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Preserving Trade Policy Flexibility in Antidumping Reform

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Antidumping ist zum bevorzugten Instrument für temporäre Handelsbeschränkungen avanciert. Diese Entwicklung gibt Anlass zur Sorge, da Antidumping mit stark negativen Wohlfahrtseffekten einhergeht. Zahlreiche Reformvorschläge wurden in der Vergangenheit gemacht. Sie beinhalten im Wesentlichen strengere Vorbedingungen für die Benutzung des Instruments, was zu einer Schmälerung handelspolitischer Flexibilität führen würde. Entsprechende Reformversuche wurden bereits in der Uruguay Runde unternommen, allerdings ohne Erfolg. Dieser Artikel schlägt ein alternatives Reformkonzept vor: Es umfasst die völlige Abschaffung von Antidumping bei gleichzeitiger Einführung einer modifizierten Schutzklausel gemäss Artikel XIX GATT. Diese Schutzklausel würde temporäre Handelsbeschränkungen ohne jegliche Vorbedingungen erlauben, womit die handelspolitische Flexibilität des heutigen Antidumpingregimes aufrechterhalten bliebe. Gleichzeitig würde aber jede temporäre Handelsbeschränkung mit der Leistung vollständiger Kompensation in Form von handelsliberalisierenden Massnahmen in anderen Sektoren verknüpft.

Keywords: Antidumping, Compensation, Safeguard Clause, Trade Policy Flexibility, WTO
JEL-Codes: F02, F13, K33

1 Introduction

Antidumping has become the dominant instrument used by both developed and developing countries for introducing temporary import restrictions. Concerns are warranted, as it represents a trade policy measure with considerable negative impact on aggregate social welfare. Despite popular claims to the contrary, antidumping has lost its connection with anticompetitive foreign practices and is almost exclusively applied to the protection of well-organised industries. Many observers have made suggestions as to how the current situation may be improved. These suggestions aim at restraining antidumping by reducing the number of economic circumstances in which it may be applied. In other words, they envisage

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higher prerequisites for the use of antidumping. Attempts to raise the prerequisites have already been undertaken at the Uruguay Round. These attempts, however, clearly failed.

Higher prerequisites for temporary import restrictions impair the government's trade policy flexibility. We define trade policy flexibility as the ability to decide *ex post* on when to introduce temporary import restrictions. This article contends that governments are not ready to sacrifice this flexibility by means of multilateral trade agreements, such as those constituting the World Trade Organisation (WTO).

Our argument is based on a simple theoretical framework. As detailed later, it is assumed that the government is in charge of trade policy and maximises its own objective function. Two political circumstances are distinguished. Under normal political circumstances, the government favours aggregate social welfare and abstains from introducing temporary import restrictions, provided that it cannot improve the balance of market access concessions. However, under exceptional political circumstances, defined as political stress, the fortune of the government entirely depends on the support of a particular import-competing sector. In such cases, more protectionism is unavoidable for a while.

Multilateral trade agreements cannot be made contingent on political circumstances because periods of political stress cannot be contractually specified. Agreements are necessarily incomplete in this respect. In order to be able to restrict imports under exceptional political circumstances, governments need trade policy flexibility.

It follows from the theoretical framework that an antidumping reform will only find acceptance among governments if trade policy flexibility is not impaired. Isolated attempts to raise the prerequisites of antidumping are therefore doomed to fail. This is confirmed by historical experience. We propose an alternative solution for antidumping reform. It considers abolishing antidumping altogether and instead introducing a revised safeguard clause. This clause permits temporary import restrictions without any prerequisites, thereby maintaining the trade policy flexibility provided by the current antidumping regime. However, it makes these restrictions dependent on full compensation for affected trading partners in form of trade-liberalising measures in sectors unrelated to the temporary protection.

According to our theoretical framework, the imposition of full compensation will ensure that governments do not introduce temporary import restrictions under normal political circumstances because the market access balance will remain unchanged. This represents considerable progress compared to today's antidumping regime: since antidumping action improves the market access balance, it is used also under normal political circumstances. Furthermore, the imposition of full compensation should not conflict with governments' dependence on temporary import restrictions in times of political stress.

The next section briefly traces developments in the use of antidumping against the background of the new multilateral regime concluded in the Uruguay Round. Additionally, the main problems with antidumping will be identified. *Section 3* presents existing suggestions and looks for a common denominator. *Section 4* challenges their feasibility and elaborates on the characteristics of an alternative solution for antidumping reform. *Section 5* proposes to abolish antidumping and to introduce a revised safeguard clause as the appropriate way of implementing the alternative solution. Furthermore, implications for the role of the WTO dispute settlement are discussed.

2 The Extensive Use of Antidumping

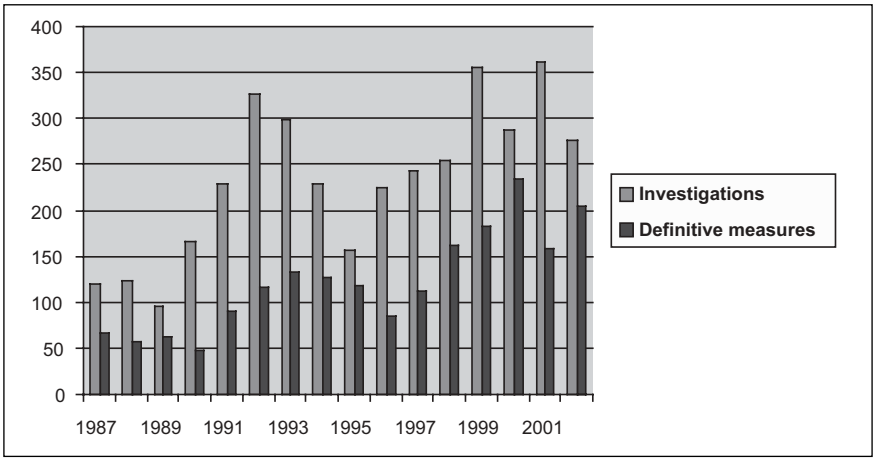
2.1 Increasing popularity after the Uruguay Round

The popularity of antidumping as an instrument for temporary import restrictions is not surprising, given its broad applicability since the adoption of the Tokyo Round Antidumping Code in 1979. Both the inclusion of sales below cost for the definition of "less than fair value" and the abolition of the requirement that dumped imports be demonstrably the principal cause of material injury[1] have opened a door for temporary protection that is without precedent in the history of multilateral trade liberalisation. Today, the requirements for the determination of dumping are extremely low. Furthermore, since dumping has always been judged to represent unfair behaviour, antidumping measures do not require compensation, in contrast to many other measures of temporary protection.

