the binding overhang.

*Binding overhangs are a prominent feature of the WTO commitments of most members.*

A close examination of tariff bindings in developing countries shows that in a large number of these countries 70 per cent to 90 per cent of tariffs could be raised by 15 percentage points without violating WTO commitments. A binding overhang exists in other areas, such as in the case of developed country tariffs in the agricultural sector (as well as domestic and export subsidy commitments), and in relation to the services schedules of most members. However, an exact quantification of these overhangs is more difficult due to the nature of commitments in these areas.

## EXPORT TAXES

*A lack of binding commitments on export taxes on the part of most members reflects the incompleteness of the WTO Agreement and provides members with a largely uncontrolled form of flexibility.*

Potentially, members could heavily restrict trade through the imposition of export taxes without having to comply with specified procedural requirements, to demonstrate the existence of specified circumstances, or to submit to the limitation imposed by sunset reviews.

On the other hand, a limitation on the discretionary use of export taxes is imposed by the general applicability of the most-favoured-nation principle. In addition, for some WTO members the use of export taxes is limited by binding commitments assumed at the time of accession to the WTO. Other countries face limitations in the use of export taxes through commitments under regional trade agreements or as a result of national legislation.

*Export taxes may be used for a variety of reasons, but generally they do not amount to first-best policy under perfect market assumptions.*

An analysis of Trade Policy Reviews conducted from 1995 to 2008 shows that governments use export taxes primarily with the stated objectives of insulating a country from sudden price changes (shocks), easing government revenue constraints in a situation of sharp currency devaluation, nurturing infant industries, and protecting the environment.

Export restrictions, like tariffs, are in general not a first-best policy in market-based neoclassical analysis. But in some circumstances their use may be justified as a second-best policy and they may be preferred to import restrictions.

## THE CHOICE AMONG INSTRUMENTS OF CONTINGENT PROTECTION

*Differences in the applicable legal framework – both domestic and international – appear to be a major factor in the choice by governments of particular contingent trade policies.*

The predominant use of antidumping by many countries is eye-catching. One of the reasons may be the absence of an obligation under WTO rules to provide compensation. If an antidumping measure is challenged in a dispute, the expected compensation (or the retaliation the country may face) may not be different from what the country would be required to give in any event under the Agreement on Safeguards or in renegotiations.

Another advantage of antidumping over safeguards is the possibility of multiple extensions subject to sunset reviews. In many cases, these do not seem to have constituted a major hurdle to prevent the prolongation of such measures.

The discriminatory application of antidumping duties as opposed to safeguards and tariff increases as well as the possibility to negotiate price undertakings are elements of flexibility that may be appreciated by governments. Voluntary understandings of the latter variety may also help to contain the risk of reputation damage associated with the extensive use of antidumping.

Domestically, the involvement of various actors in the decision-making process may differ for different contingent trade policies. Depending on whose agreement is needed and how much discretionary authority is provided to individual decision-makers,

the outcome for the domestic industry may be subject to more or less uncertainty.

*Political economy factors may also play a part.*

In political economy terms, the fact that anti-dumping measures imply that action is the result of an “unfair” trade practice on the part of foreign trade partners may make this contingent measure more attractive than one which turns exclusively on a consideration of conditions in the domestic economy. Of the flexibilities considered in detail in this report, anti-dumping and countervailing measures are the only ones that embody this feature. Countervailing duty measures are different from anti-dumping measures in that the implied unfair trade practice is attributable to a government as opposed to the private sector. Acting against another government may be less attractive in political economy terms than doing so against firms.

None of the above points in isolation can conclusively explain the popularity of antidumping over the other contingent trade policies discussed in this Report. However, taken together, it seems that the rules on antidumping, including domestic arrangements, provide considerable flexibility to be adapted to a wide range of circumstances calling for contingent trade policy.

## EMPIRICAL EVIDENCE

*Significant gaps exist in empirical evidence on contingent protection, making it difficult to generalize from the data.*

The bulk of the empirical literature on contingency measures focuses on antidumping measures, and there is a predominance of empirical studies on the United States and the European Union. The literature on contingent measures in developing countries has developed only very recently. But it is hard to draw general conclusions from this evidence as most of the results of these studies differ by country or by sector.

At the same time, comparable data on the various measures of contingent protection make it impossible to undertake cross-country analysis and analysis of substitution among instruments. One of the ways that the gap could be filled is through better, more timely and more comprehensive notifications of measures by WTO members.

