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Alan O. Sykes

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Protectism as a "Safeguard": A Positive Analysis of the GATT "Escape Clause" with Normative Speculations

Alan O. Sykes†

The General Agreement on Tariffs and Trade (GATT) establishes a multilateral framework for the liberalization of international trade in goods. Under the auspices of GATT, signatories have reduced tariffs affecting hundreds of billions of dollars in trade annually.1 GATT also constrains the use of quotas and other quantitative restrictions on imports and exports,2 the use of internal tax and regulatory policies to favor domestic over foreign producers,3 and a variety of other protectionist devices.

Because of the extensive GATT restrictions on government interference with international markets, it is tempting to view the Agreement as a high-minded, trade-liberalizing undertaking, devoted to the pursuit of free trade and to the defeat of protectionist forces. But scholars have long argued that such a view of GATT is naive, and that it must instead be understood as an expedient bargain among the self-interested political leaders of GATT signatories.4 Although GATT can largely be justified by sound arguments about the public interest in a liberal trading order, it is best understood with the aid of public choice theory.

The subject of this Article is a particular GATT provision that is indeed difficult to comprehend without the public choice perspective—Article XIX, which allows signatories to renege upon their commitments to reduce trade barriers. More precisely, Article

† Professor of Law, The University of Chicago. I have received thoughtful comments on a preliminary draft from David Friedman, John Jackson, Richard Posner, Eric Rasmusen, and George Stigler, and from participants in law and economics workshops at Chicago, Harvard, Michigan and the University of Pennsylvania law schools. I thank the Lynde and Harry Bradley Foundation and the Olin Foundation for financial support.

3 GATT Art III.
4 See, for example, Jagdish N. Bhagwati, Protectionism 40-41 (MIT, 1988); Robert E. Baldwin, Trade Policy in a Changing World Economy 137-47 (Chicago, 1988).
XIX allows member nations to suspend GATT obligations when increased imports “cause or threaten serious injury to domestic producers" of competing products “to the extent and for such time as may be necessary to prevent or remedy such injury.” In GATT parlance, a protective measure under Article XIX is a “safeguards” action. Article XIX is also often termed the GATT “escape clause,” as it allows signatories to “escape” from their GATT commitments.

Numerous GATT signatories, especially the United States, the European Community, Canada, and Australia, have invoked Article XIX to afford protection to a range of “injured” industries. For example, Article XIX provides the GATT foundation for a comprehensive system of import restraints designed to protect the U.S. steel industry. Other U.S. producer groups that have benefited from safeguards measures include apparel manufacturers, footwear manufacturers, the lone U.S. producer of motorcycles (Harley), and producers of various agricultural products.

Related to Article XIX, although outside its formal ambit, are various negotiated agreements between importing and exporting nations for limitations upon the quantity of exports. Such "volun-

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5 GATT Art XIX(1)(a). Article XIX(1)(a) reads in full:
If, as a result of unforeseen developments and of the effect of the obligations incurred by a contracting party under this Agreement, including tariff concessions, any product is being imported into the territory of that contracting party in such increased quantities and under such conditions as to cause or threaten serious injury to domestic producers in that territory of like or directly competitive products, the contracting party shall be free, in respect of such product, and to the extent and for such time as may be necessary to prevent or remedy such injury, to suspend the obligation in whole or in part or to withdraw or modify the concession.


7 See, for example, President Rejects Import Relief Plan For Steel Industry, Sets "New" Policy, 1 Intl Trade Rptr (BNA) 296 (1984); U.S. Opens VRA Talks with Foreign Producers; Dispute Erupts over Marking Requirement, 1 Intl Trade Rptr (BNA) 497 (1984); EC Agrees to Limit Pipe and Tube Shipments to 7.6% of Market in Bid to Settle Dispute, 2 Intl Trade Rptr (BNA) 4 (1985); U.S., EC Reach VRA Agreement Providing for Small Increase in EC Quota, Officials Say, 6 Intl Trade Rptr (BNA) 1340 (1989).

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tary export restraints” (VERs) have proliferated in recent years.

The restrictions on Japanese exports of automobiles to the United States during the 1980s and the Multifiber Arrangement, a longstanding network of agreements governing world textile trade, exemplify these agreements.

Many academics and government officials argue that Article XIX warrants revision. Developing countries contend that developed countries systematically use safeguards measures for extended periods of time to protect their declining industries from the emergence of more efficient competitors. Developed countries contend similarly that their trading partners abuse Article XIX for protectionist ends. These criticisms of Article XIX have led to various reform proposals to constrain the circumstances in which Article XIX may be invoked and the protective devices that may be employed.

Other writers argue, however, that Article XIX is too restrictive of the conditions under which “escape” from GATT obligations is permitted, causing the modern proliferation of VERs. VERs, they argue, undermine the legal authority of the GATT system, introduce the evils of discrimination into a trading regime grounded in principles of nondiscrimination among trading partners, and afford protection of open-ended duration. Thus, some writers favor easing restrictions upon safeguards actions to encourage greater resort to Article XIX, coupled with clear prohibition of discrimination in safeguards remedies.

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8 See 6 Intl Trade Rptr (BNA) 869 (cited in note 6). VERs are also frequently termed VRAs (voluntary restraint agreements).
10 See Barton and Fisher, International Trade and Investment at 234-41 (cited in note 8).
16 Discriminatory safeguards are measures applied selectively to some exporting countries but not to others. See Sampson, Safeguards, in Finger and Olechowski, eds, The Uruguay Round at 148 (cited in note 6).
These proposals and others have been the subject of discussion during the ongoing Uruguay Round of GATT negotiations. As of this date, the eventual outcome of those negotiations remains in doubt, and the possibility exists that disagreements over agricultural policy may scuttle the Uruguay Round altogether. Nevertheless, negotiators in the safeguards group have concluded a draft "Agreement on Safeguards" to "clarify and reinforce the disciplines of the General Agreement, and specifically those of its Article XIX." The draft declines to resolve certain issues of lingering controversy, such as the permissibility of discrimination in safeguards remedies and the obligation of signatories to abandon VERs, but does clarify other aspects of Article XIX and introduces some significant departures from its original text.

This Article draws upon public choice theory and the economics of contracting to explain the particulars of existing law and practice under Article XIX, as well as certain areas of agreement and controversy under the draft Agreement on Safeguards. The analysis also yields useful insights into the merits of various reform proposals.

The point of departure is the observation that GATT is a contract, and that parties to contracts have an incentive to include provisions that are "Pareto optimal" or "efficient" from their perspective. This proposition raises a number of questions about Article XIX. Why is the opportunity to renege on commitments to reduce trade barriers, under the conditions specified in Article XIX, an "efficient" part of the bargain? What is the relationship between "efficiency" from the perspective of the negotiators of GATT, and "efficiency" from a societal standpoint? This Article explores these questions and others, developing their positive and, to a lesser extent, normative implications.