1 See Blonigen and Prusa (2001).

Figure 1 sheds light on the world-wide use of antidumping since the early days of the Uruguay Round. Between 1987 and 2002, some 3,750 investigations were initiated, of which almost 2,000 resulted in definitive measures. Despite the new Agreement on Antidumping, which nurtured some positive expectations, antidumping activity became more intense after the conclusion of the Round: the average annual number of investigations increased from 198 (between 1987 and 1994) to 270 (between 1995 and 2002), and the respective number for definitive measures rose from 88 to 157.[2] Admittedly, a significant part of this surge can simply be explained by rapidly growing trade volumes. However, more attention should be drawn to the fact that the number of countries applying antidumping has risen substantially over time. In 1987, six countries (or customs unions) initiated investigations,[3] but 24 did so in 2002. Mexico and Korea were the only non-industrialised countries applying antidumping investigations in 1987, reporting 16 percent of all investigations. In contrast, the developing world initiated clearly more than half of all investigations in 2002.[4]

Figure 1 Antidumping Investigations and Definitive Measures, 1987–2002



Source: Own graph; data from the homepage of the WTO (see Trade Topics – Antidumping) and from MIRANDA, TORRES and RUIZ (1998).

2 The data on the use of antidumping in 2002 is provisional and will finally be slightly higher than reported here.
3 Finland is not counted for reasons of comparison (EC membership since 1.1.1995).
4 Based on WTO data.

These numbers tell us something about the relative attractiveness of antidumping over time. Likewise, it is helpful to compare them with the respective numbers of other instruments offering temporary protection. The most obvious candidate for such a comparison is the safeguard clause, in accordance with Article XIX GATT and the Agreement on Safeguards. Between 1995 and 2002, a total of 105 investigations were initiated and 39 definitive measures imposed.[5] This translates into average annual numbers of 13 and 5, respectively, which are higher than the numbers for the period between 1987 and 1994.[6] Furthermore, the last two years display a rising trend. Based on this simple comparison, one cannot completely reject the claim that antidumping has replaced some safeguard clause action over the years. However, more convincing is the suggestion that antidumping has been used in addition to it.

The rising popularity of antidumping after the Uruguay Round must have been a surprise for those who expected that the new Agreement on Antidumping would reduce its attractiveness.[7] This expectation was caused by seeming efforts to raise the level of prerequisites for the use of antidumping. For example, Article 5:8 provides for a "de minimis"-rule, which states that "[t]here shall be immediate termination [of investigation] in cases where the authorities determine that the margin of dumping is de minimis [i.e. less than two percent], or that the volume of dumped imports, actual or potential, or the injury, is negligible." Another rise of prerequisites seemed to come from reduced discretion with respect to a variety of technical methodologies. Article 2:4 requires to make a "fair comparison" of prices when calculating the dumping margin. In particular, the comparison must be either on an average-to-average or on a transaction-to-transaction basis.

In addition to its rising popularity, the landscape of antidumping use has changed significantly in other ways as well. The traditional users of antidumping, namely Australia, Canada, the European Communities (EC), Mexico, New Zealand and the United States (US), are increasingly targeted themselves by antidumping measures. *Figures 2(a)* and *2(b)* are drawn for antidumping investigations and definitive measures, respectively. For

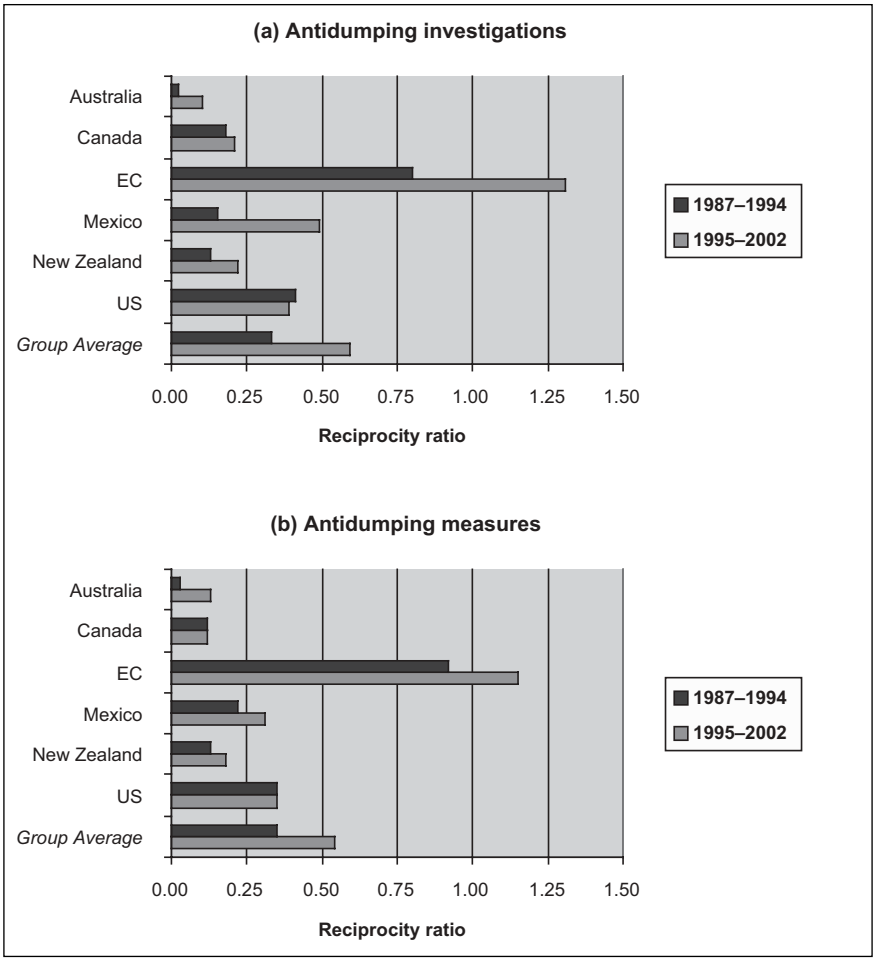
5 See the annexes to the reports of the *Committee on Safeguards* to the *Council for Trade in Goods,* dated 23 November 2000, 31 October 2001, and 4 November 2002, Documents No. G/L/409, G/L/494, and G/L/583, respectively. The reporting period ended at 28 October 2002.

6 WTO (1995) counts 18 cases resulting in protection between 1 January 1987 and 30 November 1993. FINGER (1998) provides a detailed overview on the evolution of the safeguard clause.

7 In an article from 1995, HORLICK and SHEA (1995, p. 5) expected "a reversal of a tendency to make the imposition of antidumping easier".

each traditional user, the bars indicate what may be called the "reciprocity ratio". This ratio is calculated by dividing the number of cases where the companies of a country are confronted with foreign antidumping by the number of cases where the country applies antidumping itself.

Figures 2(a) and 2(b) Reciprocity Ratios for Traditional Users



Source: Own calculations; data from the homepage of the WTO (see Trade Topics – Antidumping) and from MIRANDA, TORRES and RUIZ (1998).