*One interesting feature that emerges from observed patterns and trends in the use of contingent protection is that the preference for particular measures is sector-specific. Some countries also make relatively more use of certain forms of trade remedies than others.*

Antidumping actions, countervailing duties and safeguards, and to a lesser extent renegotiations, are mainly related to the chemicals and steel industries. Export taxes apply mainly to fishery, forestry, gold and precious metals and cereals. The use of tariff increases is much less concentrated at the sectoral level than the use of these other measures of contingent protection.

At the country level, data allow us to distinguish between traditional and new users of antidumping and countervailing duties, and safeguards. Developed countries are the major users of countervailing measures. In recent years, developing countries have become the main users of antidumping duties, safeguards, export taxes, renegotiations and tariff increases within bindings. In particular, in our restricted sample, the six countries that use tariff increases most intensively are African, which offers a significant contrast from the list of users of antidumping. A reason for this may be that developing countries, particularly the poorer ones, prefer to use tariffs because they lack the necessary resources to comply with the procedural requirements for the use of antidumping, safeguards or countervailing duties.

*Unfortunately, not much empirical literature has emerged to test the proposition that trade contingent measures are a quid pro quo to facilitate deeper market-opening commitments.*

Case study evidence suggests that the relationship between contingent measures and market opening is one of complementarity. Trade contingent measures have often been used to accommodate and isolate protectionist pressures that would otherwise have grown into large-scale threats against the whole policy of openness.

In the specific case of antidumping measures, however, econometric evidence on the trade-off between flexibilities and commitments is ambiguous. One study that focuses on whether a country has an antidumping mechanism in place at the moment of joining the GATT/WTO supports the view that the potential to use flexibility measures helps to further the overall process of

market opening. But econometric studies based on disaggregated sectoral data cast doubts on these conclusions. For developing countries that use antidumping intensively, the studies tend to find an increase in the use of antidumping actions in the aftermath of trade opening, and that past use of antidumping actions is not associated with further tariff reductions.

Much more research is needed on whether contingent protection has enabled countries to commit to further market opening.

Studies that focus on regional trade agreements show that the great majority of such agreements maintain antidumping, countervailing duty and safeguard provisions. This is consistent with the argument that flexibility is required by countries when they commit to further trade opening. The few preferential trade agreements (PTAs) which have managed to abolish antidumping, countervailing duties or safeguard measures are characterized by deeper integration and a greater degree of coordination or harmonization of their “behind-the-border” policies. This does not mean that the demand for flexibility vanishes as preferential trade agreements achieve deeper integration. Rather, what appears to happen is that deeper integration calls for a different set of instruments to achieve flexibility and manage adjustment, much like the role played by structural funds in the European Union.

*Evidence on antidumping, countervailing duties and safeguards is generally consistent with the view that these measures are tools of flexibility to confront difficult situations. The evidence is less clear for increases in applied tariffs, export taxes and the modification of tariff commitments.*

Available empirical literature suggests that the use by governments of antidumping, countervailing duties and safeguards is explained in significant measure by movements in the business cycle, the real exchange rate and industry-specific determinants. The frequency of trade contingent actions, particularly antidumping, increases during periods when countries suffer decreases in aggregate economic activity. Changes in the real exchange rate also appear to influence the number of filings even though it has opposing effects on the likelihood of dumping and injury. Holding everything else constant, industries which have a high level of import penetration, employ a large number of workers, and are capital-intensive seem more likely

to file antidumping petitions. Recent studies have also highlighted the export orientation of domestic industry as a factor that determines the frequency of antidumping filings. Investigating authorities are more willing to grant trade-contingent protection to industries that confront a reduction in profits or increasing imports, but a “political” element reflecting the size or importance of the affected industry also appears to be relevant.

No systematic empirical evidence exists that investigates what factors determine the modification of concessions, applied tariff increases within bindings, and the use of export taxes. However, a preliminary analysis of the data suggests that, as may be expected from consideration of adjustment costs, modifications of concessions primarily occur in the aftermath of the conclusion of a round. In addition, data on export taxes suggest that although they may be used to deal with contingencies such as price or inflationary effects, much of the motivation appears to stem from long-term goals such as generating tax revenues, supporting downstream industries and environmental protection.