In particular, the proposition that GATT is an astute bargain among the self-interested political officials of signatory countries provides ready explanation for the existence of an escape clause in GATT, for the central features of the injury test under Article XIX, and for the convergence of modern safeguards practice on an equilibrium in which signatories effectively ignore certain textual

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17 See GATT Secretariat, Draft Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations 183-92 (Nov 26, 1990) (unpublished; on file with U Chi L Rev) ("draft Agreement on Safeguards").

18 See, for example, Steven Shavell, Damage Measures for Breach of Contract, 11 Bell J Econ 466 (1980). More precisely, the parties to any contract have an incentive to incorporate provisions that allow a Pareto improvement ex ante, with due regard to the transaction costs of negotiating and enforcing those provisions.
prerequisites for safeguards action. When coupled with concerns relating to the control of strategic behavior, this proposition further explains the compensation and retaliation provisions of Article XIX, their retention in the draft Agreement on Safeguards in modified form, and the relationship between Article XIX and other GATT provisions that permit the renegotiation of commitments. Finally, it suggests why the controversy over discrimination in safeguards remedies has proven so difficult to resolve despite the adherence to principles of nondiscrimination elsewhere in GATT.

The normative component of the analysis, decidedly more speculative in character, considers the relation between the efficiency of the GATT escape clause from the political standpoint of its negotiators and its "second-best" efficiency from a social welfare standpoint. A tradeoff likely exists between trade liberalization ex ante and opportunities to reimpose protection ex post. When self-interested political officials must decide whether to make trade concessions under conditions of uncertainty about their political consequences, the knowledge that those concessions are in fact "escapable" facilitates initial trade concessions and may reduce the social costs of protection over time. This defense of Article XIX, though conjectural, is nonetheless far more convincing than popular rhetoric about the importance of the escape clause for restoring competitiveness or facilitating an orderly contraction in declining industries, or the hypothesis that escape clause measures provide an ex post "safety valve" for protectionist pressures. Further, because of the linkage between ex post protection and ex ante liberalization, it is exceptionally difficult to ascertain how to improve Article XIX even putting aside the question whether improvement is politically feasible. The adoption of proposals to eliminate discriminatory safeguards actions might prove counterproductive, as might the adoption of certain proposals to encourage greater use of Article XIX in preference to VERs. The elimination of the compensation/retaliation provisions of Article XIX would be especially troubling in this regard.

I. SOME PRELIMINARIES: THE ECONOMICS OF PROTECTION FOR "INJURED" INDUSTRIES

Political rhetoric often holds that the protection of "injured" industries directly promotes defensible public policy goals. Such

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19 "First-best" efficiency from a social welfare standpoint, as discussed in Section I, would likely entail binding commitments to free trade without any escape clause.
rhetoric even finds its way into formal legislative pronouncements. For example, the statute that provides domestic authority for escape clause action in the United States\textsuperscript{20} directs the President to impose protective measures when they will facilitate "a positive adjustment to import competition and provide greater economic and social benefits than costs."\textsuperscript{21} Such benefits ostensibly arise when, as a consequence of protective actions, (1) "the domestic industry is [then] able to compete successfully with imports"\textsuperscript{22} or "the domestic industry experiences an orderly transfer of resources to other productive pursuits";\textsuperscript{23} and (2) the "dislocated workers in the industry experience an orderly transition to productive pursuits."\textsuperscript{24} These notions that protection will allow an industry to become competitive again or will facilitate its "orderly" contraction, thereby generating greater "social benefits than costs," provide a popular and politically expedient justification for escape clause actions.

This section disputes these popular notions, arguing that protection for "injured" industries cannot be justified by principled efficiency or equity arguments regarding its effects upon the protected industry and workers. Rather, only the public choice perspective elaborated in Section II provides a convincing positive account of and a plausible normative justification for GATT safeguards policy.

A. Economic Efficiency

Economists conventionally posit that the objective of trade policy is, as Adam Smith phrased it, to maximize the wealth of nations. The field of international economics thus devotes much attention to the effects of trade policy on the economic "efficiency" or "welfare" of the country that implements it. The change in economic welfare due to policies such as tariffs and quotas is measured by the change in the sum of national producer surplus,\textsuperscript{25} nat-

\textsuperscript{20} Section 201 of the Trade Act of 1974, 19 USC § 2251 et seq (1988).
\textsuperscript{21} Id at § 2258(a)(1)(A).
\textsuperscript{22} Id at § 2251(b)(1)(A)(i).
\textsuperscript{23} Id at § 2251(b)(1)(A)(ii).
\textsuperscript{24} Id at § 2251(b)(1)(B).
\textsuperscript{25} Producer surplus is equal to the sum of economic profits and rents earned by firms and workers. An economic profit arises when the return on the operation of a firm exceeds the "competitive" return on investment capital. An economic rent arises when the sale of a factor of production (such as land or labor) yields a price in excess of the price available in that factor's next best alternative use.
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tional consumer surplus,\(^{26}\) and national government revenue.\(^{27}\)

1. Background: The unilateral and multilateral effects of protectionist policies.

Classical economic theory holds that trade restrictions of any sort often reduce the economic welfare of importing nations, let alone the trading community as a whole. A tariff or quota will cause the price of an imported good to rise. Domestic consumer surplus may well fall, the story runs, by more than the combined increase in government revenue and domestic producer surplus. The reason for the net loss is twofold. First, the price increase induces some consumers to exit the market, and their consumer surplus is altogether lost—it is not captured as an increase in producer surplus or government revenue. Second, the price increase induces an increase in domestic output, but the marginal cost of the additional units exceeds the price of the imports that they replace, and thus the importing nation pays an unnecessary premium for these units.\(^{28}\) Therefore, if an importing nation seeks to maximize its own economic welfare, a policy of free trade may be in its best interest, regardless of the policies adopted by its trading partners.

Such analysis relies, however, on a static, competitive model of a market in a “small” country. It assumes that output and input markets are competitive and at all times in equilibrium, that no nonpecuniary externalities exist, and that the importing nation is unable to influence through trade restrictions the price that it pays for its imports (or, more precisely, that it is unable to influence its “terms of trade”—the relative price of imports and exports). Over the years, economists have developed a variety of welfare-based arguments for protection when these conditions do not hold.

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\(^{26}\) Consumer surplus arises when a consumer’s reservation price—the consumer’s maximum willingness-to-pay for a good or service—exceeds the price actually paid.