Comparing the periods of 1987–1994 and 1995–2002, most reciprocity ratios increased substantially. The rise is particularly strong for investigations where the group average increased from 0.33 to 0.59. The latter ratio

means that, for every ten antidumping investigations initiated by themselves, traditional antidumping users are confronted with almost six foreign investigations. The situation is most pronounced for the EC, which has a reciprocity ratio well above one, and which is therefore affected by foreign investigations much more often than conducting investigations themselves.

2.2 A prisoner's dilemma?

In the introductory section, a theoretical framework for the study of trade policy was mentioned. According to this framework, the government abstains from introducing temporary import restrictions under normal political circumstances, provided that it cannot improve the balance of market access concessions previously negotiated in multilateral trade agreements. This market access balance is defined as the foreign market access for domestic exporters relative to the domestic market access for imports. Initiating an antidumping measure improves the balance of market access because it reduces imports while keeping the level of exports constant. Therefore, the theoretical framework predicts antidumping activity even under normal political circumstances.

However, high reciprocity ratios support the notion that antidumping has degenerated into what game theorists call a "prisoner's dilemma". In a prisoner's dilemma, the government uses antidumping under normal political circumstances in order to improve its market access balance, but since foreign governments do the same, market access balances may eventually remain unchanged. At the same time, the level of market access deteriorates world-wide. This in turn impairs aggregate social welfare and thereby the objective function of the government.

Such a dilemma can effectively stimulate antidumping reform. We argue, however, that the potential readiness of governments to restrict the use of antidumping does not imply a willingness to sacrifice trade policy flexibility. While governments might finally agree that antidumping is not in their common interest under normal political circumstances, they will not accept a reform that makes temporary import restrictions impossible in times of political stress.

2.3 Problems associated with antidumping

From an aggregate social welfare perspective, the trouble with the extensive use of antidumping is at least threefold. First, there is no rationale for antidumping action as long as dumped imports are not based on predatory intent.[8] Such an intent is difficult to prove, but can easily be precluded in most cases. For example, SHIN (1998) analyses 282 antidumping investigations in the US between 1980 and 1989 with nonnegative outcomes.[9] Only 39 of them can be upheld after consideration is given to market structures that are simply irreconcilable with monopolistic behaviour. Apart from the fact that they represent just 14 percent of the sample, these cases would have to be examined further, seeking for example for the existence of market entry barriers as another necessary precondition for successful predatory practice. MESSERLIN (2001) does a similar exercise as SHIN, but for the EC. He concludes that only two percent of 461 cases initiated between 1980 and 1997 are candidates for closer examination on predation grounds.[10]

Second, there is substantial evidence that antidumping is used even in the absence of any dumping. The Agreement on Antidumping and national antidumping laws make it possible to deviate strongly from economically reasonable calculation methods. LINDSEY (2000) concludes that current US law is unable of reliably identifying either price discrimination or sales below cost. HINDLEY (1993) reasons that European antidumping law "is more appropriately associated with Kafka than with fairness." He particularly points to special "tricks" with averages that help to establish positive dumping margins.

Third, the current antidumping practice can create a paradox situation: although it is ultimately intended to secure competition at home, there are strong indications that antidumping promotes collusive arrangements between foreign exporter and domestic import-competing industry.[11] Since it is merely the threat of an antidumping investigation that is in many instances responsible for such an arrangement, the numbers presented above clearly underestimate the negative implications of the current policy.

8 See e.g. CORDEN (1997).
9 Nonnegative outcomes consist of the cases in which antidumping was eventually imposed and the cases that were suspended or terminated.
10 In contrast to SHIN (1998), MESSERLIN's (2001) original dataset includes the cases with negative findings.
11 See PRUSA (1992).

Summarising the findings thus far, antidumping surged globally in the last two decades, but it lost its connection with "unfair trade", whatever the precise meaning of unfair may be. Therefore, it has become an ordinary trade policy instrument used to protect well-organised industries. Economic theory teaches us about the consequences of such a trade distortion, and there is no doubt that the welfare loss by far exceeds the effects of definitive antidumping measures. PRUSA (1999) calculates that antidumping duties cause the value of imports to fall by 30 to 50 percent on average, but that trade declines by almost as much in settled cases. Furthermore, even negative findings of the responsible authorities cannot avoid a decrease in trade by 15 to 20 percent. GALLAWAY, BLONIGEN and FLYNN (1999) estimate the combined welfare loss of US antidumping and countervailing measures for the domestic economy to be almost four billion US dollars in 1993 alone. This amount does not include the effects of actions that have been threatened, but not implemented. However, whereas antidumping is condemned by most economists, the public does not seem to have recognised its negative impact on welfare. In contrast, the argument of unfair trade, questionable as it might be, still meets with high response in the public debate of industrialised countries.

3 Existing Suggestions for Reform

3.1 General remarks

Due to the global prevalence of antidumping and its negative impact on aggregate social welfare, many ideas have been brought forward on how to improve the current situation. Most of these suggestions intend to make the use of antidumping less attractive for self-interested governments. Additionally, some envisage a more attractive safeguard clause. The consideration of the safeguard clause is explained by the hope that the clause might be able to (gradually) replace antidumping provisions.

From the perspective of a government, the attractiveness of an instrument for temporary import restrictions is negatively correlated with the respective level of both "prerequisites" and "compensation". The prerequisites of an instrument are high if it can be used only under a few economic circumstances. High prerequisites effectively limit the ability of the government to decide on when to introduce temporary import restrictions, thereby depleting trade policy flexibility. On the other hand, low prerequisites barely impair trade policy flexibility.

The compensation dimension, on the other hand, states if and to what extent affected trading partners are reimbursed for the loss incurred by the temporary import restriction. Protection harms domestic consumers (of finished and intermediate products) and foreign exporters. If the WTO provided individual rights for private actors, compensation would obviously be owed to all of them. However, the WTO is not intended to establish private rights. Private actors cannot challenge a temporary import restriction.[12] Consequently, compensation is only owed to affected foreign countries as a whole, represented by their governments. It is generally understood as consisting of improved market access in sectors unrelated to the temporary protection.[13] Full compensation would be market openings that maintain the overall balance and the level of concessions existing among multilateral trading partners before the introduction of a temporary import restriction. Such compensatory market openings have the attractive attribute of liberalising trade. However, since they may only be provided on a most-favoured-nation basis, sophisticated mechanisms have to be used in order to determine their appropriate level.

Figure 3 depicts the attractiveness of antidumping and the safeguard clause from a government perspective according to the current regime. It uses prerequisites and compensation as two axes of a plane. The circles show where the two instruments for temporary import restrictions would have to be localised. Obviously, antidumping is more attractive than the safeguard clause in respect to both compensation and prerequisites.