*Important differences exist across countries as to the degree of flexibility that different measures of contingent protection provide.*

While multilateral agreements have increased uniformity in trade remedy practices, there are nevertheless significant differences among countries on procedural and substantive issues that affect which measure is chosen, the perceived likelihood of positive findings, and the impact of the measures.

A high degree of discretion appears to be given to national authorities in deciding on a range of important trade remedy questions, such as the use of constructed normal values in the case of anti-dumping, the treatment of non-market economies, and the determination of injury and causation.

*Existing empirical evidence on the economic impact of adopting measures of contingent protection shows that there are costs associated with the use of these measures, but the magnitude of these costs is uncertain.*

Contingent protection can hurt domestic consumers because it may raise domestic prices, either directly or indirectly, through its effect on the domestic market power of producers. Evidence based on the overall welfare effect of antidumping and countervailing duties estimates significant costs

of contingent protection. The results of existing studies on the effects of contingent protection on the market power of the import-competing industry differ, however, by country.

As regards the effectiveness of contingent protection in mitigating import competition and helping an industry in its restructuring or in catching up technologically, there is no conclusive evidence. On the one hand, contingent protection has trade-diverting and tariff-jumping foreign direct investment effects. On the other hand, factors other than contingent protection appear to have greater effect in promoting industrial recovery or accelerating technological catch-up.

## CONCLUSIONS

*A trade-off exists between flexibility that allows the adoption of contingency measures in a trade agreement and the binding nature of commitments.*

Standards relating to injury, causality and the duration of measures are designed to strike an appropriate balance. The same may be said of the rules on compensation.

*Trade contingency measures adopted by members can involve both benefits and costs.*

It is important to distinguish between the reasons for incorporating flexibilities in trade agreements and the effects of such measures. Flexibilities allow governments to commit to deeper opening in a trade agreement while reducing the economic and political opposition to the agreement. However, in the absence of market failures, trade restrictions will cause losses in economic welfare. While contingency measures address injury to the industry, little or no account is taken of how the economy as a whole is affected – a feature of the system regarded as a weakness by some.

*Differences in legal frameworks and political economy factors help to explain how governments choose among contingency measures.*

The choice of a particular contingency measure may depend on how easy it is to invoke the measure, the possibility of discriminating among sources of imports, whether the period of applicability of a measure may be extended, reputation costs, and the necessity or otherwise of providing compensation

upon adoption of a contingency measure. While multilateral agreements impose a certain uniformity among countries in the design of contingency measures, significant differences remain in terms of procedural and substantive issues.

*Existing empirical evidence supports the argument that flexibilities are needed in trade agreements to address future unforeseen difficulties.*

Contingency measures are more likely to be used in difficult economic circumstances. However, the evidence cannot preclude the possibility that such measures are sometimes used as a protectionist device. Although some case study evidence suggests that flexibilities allow countries to commit to deeper opening, recent attempts to show this on the basis of economic analysis offer ambiguous results. Data limitations have limited the scope and coverage of existing research on trade remedies. More timely notification by WTO members of contingency measures could help to address this problem.

*The use of contingency protection measures in times of economic crisis can present particular problems.*

Members have an uncontested right to use contingency measures that are consistent with WTO rules. In normal circumstances such measures would generally be seen as exceptional and their use would be infrequent. But at a time of global crisis, a proliferation of such measures among trading partners would have adverse economic effects with few of the positive offsetting advantages that might otherwise be invoked to justify such measures.

*Restraint in the use of restrictive trade measures will contribute to a more rapid recovery in the world economy.*

Experience from the Great Depression in the 1930s suggests that while trade policy may have little or nothing to do with the onset of an economic crisis, protectionism can certainly deepen and lengthen a severe downturn. Evidence to date suggests some increase in the use of measures that restrict trade, but so far against a background of general restraint. While it is a comparatively straightforward matter to detect the use of contingency measures of the kind analysed in this Report, it is more difficult to identify trade-restrictive measures and subsidies with adverse trade effects that may be embedded in financial rescue and fiscal stimulus packages.

*Transparency and effective monitoring make a decisive contribution to managing trade policy, especially in adverse economic circumstances.*

Free-flowing information on policies affecting trade is essential to cooperation among countries seeking to manage the crisis. Comprehensive and timely notification of trade contingency measures to the relevant WTO bodies is essential to ensure proper monitoring.