\(^{27}\) The inclusion of government revenue (usually tariff revenue) as part of “surplus” is a simplification. In a complete model of the economy, government receipts are spent and a complete accounting of producer and consumer surplus will capture the entirety of the change in national economic welfare.

\(^{28}\) See, for example, Peter B. Kenen, *The International Economy* 175-80 (Prentice-Hall, 1985). Of course, government revenue will not increase at all under a quota system unless the government sells the quota rights. For the more complex but nevertheless adverse “general equilibrium” effects of protection, see Jagdish N. Bhagwati and T.N. Srinivasan, *Lectures on International Trade* 162-66 (MIT, 1983).
For example, a nation large enough to influence the price of the imports it purchases can behave as a monopsonist—it can impose a tariff or auctioned quota to restrict imports to the monopsony optimum, capturing monopsony rents through the tariff or quota auction revenue. Similarly, a country that purchases imports from a foreign monopoly or oligopoly can use tariffs to extract monopoly rents because the foreign monopolist will ordinarily respond to a tariff by reducing price and thereby ceding some of its monopoly rents to the government imposing the tariff. Alternatively, if a domestic industry generates positive externalities, and those externalities are lost when production occurs abroad, then protection may be used to induce expansion of domestic producers at the expense of foreign producers and thereby shift external benefits from foreign economies to the domestic economy.

For two reasons, however, these departures from the competitive model do not provide an economic justification for the protection of “injured” industries in general, or for Article XIX in particular. First, and most obviously, none of these arguments for protection relates closely to the condition of the industry in question, yet Article XIX requires actual or threatened injury to an industry.

29 That is, the nation is large enough that it faces an upward sloping supply curve for imports of some goods.

30 Under an auctioned quota, the large nation requires producer countries to bid for quota allotments, thus allowing the government to capture monopsony rents similar to the manner in which it captures such rents from a tariff. The study of how nations may exploit their monopsony power in trade is generally termed “optimal tariff theory.” See, for example, Avinash K. Dixit and Victor Norman, *Theory of International Trade* 150-52 (Cambridge, 1980); Bhagwati and Srinivasan, *Lectures on International Trade* at 174-84 (cited in note 28).


32 Because of difficulties in appropriating the returns to innovation, research and development activities are often thought to generate positive externalities. If knowledge spreads primarily through word-of-mouth and exchange of personnel, these externalities may be confined to the locality or nation of the innovator. Such analysis has often been advanced to justify protection for certain high-technology industries. See, for example, Paul R. Krugman, *Is Free Trade Passè?,* 1 *J Econ Persp* 131, 137-38 (Fall 1987).

A closely related argument for protection arises when an oligopoly includes both domestic and foreign producers. In that case, protection not only serves as a device for the extraction of rents from foreign producers but also facilitates the expansion of domestic oligopolists at the expense of foreign oligopolists. If such expansion allows the domestic oligopolists to reap economies of scale or to increase their share of oligopoly rents in world markets, a further gain in domestic welfare may arise in the form of increased producer surplus. See id at 134-37; James A. Brander, *Rationales for Strategic Trade and Industrial Policy*, in Paul R. Krugman, ed, *Strategic Trade Policy and the New International Economics* 23 (MIT, 1987).
Second, in each of these scenarios, the loss of economic welfare abroad generally exceeds the gains to the importing country. The exploitation of monopsony power by a large nation, for example, introduces the inefficiency of monopsony into the trading system. A tariff designed to extract monopoly rents from foreign producers induces them to contract their output, thereby exacerbating the preexisting distortion attributable to monopoly. Protection aimed at shifting external economies from one nation to another not only distorts consumer prices in the protected economy, but often induces an expansion of comparatively inefficient domestic producers at the expense of comparatively efficient foreign producers.\footnote{This argument for safeguards measures is akin to the familiar "infant industry" argument for protection in international economics, which asserts that small, developing industries need a period of protection while they move down the "learning curve" and become competitive with established foreign rivals. See, for example, Charles P. Kindleberger, \textit{International Economics} 113 (R.D. Irwin, 5th ed 1978).}

Policies that enhance national economic welfare at the expense of worldwide economic welfare may well be tempting in an environment in which trading nations behave noncooperatively. Ideally, however, the very function of a cooperative agreement such as GATT is to constrain or eliminate self-regarding protectionist policies for the mutual benefit of all signatories. Hence, the mere fact that protection may at times afford economic gains to an importing country hardly provides an economic justification for safeguards measures under GATT. Rather, an appealing justification, if one exists, must rest on the proposition that safeguards actions afford net gains to GATT signatories in the aggregate. It remains to consider whether the popular justifications for escape clause actions—to restore competitiveness or to facilitate orderly contraction of declining industries—suggest possible sources of such net gains.

2. Restoring competitiveness.

The argument for safeguards measures to restore "competitiveness" is straightforward. Safeguards actions provide ailing firms with an increase in profits, enabling them to invest in new technology and modern equipment, which will later allow them to compete successfully in the international marketplace.\footnote{To be sure, trade restrictions in the presence of nonpecuniary externalities may increase domestic welfare more than they reduce foreign welfare—it all depends upon the circumstances. Because Article XIX is in no way tailored to circumstances in which externalities are plausibly important, however, this analysis does not pursue the issue further.} The purported source of net gains to the international community (and to

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To be sure, trade restrictions in the presence of nonpecuniary externalities may increase domestic welfare more than they reduce foreign welfare—it all depends upon the circumstances. Because Article XIX is in no way tailored to circumstances in which externalities are plausibly important, however, this analysis does not pursue the issue further.
the importing nation) lies with the eventual emergence of efficient competitors. The premise is that the protected industry will in time lower its costs of production to the point that protection is no longer necessary to its survival, and that the eventual savings in production costs (or perhaps the elimination of distortions attributable to monopoly power that would otherwise exist) will more than offset the short-term inefficiencies that arise during the period of protection.

This argument is problematic for several reasons. First, it relies on the questionable assumption that governments can accurately identify and protect only those industries that can become "competitive" (or "competitive again" in the case of declining industries). The more probable outcome is that well-organized producer lobbies will secure protection irrespective of the impact such protection is likely to have on the "competitiveness" of their particular industry.

Second, even if governments were competent to identify appropriate candidates for assistance and would properly exclude poor candidates, protection is not necessarily the best way to provide such assistance. Direct loans or subsidies to the troubled industry are in theory superior to protection, unless such measures entail sufficiently higher administrative costs. Loans or subsidies to cover periods of losses can be as effective as protection in enabling an industry to become "competitive," but they do not introduce the deadweight loss attributable to the protection-induced distortion of consumer prices.35

Finally, and most importantly, government intervention to restore "competitiveness" is simply unnecessary, at least in developed countries with substantial private capital markets.36 Private lenders will finance efforts to become "competitive" as long as the returns from such investments justify the apparent risk. Absent some distortion affecting the market rate of interest, therefore, economically worthwhile investments will be financed without government assistance. And, at any rate of interest, investment in industries that are unwilling or unable to borrow in the capital market diverts resources from other investments where the expected returns are greater.