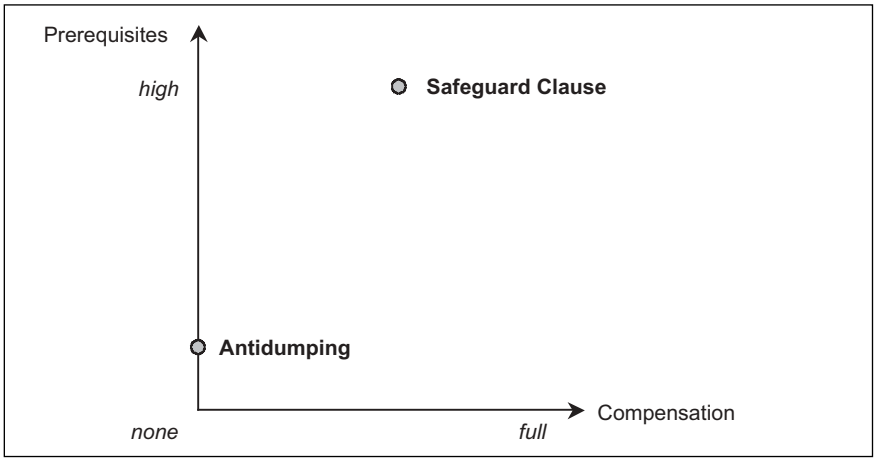
Antidumping does not come along with compensation, since it is allegedly based on unfair trade. The use of the safeguard clause in principle requires full compensation, but there is an exception that should be noted. No compensation is owed for a three-year time period in case of an absolute increase in imports.[14] On average, a medium level of compensation is therefore required.

12 Private actors would derive individual rights from WTO agreements if these agreements had "direct effect". Although the academic discussion has provided good arguments in favour of introducing direct effect into the world trading order, COTTIER and SCHEFER (1998, p. 118) conclude their extensive analysis of the concept by stating that "the prospects of widespread acknowledgement of the direct effect of WTO provisions are dim". At present, no WTO member government provides for direct enforcement of WTO rules in its own courts, see CHARNOVITZ (2001).

13 See in particular Article 8:1 of the Agreement on Safeguards which explicitly uses the term "trade compensation".

14 In Article 8:3 of the Agreement on Safeguards, the right of negatively affected trading partners to suspend equivalent concessions is disabled for a three-year time period in case of an absolute increase in imports. We infer from this rule that no compensation can be expected either, although this question ultimately depends on bilateral negotiations between the country applying the safeguard clause and its affected trading partners.

Figure 3 Localising Antidumping and the Safeguard Clause



Source: Own graph.

With regard to prerequisites, the classification becomes somewhat more burdensome. According to the Agreement on Safeguards, measures may be applied if imports enter the country "[…] in such increased quantities, absolute or relative to domestic production, and under conditions as to cause or threaten to cause serious injury to domestic industry […]."[15] In addition, Article XIX:1 GATT requires that the increase in imports is a result of both unforeseen developments and ongoing liberalisation. Antidumping is formally restricted to dumping that "[…] causes or threatens material injury to an established industry […] or materially retards the establishment of a domestic industry."[16] It is difficult to judge the exact severity of these prerequisites and to uncover properly the respective differences between safeguard clause and antidumping.[17] However, some observations are straightforward. First, the use of a more stringent injury standard (serious instead of material) is an obvious way of complicating access to the safeguard clause relative to antidumping. Second, the safeguard clause requires an increase in the import level, unforeseen developments, and a connection with ongoing liberalisation. All these prerequisites cannot be found in the antidumping provisions. Third, only antidumping has a price component, as it requires that imports be dumped. However, this prerequisite can easily be construed. In short, whereas no attempt has been made here to precisely quantify the scale of prerequi-

15 Article 2:1 of the Agreement on Safeguards.
16 Article VI:1 GATT.
17 A comprehensive analysis is offered by JACKSON (1997).

sites, the following conclusion is drawn: the level of prerequisites is substantially higher for the safeguard clause than for antidumping.[18]

3.2 Reducing the attractiveness of antidumping

With this classification in mind, existing suggestions for reform can now be analysed. As already mentioned, they can be divided into two categories. The first category consists of proposals that would make antidumping less attractive from a government perspective. The respective suggestions are mostly based on the belief that antidumping has been abused in the past, but that the concept as such is nonetheless a legitimate element of the world trading order. Consequently, they are not about making its use more expensive for the government by requiring some kind of compensation.[19] Instead, they intend to raise the level of prerequisites. This can generally be done by enriching the Agreement on Antidumping with rules that are better based on sound economics. Major suggestions in this respect focus on the calculation of the dumping margin, on the inclusion of market structure analysis, and on the determination of injury.

To begin with, the enormous leeway in construing the dumping margin could be reduced.[20] The margin is calculated by subtracting the export price from "normal value", which is the price for the like product when destined for consumption in the exporter's home country. It has been recommended that when there are few or no domestic sales, normal value should mandatorily be calculated based on the price of exports to the largest third market. The suggestion intends to provide the most reliable data, and more importantly, to avoid an arbitrary estimation of the exporter's production costs for the determination of normal value. Another proposal is to eliminate the exception to the requirement that price comparisons must be either on an average-to-average or on a transaction-to-transac-

18 Support for this conclusion also comes from WTO case law. As DIDIER (2001, p. 34) notes, recent decisions have both "watered down" the requirement of material injury and "emptied" the need for causality between dumping and injury.

19 At first sight, BOWN (2002) is a notable exception. He suggests that antidumping users deposit all revenue into an escrow account. The distribution of these funds would then be determined by the WTO, based on the statutory acceptability of the antidumping measure imposed. Though this suggestion seems to combine antidumping with compensation, it in fact does not. Only those cases that are decided by the Dispute Settlement Body (DSB) in favour of the target would lead to financial refunds. Compared to the overall number of antidumping cases, these incidents would be extremely rare – given that the substantive rules on antidumping remain the same as they currently are. A true impact on the antidumping regime would therefore have to come again from raising the prerequisites.

20 See MIRANDA, TORRES, and RUIZ (1998) for a concise discussion.

tion basis.[21] This in fact counters a popular form of the "zeroing method", which assigns zero values to negative dumping margins.[22] Overall, the construction of the dumping margin should be guided by a fair comparison of export price and normal value. For this to be the case, it seems rather natural to suggest that identical products be used whenever possible, and that they not be taken from different stages of the distribution chain.[23]

A higher degree of sound economics would also be applied if antidumping measures were made dependent on positive findings that dumped imports have a negative impact on market structure. Such an impact can be ruled out categorically whenever the relevant market shows a low level of concentration, since this indicates that the industry under investigation does not have positive economies of scale.[24] Inspired by this idea is the suggestion that the "de minimis" rule ought to be expanded.[25] Moreover, the rule should be based on market shares instead of import shares. The fear of monopolising tendencies is unfounded as long as investigated imports are small relative to overall market size.

Economic expertise could be applied more diligently when determining injury. HOEKMAN and LEIDY (1989) have long been suggesting that the number of admissible indicators for injury be reduced dramatically, and that the threat of injury alone should not be a cause for antidumping action. Furthermore, demonstrating that dumping and injury exist at the same time should not be sufficient to conclude that all injury is caused by dumping, nor is it appropriate to directly infer the level of injury from the amount of price undercutting, as is often done in practice. In addition, a number of studies show how strongly the practice of cumulating imports over countries for injury determination purposes has contributed to positive findings in antidumping investigations.[26] It has been proposed then

21 See MESSERLIN (2000). The exception is provided for in Article 2:4:2 of the Agreement on Antidumping and concerns a "pattern of export prices which differ significantly among different purchasers, regions or time periods."

22 Only recently, other forms of zeroing applied by both the US and the EC were successfully challenged in two WTO disputes. See *EC – Antidumping Duties on Imports of Cotton-type Bed Linen From India* (WT/DS141) and *US – Imposition of Antidumping Measures on Stainless Steel Plate in Coils and Stainless Steel Sheet and Strip from Korea* (WT/DS179).

23 DIDIER (2001) provides detailed suggestions in this respect.

24 See SHIN (1998).

25 See MESSERLIN (2000).

26 See PRUSA (1998), THARAKAN, GREENAWAY and THARAKAN (1998), or HANSEN and PRUSA (1996). Article 3:3 of the Agreement on Antidumping permits the investigating authorities to cumulatively assess the effects of imports from more than one country when these are subject to simultaneous investigation.

that cumulation be eliminated or confined to cases where evidence of collusion between exporters is at hand.[27] Dealing with the question of injury has inspired observers such as FINGER (1998) to propose a "national interest clause"[28] which clearly goes beyond the hearing of interested parties provided for in the current Agreement. The clause would require a comparison of any injury incurred by import-competing producers with the benefits for consumers arising from lower prices.

3.3 Raising the attractiveness of the safeguard clause

The second, less noted category of measures for reform aims at increasing the attractiveness of the safeguard clause from a government perspective. It is argued that a new safeguard regime could attract at least part of the temporary protection that is now handled under antidumping rules. Obviously, such attraction could be achieved by approaching antidumping along one of the two axes in *Figure 3,* or along both of them: compensation could be reduced and/or prerequisites could be lowered. Steps in the first direction were actually taken within the framework of the Uruguay Round. An important result from this perspective was the suspension of the compensation requirement for a three-year time period in case of absolutely increasing imports. Yet, there are observers who would like to go even further by completely getting rid of compensation.[29]

As to lowering the prerequisites of the safeguard clause, we are not aware of any substantial proposals.[30] MESSERLIN and THARAKAN (1999) consider how to improve the determination of serious injury by using a better proxy or by increasing transparency. But their aim is to achieve a more homogenous procedure, and not to raise the number of economic circumstances where the safeguard clause may be used. Nevertheless, it is evident that the attractiveness of the safeguard clause could be raised dramatically if the number of prerequisites to be fulfilled were reduced.

27 See DIDIER (2001), MESSERLIN (2000), or THARAKAN (1999).

28 Synonymous would be a mandated "cost-benefit analysis" of antidumping measures, see BRONCKERS (1996).

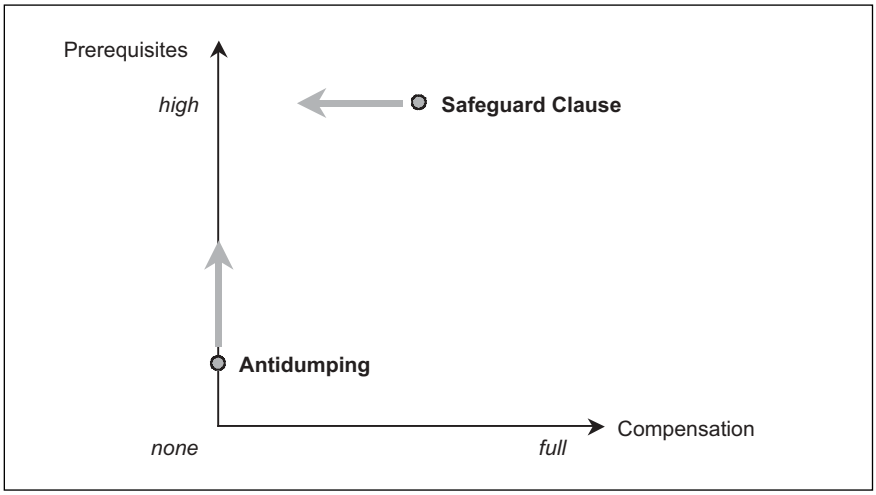
29 See e.g. HOEKMAN and LEIDY (1989). Actually, the compensation component of the safeguard clause fell in disgrace long ago. TUMLIR (1974, p. 262) considered that "Article XIX is, at one and the same time, too exacting and too lenient". Whereas "lenient" refers to the fact that temporary protection could become permanent, the requirement to compensate is "too exacting". In this spirit, ROBERTSON (1992, p. 47) is convinced that "[r]eciprocity has no place in dealing with *temporary* emergency actions if they are properly supervised."

30 In contrast, there have been suggestions to *raise* the level of prerequisites. See e.g. LEE and MAH (1998), who want the Agreement to specify that imports must be the "major" cause for injury or threat thereof.

MESSERLIN (2000) argues that the Uruguay Round relaxed the prerequisite requiring ongoing liberalisation as the cause for import surges, since Article 2:1 of the Agreement on Safeguards does not mention it anymore. The same is true for unforeseen developments. However, although this omission makes the two prerequisites somewhat more ambiguous, there is in principle no reason to assume that they have lost their validity.[31]

Summarising the analysis above, it can be noted that the existing suggestions for reform pursue two directions, as shown by the arrows in *Figure 4:* raising the level of prerequisites for antidumping, and, less vigorously, reducing the amount of compensation for safeguard clause measures. Accordingly, existing suggestions seem to indicate that an "optimal" instrument for temporary import restrictions must be found in the upper-left region of the plane.

Figure 4 Directions of Existing Suggestions for Reform



Source: Own graph.

31 In both *Argentina – Safeguard Measures on Imports of Footwear* (WT/DS121) and *Korea – Definitive Safeguard Measure on Imports of Certain Dairy Products* (WT/DS98), the Appellate Body explicitly refers to "unforeseen" circumstances. See para. 94 and para. 87, respectively. In *US – Safeguard Measures on Imports of Fresh, Chilled, Frozen Lamb Meat from New Zealand and Australia* (WT/DS178), it emphasises the full and continuing applicability of Article XIX GATT (para. 70).