35 Regarding the distortive effects of taxes necessary to finance the subsidies, and the conventional wisdom as to why they are smaller than the distortive effects of protection, see note 45.
36 For developing countries, Article XVIII(2) provides a special exception that allows "infant industry"-type protection.
To be sure, if the industry in question generates some external economy that individual firms in the industry cannot capture (perhaps R&D spillover), the social returns to investment in the industry will exceed the private returns. But other policy instruments, such as loans and subsidies, are still preferable in theory to protection. Further, the observation that protection for some "injured" industries may generate external benefits hardly justifies the escape clause now in existence, which requires no showing of an externality. The suggestion that temporary protection may restore the competitiveness of failing industries is ultimately unpersuasive.

3. Orderly contraction.

Beyond question, protection can slow the rate of industrial contraction in response to import competition, or end contraction altogether. But such delay is ordinarily an economic vice, not a virtue.

Industries contract because the price that they can command for marginal units of production at higher levels of output is insufficient to cover the marginal costs of the inputs needed to produce those marginal units. In competitive markets, this statement is equivalent to the observation that those inputs are better employed elsewhere (or better left unemployed). The reason, put simply, is that the competitive price of marginal inputs is equal to their opportunity cost, the price that those inputs can command in their best alternative use. Thus, if the owners of the necessary inputs—whether land, capital equipment, labor, or raw materials—collectively require a price to supply them at the margin that exceeds the value of the additional output they will ultimately produce, it follows that those inputs collectively are more valuable in alternative uses. It is inefficient to discourage their redeployment to those uses.

In the transition to an alternative use, of course, some inputs may spend a period of time unemployed, or may remain unemployed forever. The laid-off worker will have to search for another job, or may decide to stop working altogether in preference for lei-

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38 In contrast, other provisions of GATT do allow the imposition of protective measures in the face of various arguable "externalities"; for example, national security concerns (Article XXI) and measures necessary for the protection of human, animal, or plant health (Article XX(b)).
sure time. A closed factory may never reopen. But in competitive markets, there is nothing inefficient about such unemployment. The worker who is unemployed while searching for another job makes an efficient investment in the search, trading off the costs of additional search time against the expected benefits of a better compensation package or a more attractive work environment. The worker who exits the labor force altogether does so efficiently because the value of leisure to that worker exceeds the returns to working at the available wage. Similarly, the factory that closes permanently does so efficiently because it cannot operate at a level where the price it can command for its output exceeds the marginal costs of production.

Plainly, however, these conclusions rest upon a key assumption in the competitive model—that the price of marginal inputs is equal to the price that they can command in their best alternative use. The accuracy of this assumption might be questioned, perhaps most often with regard to labor. The assumption that marginal workers earn a return just equal to what they can command in their next best employment opportunity implies that they are indifferent between their current jobs and their best alternative. Involuntary unemployment, therefore, does not exist. Workers who move from higher paying jobs to lower paying jobs do so only when the added psychic compensation fully offsets the reduction in monetary compensation. Unemployed workers searching for work do so only by choice—they expect continued search to yield attractive job opportunities preferable to their existing job offers. These notions seem at odds with the common intuition and apparent experience that unemployment is not always voluntary.

Indeed, for a variety of reasons, marginal workers may earn a premium over what they can earn elsewhere—in economic parlance, a marginal "rent." Unionization and minimum wages are one source of such rents. Excessive investment in job search due to overly optimistic information about job opportunities elsewhere (most likely during a cyclical downturn) is a further source of marginal rents. Marginal rents can also result from the subsidization

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39 To be sure, other factors of production earn rents. Rents accrue to any fixed factor such as land, and the return on investment to any industry-specific capital asset is often termed a "quasi-rent." But there is probably less reason to believe that such rents will not decline in the face of falling demand for the resource to keep the resource employed in its most-valued use. Rather, such rents will tend to be inframarginal and will not reflect any inefficiency in the market as discussed below.

Protectionism as a Safeguard of leisure by a government transfer payments system, which can encourage workers to spend an inefficiently long period on the unemployment rolls. And, as suggested above, truly involuntary unemployment necessarily reflects the presence of rents to marginal workers, whether it is an equilibrium or disequilibrium phenomenon.

Arising for any one of the reasons noted above, rents at the margin in the labor market lead to an equilibrium (or reflect a disequilibrium) in which wages are inefficiently high and employment is inefficiently low. Protective measures will stimulate the demand for domestic goods and in turn stimulate employment—they can thereby generate an efficiency gain at the margin in the labor market. And, even though this gain is offset by the distortion of the product market caused by that protection, it is conceivable that protection provides a net gain, considering the aggregate welfare of all producers, workers, and consumers in the protected industry. At first, this observation seems to justify protection for an “injured” industry in which a significant number of workers are inefficiently unemployed (or perhaps “underemployed,” as when a $25 per hour steel worker is reduced to cooking hamburgers for the minimum wage). It further suggests some advantage to “orderly contraction,” so that most workers can remain employed while they conduct their job search, and the number of workers unemployed at one time is limited.

But a number of objections arise. First, protection is quite possibly an inferior policy instrument for addressing any problems

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41 Transfer programs and unemployment insurance have sometimes been advanced as at least partial explanations for a downward “stickiness” of real wages—an apparent tendency for real wages to remain stable in the face of slackening labor demand—that causes unemployment to rise more than might be expected in an otherwise competitive labor market. See Martin Neil Baily, Wages and Employment Under Uncertain Demand, 41 Rev Econ Stud 37 (1974); Robert J. Gordon, The Theory of Domestic Inflation, 67 Am Econ Rev Pap & Proc 128, 130-31 (1977).


43 An important caveat is suggested by recent work on “efficiency wage” theory, which posits, among other things, that involuntary unemployment can be an efficient adaptation to agency costs. A useful collection of essays is George A. Akerlof and Janet L. Yellen, Efficiency Wage Models of the Labor Market (Cambridge, 1986).

of inefficient unemployment, just as it is for restoring competitiveness. Even assuming that direct legislation to eliminate the source of the marginal rents is infeasible (for example, repeal of the antitrust exemption for unions), employment subsidies are potentially preferable to import restrictions. A properly calculated subsidy could eliminate any inefficient disparity between the private marginal cost of labor and the social marginal cost of labor, without introducing a distortion of consumer prices in the protected market.\footnote{45}

Second, protection will shift the terms of trade. By reducing the demand for foreign currencies to buy imports, protection will cause the home-market currency to appreciate. As a result, overseas demand for domestic exports will decline.\footnote{46} If rents at the margin in exporting industries are as large as in the protected importing industry, nothing will have been gained—the costs of inefficient unemployment will simply have been shifted from an import-competing industry to export industries.