4 An Alternative Solution

4.1 A theoretical framework for the study of trade policy

In the introductory section, it was argued that higher prerequisites for temporary import restrictions impair the government's trade policy flexibility, defined as the ability to decide *ex post* on when to introduce temporary protection. Recent theoretical and empirical research emphasises important advantages of agreements that do not intend to completely tie the hands of governments.[32] Such agreements can be more stable and are easier to achieve *ex ante*. We contend that governments are not ready to sacrifice trade policy flexibility by means of multilateral trade agreements such as those constituting the WTO. Isolated attempts to raise the prerequisites of antidumping are therefore doomed to fail.

Our argument is based on a simple theoretical framework, which has already been briefly introduced. A small economy is considered, facing exogenously given world prices. It is assumed that the government is in charge of trade policy and thereby maximises its own objective function. After a new multilateral trade agreement or the reform of an existing agreement has been concluded, the function consists of two components: (a) aggregate social welfare and (b) the support of strong import-competing sectors, their strength measured in terms of political influence. It bears close resemblance to the objective function used in the seminal contribution by Grossman and Helpman (1994). While their first component is identical to ours, their second one is broader in including not only import-competing, but also exporting interests. Yet, this difference is not of fundamental nature. Since exporting interests are generally not in conflict with aggregate social welfare considerations,[33] they can be subsumed under the first component of our objective function.

Our framework further distinguishes between two political circumstances that can occur after the agreement has been concluded: (a) normal political circumstances and (b) exceptional political circumstances. They could be thought of as two different pairs of weighting factors used in order to determine the relative importance of the components in the government

32 See, among others, Downs and Rocke (1995), Koremenos (2001), Ethier (2001), or Rosendorff and Milner (2001). The argument is in obvious contrast to the popular perception that multilateral trade agreements are first and foremost a tool to deprive the self-interested government from trade policy flexibility in order to make it resistant towards interest group pressure. See e.g. Staiger and Tabellini (1987) and Tornell (1991).

33 Both are in favour of free trade. The possibility of export subsidies is not considered here.

objective function. Under normal political circumstances, the government favours aggregate social welfare. It therefore abstains from introducing temporary import restrictions, provided that it cannot change the balance of market access concessions codified in the trade agreement. However, under exceptional political circumstances, defined as political stress, the fortune of the government may entirely depend on the support of a particular import-competing sector. Under these circumstances, temporary import restrictions in this sector will be unavoidable, and no consideration will be given to aggregate social welfare. Normal and exceptional political circumstances alternate over time.

Distinguishing between normal and exceptional political circumstances is quite common in trade policy literature.[34] Exceptional political circumstances, or political stress, are caused by an import-competing sector which for a while gains dominant influence on the government. We do not model the process leading to such a situation, but assume that it occurs regularly. This influence is strong enough to determine the fortune of the government, which will therefore introduce temporary import restrictions in this sector. The multilateral trade agreement cannot be made contingent on political circumstances because political stress cannot be contractually specified. The agreement is necessarily incomplete in this respect.[35] In order to be able to temporarily restrict imports under exceptional political circumstances, governments depend on trade policy flexibility, anchored in the trade agreement.

Contingent protection mechanisms such as today's safeguard clause are unable to provide trade policy flexibility. Their use is made dependent on the fulfilment of high prerequisites, all based on economic criteria, such as serious injury caused by rising imports. Exceptional political circumstances, however, are not defined by economic variables but by political stress. Although the two might often be correlated, this is not always the case. The government might have to introduce temporary import restrictions in an import-competing sector even in the absence of rising imports because this sector has been able to increase its political influence to an extent where it dominates the political agenda. On the other hand, the self-interested government might not see a political need to support a rapidly declining import-competing sector, although all prerequisites defined by the relevant mechanism for contingent protection would be fulfilled.

34 Exceptional political circumstances are often called "shocks". See e.g. Downs and Rocke (1995), Ethier (2001), or Rosendorff and Milner (2001).

35 This is in accordance, for example, with Ethier (2001).

Trade policy flexibility can only be provided by an instrument featuring low (or even no) prerequisites. Antidumping, as currently applied, fulfils this requirement. In contrast, the existing suggestions for reform with their focus on higher prerequisites are diametrically opposed to appreciating the need for trade policy flexibility. Our theoretical framework implies that governments will not give their approval to the conclusion of such a reform, knowing that later they would have to temporarily restrict imports at times of political stress even if the suggested higher level of prerequisites were not fulfilled.

How realistic is our theoretical framework? Is there some empirical evidence that supports its main assumption, namely that governments are not ready to give up trade policy flexibility? Critics might argue that there is a well-known group of countries, called the "Friends of Antidumping Negotiations", which have adopted in their proposals many of the suggestions for reform presented in *Section 3* above.[36] The group includes some active antidumping users, such as Brazil, South Korea, and Mexico. Indeed, the Friends were responsible for securing a mandate at the Doha Ministerial Conference in November 2001 to initiate negotiations on antidumping reform.

However, the mandate is extremely narrow: negotiations will have to "preserv[e] the basic concepts, principles and effectiveness" of the Agreement on Antidumping and its instruments and objectives. In other words, the mandate does not include a noteworthy change. We should therefore expect an outcome similar to that of the Uruguay Round. There, the use of antidumping was not restricted, despite seeming efforts to raise the level of prerequisites by piecemeal amendment. This failure is hardly astonishing, since FINGER (1993) aptly observes that "[r]eform will not be found in the details of the antidumping code." A noteworthy rise in prerequisites would have to alter the above-cited basic concepts, principles and the effectiveness of the regime. The experience with the Uruguay Round and with the initial stage of the Doha Round does not provide any indication that this is politically feasible.

In conclusion, even if our theoretical framework does not perfectly describe the trade policy of each individual country, it is at least representa-

36 Their proposals can be found in detail in a number of issues of the *International Trade Reporter,* see in particular Vol. 19, No. 18 of May 2, 2002; Vol. 19, No. 28 of July 11, 2002; Vol. 19, No. 47 of November 28, 2002; Vol. 20, No. 13 of March 27, 2003; Vol. 20, No. 18 of May 1, 2003; and Vol. 20, No. 19 of May 8, 2003.

tive of major WTO members who effectively determine the institutional design of the world trading order.

4.2 Trade policy flexibility subject to full compensation

Our theoretical framework predicts that the government uses antidumping even under normal political circumstances because it can thereby change the balance of market access concessions. Yet, the analysis of reciprocity ratios in *Section 2* led us to the conclusion that governments might eventually discover the prisoner's dilemma character of antidumping. This in turn could stimulate a desire for reform. In other words, the missing readiness to sacrifice trade policy flexibility does not imply that governments will not consider ways of reducing the number of temporary import restrictions under normal political circumstances. An alternative to the rise of prerequisites might be a solution.

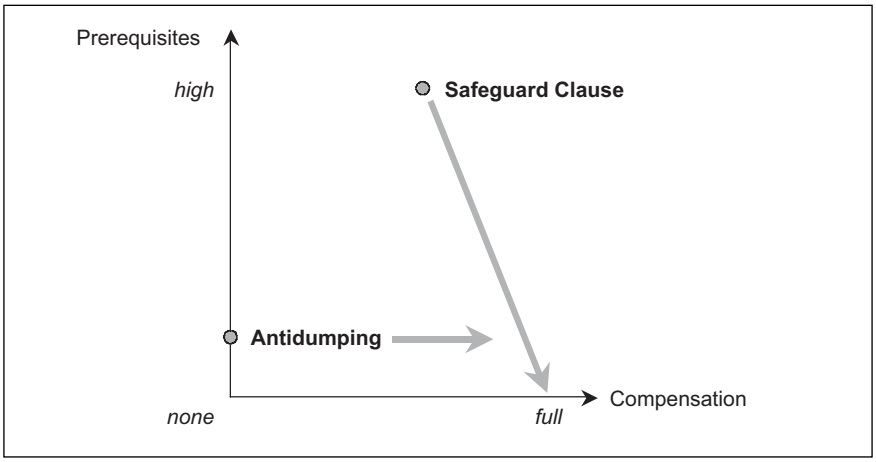
This alternative could consist of shifting the focus from prerequisites to compensation. A new regime might maintain the trade policy flexibility inherent in current antidumping rules by requiring low or even no prerequisites for temporary import restrictions. However, any restriction would have to be combined with full compensation for affected trading partners. According to the theoretical framework, full compensation will ensure that no government introduces temporary import restrictions under normal circumstances because the market access balance would remain unchanged. On the other hand, full compensation maintains trade policy flexibility. At times of political stress, the government will be able to satisfy the interests of a strong import-competing sector which in return provides the necessary political support.

In contrast to high prerequisites, based on economic criteria, the compensation concept does not interfere with the political nature of exceptional circumstances. Full compensation makes it useless for governments to specify circumstances where temporary import restrictions may be introduced because it automatically induces governments to raise import barriers only under exceptional political circumstances. Therefore, our alternative solution should lead to a considerable reduction of temporary import restrictions, as compared to the situation today.

5 Implementing the Alternative Solution

The existing suggestions for the reform of antidumping focus either on antidumping itself or on the safeguard clause. As *Figure 5* indicates, the alternative solution outlined above could also pursue two different directions:

Figure 5 Directions for the Implementation of the Alternative Solution



Source: Own graph.

The first direction is characterised by maintaining antidumping but combining it with full compensation. Although conceptually interesting, it will be shown that such a combination is not promising. In contrast, the second direction merits considerable attention. It envisages the abolition of antidumping, supplemented by two modifications of the safeguard clause: a removal of prerequisites and an elimination of the exception to the full compensation requirement.

5.1 Antidumping with compensation

As noted in *Section 3,* existing suggestions for reform have not intended to make antidumping contingent on the provision of compensation. This is hardly astonishing, since the alleged connection between antidumping and unfair trade is not reconcilable with the compensation of affected parties. Before proposing compensation, it would be necessary to get rid

of the unfair trading argument. However, this would deprive antidumping of its most important justification.

That being said, it must be recognised that measures against alleged dumping were actually accompanied by compensatory effects on several occasions in the past. This was the case whenever antidumping investigations were terminated by a "voluntary price undertaking", which was imposed instead of antidumping duties. Such an undertaking helps to restrict imports of the good in question, but shifts rents to the foreign exporter by raising export prices.[37] It is a form of managed trade admissible under the Agreement on Antidumping.

However, these effects are an outgrowth of abandoned investigations, not a feature of antidumping itself. Whenever investigations lead to definitive measures, there is no compensatory effect anymore. Furthermore, this form of managed trade runs counter to the aim of banning voluntary export restraints stipulated by the Agreement on Safeguards, thereby creating an inconsistency in the world trading order. In sum, it does not look promising to combine antidumping with full compensation. The implementation of our alternative solution must obviously be based on a more fundamental change of the current system.

5.2 A revised safeguard clause

The idea of restraining antidumping action by a more attractive safeguard clause is not new, as shown in *Section 3*. However, we are not aware of any proposal that considers a reduction – let alone an elimination – of prerequisites for the purpose of raising its attractiveness. The prerequisites of the safeguard clause appear to be sacrosanct. This is problematic for three reasons. First, as the theoretical considerations have shown, prerequisites based on economic criteria are a questionable component of temporary protection because they do not respect the inherently political nature of exceptional circumstances.

Second, thinking about concepts such as injury, causal effect, unforeseen developments and the like, lobbying in the presence of prerequisites is

37 Bown (2002) indicates a second method of rent-shifting practised in the context of antidumping. In many instances of formal trade disputes concerning antidumping measures, the defendant evaded a DSB Ruling (and its potential consequences) by withdrawing the antidumping measure and *refunding* the collected duties.

mostly about convincing the government that the current situation represents a state of the world which fits exactly into the straightjacket mandated by these prerequisites. Taking into account the huge information asymmetries to the disadvantage of governments, it is conceivable that protection-seeking interests often have an easy play.[38]

Third, it can be shown that the actual selection of prerequisites in today's safeguard clause reflects considerable arbitrariness and can hardly be based on sound economic reasoning. If these prerequisites were meant to ensure that the clause contributed to aggregate social welfare, they would presumably promote a smooth structural adjustment in import-competing sectors. Yet, it is doubtful that the structural adjustment argument for the safeguard clause has any merits on economic grounds. First, as a matter of fact, the employment-displacement effects from liberalised trade are chronically exaggerated.[39] Second, even in the case of a strong need for adjustment, there are more efficient ways of temporarily supporting ailing industries than the restriction of imports.[40] Moreover, there is no guarantee that the safeguard clause actually promotes adjustment. The converse could be true.[41] Finally, the need for adjustment not only arises because of increasing world trade. This need could also be attributed to changing consumer tastes, technology bringing about new production methods, or environmental concerns causing more stringent national regulation. In all these cases, temporary import restrictions might ease the pressure on import-competing industries and allow for a smooth adjustment. Thus, the question is: why is adjustment necessitated by rising imports a justification for safeguards, whereas adjustment caused by other factors is not?[42]

An elimination of the prerequisites stated in the safeguard clause would make it possible for governments to give up the antidumping instrument without compromising trade policy flexibility. They would still be able to decide on when to introduce temporary import restrictions. The form of protection, however, would have to satisfy the most-favoured-nation principle of Article I GATT.[43] Furthermore, the revised safeguard clause

38 Robertson (1992, p. 43), referring to the injury prerequisite of the safeguard clause, confirms that "[…] the determination of serious injury is often based on domestic political pressures, not on economic analysis."

39 See e.g. Lawrence and Krugman (1993).

40 Production subsidies would be an example. They do not bring about distortions on the consumption side.

41 Kohler and Moore (2001) show in a model with asymmetric information about costs that the safeguard clause leads to under-adjustment.