Third, the purported efficiency gain at the margin in the labor market can evaporate if protection causes rents at the margin to increase. This concern is especially important when rents at the margin are attributable to unionization. If unions know that they are more likely to obtain protection when rents at the margin are

\footnote{45} In models of international trade with "sticky wages" (the source of the "stickiness" typically left unspecified), import competition produces inefficiently high unemployment levels because wages do not decline to clear the labor market. It is this domestic market "distortion" that the government seeks to "correct." Neglecting the transaction costs of tax collection and subsidy disbursement, a domestic wage subsidy is a more efficient correction than a tax on the imported product in the form of protection. See Bhagwati and Srinivasan, Lectures on International Trade at 212-32 (cited in note 28); Harry G. Johnson, Aspects of the Theory of Tariffs 117-51 (Harvard, 1972); Jagdish N. Bhagwati and T.N. Srinivasan, The Theory of Wage Differentials: Production Response and Factor Price Equalisation, in Robert C. Feenstra, ed, The Theory of Commercial Policy 481 (MIT, 1983); Jagdish N. Bhagwati and T.N. Srinivasan, On Reanalyzing the Harris-Todaro Model: Policy Rankings in the Case of Sector-Specific Sticky Wages, in id at 498; Jagdish N. Bhagwati and T.N. Srinivasan, Alternative Policy Rankings in a Large, Open Economy with Sector-Specific, Minimum Wages, in id at 505.

\footnote{46} To be sure, a wage subsidy must be financed through taxation, and in practice all forms of taxation (lump sum taxes existing only in theory) introduce their own distortions. But this point does not establish that protection is the better policy instrument. Protection is, after all, a way of providing aid to needy individuals (workers in the protected industry) that is financed by a tax (duty) on the consumption of a particular good. Given all of the alternative ways of financing the same amount of aid to the same individuals through income, consumption, or other taxes, it is highly improbable that the duty is the most efficient method of raising the necessary revenue. See Warner Max Corden, Trade Policy and Economic Welfare 43-45 (Clarendon, 1974). As a first approximation, one would expect any decline in the value of imports to be offset by an equal decline in the value of exports.
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high—that is, when they resist wage concessions in favor of unemployment for union members—then a policy of protecting unionized industries may be counterproductive.

Fourth, recall that under Article XIX, protection for “injured” industries is to be temporary, limited to the period of “serious injury.” The argument for temporary protection as a response to inefficient unemployment has little force if it merely postpones dislocation to a future period. Such an outcome is likely where the “injury” to the protected industry is attributable to a decline in its competitiveness. Once protection is lifted, the unemployment problem will likely recur.

Finally, even if the importing country would gain from protection, what of exporting countries? Protection will reduce the demand for labor in exporting nations and may create unemployment among workers in those nations comparable to any reduction in unemployment in the importing nation. Once again, a convincing economic rationale for a provision such as Article XIX must explain how GATT signatories gain in the aggregate, rather than simply shifting unemployment from country to country.

For these reasons, the argument that safeguards measures can efficiently alleviate unemployment in the presence of labor market distortions is quite problematic. A fortiori, arguments that such measures can efficiently alleviate unemployment affecting other factors of production are also problematic, as such unemployment seems less likely to be inefficient. Thus, the “orderly transfer of resources” notion ultimately fails to provide a convincing efficiency rationale for protecting injured industries.

B. Equity and Redistribution

Even if protection for “injured” industries typically lowers economic welfare in the importing nation and in the GATT community as a whole, economic welfare is surely not the sole metric for assessing the wisdom of public policy. Governments routinely accept reductions in aggregate social wealth for the purpose of redistribution, and such policies enjoy significant popular support. The question thus arises whether trade policy, and safeguards measures

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47 See note 39.

48 Although the analysis in the text suggests that protection for industries with extensive unemployment is not likely to increase economic welfare, protection in such cases may be less inefficient than in other cases. This observation motivated another recent article by the author on options for reform of the injury test under Article XIX. See Sykes, GATT Safeguards Reform, in Trebilcock and York, eds, Fair Exchange at 203 (cited in note 14).
in particular, provide useful tools for enhancing the equity of the wealth distribution or for protecting an important "entitlement." For a number of reasons, the answer is likely "no."

Plainly, an increase in import competition may cause firms in an importing country to contract or fail. Employees and their families may then suffer serious financial hardship that the citizenry may wish to ameliorate. But the hardships of unemployment and economic dislocation that result from import competition are no different in character from those that can result from domestic competition or the vagaries of the business cycle. Hence, individuals who suffer financial reversals as a result of import competition arguably should enjoy no special entitlement to assistance, but rather should receive only the protection of whatever public safety net programs the government makes available to the citizenry as a whole.

One possible counterargument is that economic dislocation due to import competition at times results from changes in government policy—namely, trade concessions—and that the government ought to establish special programs to assist individuals who are seriously harmed by such policy changes. Some writers have argued, for example, that the removal of trade barriers by the government is analogous to a "taking" by eminent domain, for which safeguards measures provide limited compensation. But there are serious difficulties with this argument. A wide range of government policy decisions about government spending, regulation of the workplace, and monetary policy can cause serious economic dislocation, yet no entitlement to special assistance exists for those harmed by these actions. It is unclear why changes in the level of protection in a nation's trade policy should be treated differently. Indeed, the mere fact that some special interest group has succeeded in obtaining protection in the past hardly seems a sufficient basis for creating a permanent entitlement to that protection or for requiring compensation for its removal. Such an entitlement will only increase the expected returns to the pursuit of protection in the political arena, leading to more rent-seeking behavior by those desiring protection and probably to greater protection in the first instance. Yet another serious objection is that safeguards mea-

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50 It is perhaps more appealing to posit that the consumer should enjoy an entitlement to the benefits of free trade, and that the removal of trade barriers simply restores an entitlement that the government had previously impaired.
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sures presently are in no way limited to circumstances in which "injury" is the demonstrable result of a recent trade concession.51

An alternative argument for special assistance to workers displaced by import competition is that such workers, if their skills are not readily transferable to other industries, may suffer a greater loss of wealth than other displaced workers. When domestic firms fail as a result of competition from other domestic firms, for example, the demise of one domestic firm is typically accompanied by the expansion or creation of another domestic firm in the same line of business. Displaced workers may then have an opportunity to secure alternative employment that draws upon their existing skills and training, perhaps even in the same geographic area. In the case of workers displaced by import competition, overseas relocation is rarely an attractive option. Likewise, when workers are displaced by cyclical downturns in the domestic economy, they may at least anticipate that the displacement is temporary and that they will eventually be able to return to work in a position that draws upon their existing human capital. Workers displaced by import competition, in contrast, often have little hope of returning to work in the same industry; instead, they confront a choice between retraining themselves for a new line of work or accepting employment in unskilled positions. Thus, the argument runs, special assistance is appropriate because the adverse economic consequences of import-related displacement for the worker and dependents are particularly acute.