42 Jackson (1997, p. 176) brought up this question.

43 Exceptions could be provided on basis of today's Article 5 of the Agreement on Safeguards.

would always require full compensation. Therefore, today's exception to the full compensation requirement in case of absolutely rising imports would cease to exist.

The principles of this revised safeguard clause are similar to those found in the renegotiation provisions of Article XXVIII GATT. Paragraph 5 of that provision enables a contracting party to introduce import restrictions at any time by modifying its schedule of concessions, provided that it reserves this right by regular notification at three-year intervals. Such a reservation was made by a steadily increasing number of contract parties in the past.[44] Import restrictions based on Article XXVIII should be accompanied by full compensation ("compensatory adjustment") for affected parties,[45] otherwise these parties have the right to retaliate.

Despite this relatedness, Article XXVIII is by no means a substitute for the revised safeguard clause. The former is the basis for a permanent modification of concessions, which is difficult to revoke, and requires prior negotiations with affected parties before it can be effected. The latter offers temporary protection that is rapidly available and can be promptly terminated, without the burden of modifying the schedules of concessions. As MESSERLIN (2000) puts it, renegotiations under Article XXVIII are clearly a "disproportionate" instrument for the aim of temporary import restriction.

The revised safeguard clause can only live up to its purpose if the provision of compensation occurs instantaneously and smoothly after a temporary import restriction has been introduced. Therefore, it seems worthwhile to think about pre-selecting a set of concessions that could be offered to affected parties when necessary. Such an *ex-ante* selection would create "liberalisation security deposits"[46]. These deposits could have limited sectoral coverage, or represent prior commitments to make across-the-board cuts in barriers to trade. As soon as a temporary import restriction is introduced, affected parties would be authorised to select a package of concessions from these deposits. In order to accelerate the process

44 See HODA (2001). For the period from 1 January 2000 to 31 December 2002, 43 contracting parties – including the EC and the US – made such a reservation. (Data from the homepage of the WTO.)

45 Para. 2 reads: "[…] the contracting parties concerned shall endeavour to maintain a general level of reciprocal and mutually advantageous concessions not less favourable to trade than that provided for in this Agreement prior to such negotiations."

46 LAWRENCE (2003) came up with this idea. However, he discusses this concept as an alternative (or even as a complement) to retaliation in case of non-compliance with DSB rulings. This is of course a separate problem, but considerations regarding the optimal design of compensation are equally useful when compensation becomes an inherent element of the revised safeguard clause.

of reaching an agreement as to the proper value of full compensation, a standing arbitrator could be installed.

In order to make compensation more useful for affected trading parties, a requirement could be proposed that the respective market opening concessions are of permanent nature. In this case, their amount could be lower than the amount of concessions suspended by the initial import restriction, since the latter is only of temporary nature. If, however, the import restriction still persists after, say, three years, the amount of compensatory concessions would have to be further increased.

If governments were ready to give up the antidumping instrument in exchange for a revised safeguard clause that maintained trade policy flexibility, they would not be inhibited to combating imports that are based on predatory intent. National antitrust legislation should normally suffice as a lever against anticompetitive behaviour. In the case that an exporter under investigation is not endowed with a protected home market, it is difficult to imagine that predatory intent could exist.[47] Therefore, the antitrust procedure could be supplemented by an investigation into the contestability of the exporter's home market. Such an investigation might be guided by a multilateral competition agreement, which provided for a harmonisation of national competition rules.[48] Less ambitious (and more realistic) would be the application of "positive comity". In this case, the competition authorities in the exporter's home country would favourably treat the request from abroad to conduct an investigation into the exporter's domestic base.[49]

5.3 The role of the Dispute Settlement Understanding under the revised safeguard clause

Under the revised safeguard clause, the Dispute Settlement Understanding (DSU) does not intend anymore to deter temporary import restric-

47 A protected home market would allow the exporter to cross-subsidise lower prices in export markets. Furthermore, parallel imports could be warded off.

48 See MEIKLEJOHN (1999) for a good discussion of this suggestion. HAUSER and SCHÖNE (1994) doubt the need for harmonised competition rules, since dumping with predatory intent can be sufficiently countered by national antitrust rules (according to the "effects doctrine"). However, they recognise that a multilateral competition agreement might be a precondition in order to get the political support for the restraining of antidumping.

49 See HOEKMAN and MAVROIDIS (1996) and THARAKAN, VERMULST and THARAKAN (1998).

tions *per se.* Instead, the DSU would have to ensure that any temporary import restriction comes along with full compensation.

It was argued above that a standing arbitrator could help to determine the level of full compensation. A precondition for such a determination would be that there is no disagreement about the import restriction itself. Imagine a dispute scenario where the defendant actually denies the allegation that imports have been restricted. In reaction to this denial, the complainant government would have to follow the procedure outlined in the DSU. If no mutually accepted solution could be found in advance, the Dispute Settlement Body (DSB) would finally adopt a report issued by a panel (or by the Appellate Body). Both the panels and the Appellate Body have generally refrained from making specific suggestions in the past.[50] In cases in which the deviation from initial concessions was confirmed, they just recommended that the defendant bring the respective measure into conformity with its obligations under the WTO agreements. Such a recommendation has a very different meaning under the revised safeguard clause: "conformity" would explicitly include the temporary maintenance of the import restriction, accompanied by the provision of full compensation. Therefore, the defendant government would have free choice among two alternative means of compliance. The first alternative would be to withdraw the import restricting measure. The second alternative for the defendant would be to maintain the import restriction but to fully compensate all affected trading partners for their losses.[51] Only if the defendant refused both alternatives (withdrawal and compensation), could the DSB authorise retaliation in form of suspension of concessions by affected trading partners.

6 Conclusion

Existing suggestions for the reform of antidumping intend to restrain it by raising the prerequisites for its use. While a restraint would be welcome, the focus on higher prerequisites is neither necessary nor promising for reducing the number of temporary import restrictions and thereby increasing aggregate social welfare.

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50 See PAUWELYN (2000).

51 One could, in this respect, also think about the introduction of retroactive compensation. Although this would complicate the calculation of the appropriate amount of compensation, it would eliminate incentives for free riding.

This focus is not necessary because the aim of keeping the number of temporary import restrictions low can also be achieved by maintaining the trade policy flexibility inherent in current antidumping rules, but combining it with the provision of full compensation. This could be done by abolishing antidumping and introducing a revised safeguard clause instead. In this case, no government would have an incentive anymore to temporarily restrict imports under normal political circumstances.

Furthermore, the isolated attempt to raise the prerequisites for antidumping does not seem promising because governments cannot be expected to sacrifice their trade policy flexibility. The experience with the Uruguay Round Agreement on Antidumping has frustrated any such illusion. Trade policy flexibility is indispensable in periods of political stress.

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