It is unclear, however, whether the empirical premise of this argument is correct. The limited evidence suggests that workers displaced by import competition do not necessarily spend a longer period of time unemployed or suffer a greater reduction in their incomes than do workers displaced by other causes.52 In addition, workers who are at risk of permanent displacement due to import competition will receive added compensation ex ante if that risk is known, which seemingly weakens any argument for additional public assistance ex post. Finally, "workers whose skills are not readily transferable" are by definition skilled workers, who tend to earn more than unskilled workers; public aid to skilled workers tends to benefit individuals who are considerably wealthier than the neediest members of society.

51 See Section II.B.
But even if the arguments against special assistance for workers displaced by import competition prove unpersuasive, the suggestion that trade restrictions are an appropriate way to deliver such assistance may be questioned. Just as conventional economic wisdom suggests that other policy instruments may be preferable to protection as a solution for any labor or capital market imperfections, so too it suggests that the hardship of economic dislocation is better alleviated through tools other than restrictive trade policies. Retraining programs and public employment agencies, for example, can often reduce periods of unemployment and move workers quickly to alternative positions in which their services can be utilized efficiently. Special "adjustment assistance" programs already provide added relocation and retraining assistance to workers displaced by import competition. Economists have long maintained that such programs can reduce the hardships of economic dislocation at lower cost to the economy than protectionist policies. Indeed, these programs not only avoid the distortion of consumer prices that accompanies protection, but they also encourage the prompt movement of resources to higher-valued uses. Protection, by contrast, delays the efficient reallocation of resources.

Finally, protection is an exceptionally clumsy method of redistribution. Many of the benefits will be captured by comparatively wealthy stockholders in the companies that receive protection, and by workers who would have retained their jobs in the absence of protection. Other methods of redistribution provide aid directly to needy individuals. Thus, appeals to the equity of the wealth distribution or to the need to compensate for an impaired entitlement afford especially unconvincing arguments for protecting "injured" industries.

63 The United States, for example, has an elaborate statutory scheme in place for the provision of adjustment assistance. See 19 USC §§ 2271-98.

64 See, for example, Lawrence and Litan, Saving Free Trade at 12-33 (cited in note 15); Bhagwati and Srinivasan, Lectures on International Trade at 212-24 (cited in note 28). For an interesting formal treatment of some of the tensions between efficiency and distributional objectives in trade policy, and how best to resolve them, see Peter A. Diamond, Protection, Trade Adjustment Assistance, and Income Distribution, in Bhagwati, ed, Import Competition and Response 123 (cited in note 52). See also Steven Shavell, A Note on Efficiency vs. Distributional Equity in Legal Rulemaking: Should Distributional Equity Matter Given Optimal Income Taxation?, 71 Am Econ Rev Pap & Proc 414 (1981).

65 Once again, however, protection may be less objectionable when it succeeds in redistributing wealth to needy individuals; this observation may provide useful guidance for the design of incremental reforms to the safeguards regime. See Sykes, GATT Safeguards Re-
C. The Safety Valve Hypothesis

Even if protection for injured industries is not a "first-best" method for promoting efficiency or equity objectives, perhaps such protection represents a "second-best" policy given the political and institutional constraints confronting the GATT signatories. One argument of this sort, often advanced as a justification for the "escape clause" under U.S. domestic law, is the "safety valve" hypothesis.

Section 201 of the Trade Act of 1974 allows injured industries to appeal to the U.S. International Trade Commission, and subsequently to the President, for temporary protection.\textsuperscript{66} It thus affords an alternative to direct protectionist legislation by Congress and provides domestic authority for the United States to invoke its rights under GATT Article XIX. Several writers have argued that limited protection under § 201 is defensible because it supplants what would otherwise be more stringent or long-lasting protectionist legislation: "[The escape clause] can serve as a safety valve in the formulation of trade policy in a democratic society by relieving pressures that might result in even more extreme solutions from Congress."\textsuperscript{67} This hypothesis is to be distinguished from the analysis below, which suggests a possible tradeoff between protection ex post and trade concessions ex ante. Here, the claim is that without the escape clause, greater protection would arise ex post through direct legislation to protect the injured industry.

Whatever the merits of the safety valve hypothesis as a justification for the domestic escape clause, it seemingly fails as an argument for Article XIX. On its face, the safety valve hypothesis simply argues for the creation of an administrative proceeding that may afford protection for injured industries, and thereby deflect pressures for protectionist measures away from the legislature. But the likelihood of direct protectionist legislation also decreases if such legislation violates international obligations and results in international sanction. A GATT escape clause, by contrast, legitimates protection whether through legislation or administrative action. The ability of the Congress to resist special interest pressures

\textsuperscript{66} See 19 USC § 2251 et seq.

\textsuperscript{67} Barton and Fisher, \textit{International Trade and Investment} at 213-14 (cited in note 8). For the most elaborate statement of the argument, see Lawrence and Litan, \textit{Saving Free Trade} at 23-27 (cited in note 15).
for protection, therefore, would likely be greater in the absence of Article XIX, given that Article XIX facilitates the very measures that the special interest groups seek.

It is also doubtful that the safety valve hypothesis provides a convincing justification for the escape clause under U.S. law. Restated, the argument is that the overall level of protection will fall if the government creates an administrative avenue for interest groups to obtain protection, even though none of the preexisting avenues for obtaining protection (direct legislation) have been foreclosed. Yet, any interest group with the political muscle to obtain protection through the legislative route seems unlikely to settle for a lesser level of protection through the administrative route. The administrative route simply affords a device for some groups that lack the ability to mobilize the legislature to obtain protection anyway. The creation of a new administrative proceeding, without restricting the other legal devices for protection, simply lowers the costs of obtaining protection and likely increases the level of protection in the end.

II. A Positive Account of GATT Safeguards Policy

As the above discussion suggests, protection for "injured" industries does not directly promote economic efficiency or distributive equity—the popular rhetoric provides neither a coherent justification nor a persuasive explanation for safeguards policy. The question then arises: why does Article XIX exist in a cooperative agreement such as GATT? The proposition that GATT is a mutually advantageous contract among self-interested political officials provides a convincing answer.

A. GATT as a Political Bargain: Lessons from Public Choice

GATT was negotiated immediately after World War II. The United States was the dominant economic power at the time and, not surprisingly, U.S. representatives to the GATT negotiations had a profound influence on the terms of the agreement. Article XIX in particular was included largely because the U.S. negotiators insisted upon an "escape clause." 

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The United States, like many of the other initial signatories to GATT, is a democracy. The theory of public choice suggests that policymaking under democratic government depends on the interplay of special interest forces in the political "marketplace." There is generally no reason to expect the democratic process systematically to yield "efficient," "equitable," or otherwise "correct" outcomes by any idealized criterion for measuring the success of policy. Rather, elected officials will pursue their self interest. They will "supply" policy initiatives to interest groups that "demand" them, with the currency of the political marketplace in the form of votes or campaign contributions, for instance. Ultimately, well-organized groups—those most adept at lobbying and most capable of "paying" for policy initiatives—will have their interests vindicated, while diffuse, poorly organized interest groups may suffer.

The insights of public choice theory are not new to the study of international trade. Many scholars have used them to explain the pattern of protectionism in the developed world. Public choice theory also helps explain the existence of GATT and, as shall be seen, specific GATT provisions, such as Article XIX.

Public choice predicts that elected officials will concern themselves far more with the impact of trade policy on producer interests than on consumer interests. Individual firms in import-competing or export-oriented industries often have much to gain from specific trade policy measures. And, especially in industries with a relatively small number of large firms, free-rider problems need not seriously impede efforts to influence policy, either because each firm has sufficient incentive to act individually or because interested firms can organize themselves to act collectively through a trade association or lobbying coalition. In contrast, the number of consumers is large and the amount at stake for each consumer on a given trade issue is modest. Consequently, the costs to each consumer of acting individually in an effort to influence the political process will usually exceed the potential gains. Thus, severe free-

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61 These remarks are not intended to suggest that democratic government is inferior to some feasible alternative.

rider problems will often thwart the task of organizing consumers to act collectively to support liberal trade policies.

Although consumers are often the major beneficiaries of trade liberalization, their relative lack of influence on trade policymaking need not doom them to an environment of unyielding protectionism. Powerful producer lobbies also have an interest in an open trading system. Downstream industries that use imported input products, for example, benefit directly from reduced protection with respect to those inputs. Exporting industries can also benefit considerably from reduced protection at home if that reduction is coupled with reciprocal trade concessions in foreign markets to which they export.\(^6\) Large multinational companies also often prefer a liberal trading regime, as they frequently import from and export to foreign affiliates.\(^4\) However, producers that import and export relatively little and that confront significant import competition will benefit from greater protection. Thus, producer interests are ultimately divergent.

Historically, the intensity of producer interests on each side—free trade and protectionist—has varied over time. During the early 1930s, the forces of protectionism reigned; by the mid-1940s, trade liberalization became the dominant item on the trade policy agenda. The reason for such variability in protectionist sentiment is not immediately apparent. Plainly, an industry can gain from protection in good times as well as in bad times, as the exclusion of imports under any circumstances allows profits and employment in the protected industry to rise. Yet, conventional wisdom holds that the intensity with which producer interests lobby for protection increases as their financial condition worsens. One possible explanation for this relationship is that elected officials may be more willing to grant protection to an industry in difficulty because they can justify it to their constituents by an appeal to equity considerations. Producers, aware of this fact, increase their lobbying efforts as the likelihood of success increases.\(^5\) Another possible explanation is that when an industry confronts financial difficulties, the returns from productive activity within the indus-

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\(^6\) In fact, exporters can gain from trade liberalization even without reciprocal concessions. Reduced protection for the home market will increase the demand for imports and thus for the foreign currency necessary to buy them. The home-market currency will then depreciate relative to foreign currencies, with the result that home-market exports become more competitive in world markets.

\(^4\) See Bhagwati, Protectionism at 75-76 (cited in note 4).

\(^5\) See Baldwin, The Political Economy of Protectionism, in Bhagwati, ed, Import Competition and Response at 273-76 (cited in note 52). This of course presupposes that high-minded voters have at least some influence on policymaking.
try may decline relative to the returns from lobbying for protection, causing a reallocation of resources toward lobbying. A third possible explanation is that the long-term returns from protection may be greater when times are hard—if the rate of return to new investment in the industry is initially below the competitive return that investors require, then protection can increase the rate of return without attracting into the industry new entrants who would compete away the gains. In any event, the evidence suggests that pressures for protection indeed intensify under adverse economic circumstances.

Although the immediate postwar era was hospitable to trade liberalization, the GATT negotiators were not so foolish as to suppose that protectionist sentiments would not revive as economic conditions changed. Indeed, at the time of the original GATT negotiations, the negotiators anticipated that GATT would be supplanted within a few years by the “International Trade Organization” (ITO), an institution that never came into existence because of the revival of protectionist sentiments in the United States and the refusal of the Congress to approve U.S. accession. The negotiators thus correctly recognized that irrevocable commitments to liberalize trade might at some point preclude them (or their superiors or their political successors in interest) from providing protection in circumstances where the political rewards would be great.

The response of GATT, for reasons that the analysis to follow will elaborate, is to allow each signatory to avoid its commitments if the other signatories agree, or, in the alternative, if it is willing to bear the cost of measured retaliation. Article XXV allows signatories to obtain a waiver of GATT obligations under “exceptional circumstances” if two-thirds of the other signatories vote to grant it. Article XXVIII authorizes the renegotiation of tariff “bindings,” the commitments among signatories that place limitations upon tariff rates. If no agreement is reached during the negotiations, a party may still raise a tariff above its bound level. However, adversely affected parties can then withdraw “substantially

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68 See, for example, Bhagwati, Protectionism at 61 (cited in note 4).
70 GATT Art XXV(5).
equivalent concessions.” And, most importantly here, Article XIX permits the suspension of GATT obligations, but such safeguards measures can be applied only temporarily and only when a domestic industry suffers from or is threatened with “serious injury” due to “increased quantities” of imports. Even then, nations adversely affected by safeguards measures are entitled to withdraw equivalent concessions in response. To avoid such retaliation, the nations that invoke Article XIX frequently offer compensatory concessions.

This system of revocable commitments is complex indeed, and raises a number of intriguing questions. Perhaps most fundamentally, even accepting that “escape” from GATT obligations may yield political gains ex post to officials in an importing country, why does the attendant detriment to exporting nations not offset this gain and warrant a prohibition upon escape ex ante? Further, why did the negotiators find it useful to facilitate “escape” in alternative ways, as by including both Article XIX and Article XXVIII? What is the function of the serious injury requirement under Article XIX, and the requirement of linkage to “increased quantities?” What explains the structure of the compensation and retaliation provisions of Articles XIX and XXVIII?

The remainder of the Section suggests answers to these questions and others by melding the insights of public choice with the proposition that GATT is a Pareto optimal bargain among self-interested political actors. In so doing, it also suggests how the effort of the negotiators to promote their political self-interest may indirectly promote the public interest in a liberal trading order.

B. The Function of an Escape Clause in GATT

The genesis of the analysis to follow lies in a one sentence passage from Kenneth Dam’s prominent GATT treatise, in which Dam hints that Article XIX may facilitate trade concessions. Re-stated and considerably elaborated, the argument runs as follows: Although the reduction of protectionist barriers is almost always in

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71 GATT Art XXVIII.
72 GATT Art XIX.
73 See Jackson and Davey, Legal Problems of International Economic Relations at 606-07 (cited in note 11).
74 That is, a prohibition upon escape is Pareto optimal unless the opportunity to escape affords net gains to GATT signatories in the aggregate ex ante.
75 See Dam, The GATT at 99 (cited in note 58) (“the presence [of Article XIX] encourages cautious countries to enter into a greater number of tariff bindings than would otherwise be the case”).
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the public interest, elected officials or their subordinates may decline to pursue trade liberalization initiatives out of political self-interest, even if the political consequences of liberalization appear favorable at the time of the negotiations. The reason is that unanticipated changes in economic conditions may create circumstances in which the political rewards to an increase in protection (or the political costs of an irrevocable commitment to reduce protection) are great. Consequently, in the absence of an escape clause, trade negotiators may decline to make certain reciprocal concessions for fear of adverse political consequences in the future. But, with an escape clause in place the negotiators will agree on a greater number of reciprocal concessions, knowing that those concessions can be avoided later if political conditions so dictate. Though Dam apparently offered this observation as a normative justification for Article XIX, it also holds the key to an explanation of its terms, and indeed of its very existence.

Implicit in this explanation is an important assumption—that a formal “escape clause” is valuable to signatories that wish to “escape” their obligations because adequate substitutes do not exist. This assumption is in fact two assumptions—first, that GATT signatories regard their commitments as binding and are unwilling simply to abrogate them, and second, that future informal renegotiation of GATT commitments is an imperfect substitute for the presence of a formal “escape clause.” The accuracy of these assumptions is not self-evident.

As to the first, GATT as an institution has no coercive power other than the ability to deny signatories the benefits of membership. Hence, if signatories (or, more accurately, their public officials) determine that GATT agreements are no longer advantageous, they can simply decline to adhere to them. In this sense, an “escape clause” is part of GATT whether or not the agreement expressly includes it.76

Yet, the fact that GATT includes express provisions governing the withdrawal or modification of concessions indicates that such provisions are not superfluous. Signatories apparently regard GATT commitments as sufficiently credible and binding to make such provisions worth drafting. The reason no doubt relates to the fact that GATT is not a “single-play” game. Each signatory binds itself to thousands of concessions affecting many other signatories. The fact that GATT membership has grown steadily over time,

with no significant defections,\textsuperscript{77} suggests that these reciprocal concessions in the aggregate yield net benefits to governing officials in each signatory. To preserve those benefits and to facilitate new reciprocal agreements in the future, each signatory has an interest in maintaining a reputation for honest behavior. Hence, it is not unrealistic to suppose that the terms of any formal “escape clause” will be more or less respected by signatories and will thus place meaningful constraints on their behavior.

As to the second assumption—that renegotiation is not always an attractive substitute for a formal escape clause—it can hardly be denied that the ability of signatories to renegotiate the bargain exists, irrespective of the original text. And, as long as all affected signatories are content with the renegotiated outcome, no signatory will have sacrificed its reputation for honesty, and the integrity of the GATT system will not have been jeopardized. The modern proliferation of VERs, of dubious legality under the letter of GATT, clearly reflects the relative ease with which renegotiation can occur. But again, the very existence of Article XIX suggests that ex post renegotiation is only an imperfect substitute for formal safeguards action. The reason no doubt relates to the fact that renegotiation is always time-consuming and does not always reach a satisfactory conclusion for all concerned. This argument will be elaborated below.\textsuperscript{78}

The analysis to follow embraces the assumptions necessary to make a formal escape clause an interesting and important part of the bargain to refine and extend Dam’s conception of its function. It begins with a summary of a simple, formal model of the escape clause in trade negotiations, which shows how an escape clause facilitates agreements, and develops the conditions under which “escape” is Pareto optimal ex ante from the perspective of politically self-interested negotiators. Subsequent discussion draws upon the results of the model to provide a detailed, positive account of Article XIX as originally drafted, of GATT practice under Article XIX in the decades since its inception, and of prominent aspects of the draft Agreement on Safeguards.

\textsuperscript{77} See Jackson and Davey, Legal Problems of International Economic Relations at 324-25 (cited in note 11).

\textsuperscript{78} See Section II.B.2. (discussing why GATT allows revocation of concession without permission and why it includes Article XIX in addition to the authorization for renegotiation under Article XXVIII).
1. A formal model.

Appendix A presents a formal model of an escape clause in a bilateral agreement for reciprocal trade concessions, executed by negotiators who pursue their political self interest. It shows how an agreement with an escape clause Pareto dominates an agreement without an escape clause, and thus establishes that negotiators have a mutual interest in including one. It further characterizes the properties of a Pareto optimal escape clause, and suggests when the agreement will permit one party or the other to "escape."

The central results of the model have ready intuitive explanations. The model begins with the premise that political officials in each country have no present interest in unilateral trade concessions. Existing protective measures yield political gains or, equivalently, the elimination of protective measures would impose a political cost because of the damage to import-competing industries. But political officials recognize that the elimination of protective measures abroad will benefit exporting industries, and thus a political gain might be achieved through an agreement with the foreign government to reduce its level of protection because officials in the exporting country can take credit for such an agreement. This fact makes agreement upon reciprocal trade concession potentially attractive, and officials in each country will find it in their interest to enter such an agreement if the political gain associated with increased exports exceeds the political cost associated with increased import competition.

Officials in each country must decide whether to accept the agreement, however, under conditions of uncertainty. At the time the agreement is signed ("ex ante"), the magnitude of the political costs from increased import competition and the political gains from increased export opportunities are unclear, and vary with the ex post "state of the world." For example, if economic times prove hard, the political cost associated with a lowering of protectionist barriers at home will be greater, for reasons discussed above.

The negotiators might conclude an agreement in which the reciprocal trade concessions were irrevocable—that is, once the agreement was signed, it might provide that protection could not be reimposed by either country regardless of the eventual state of the world. As an alternative to such an agreement, however, the negotiators might agree to permit the reimposition of protection ("escape") if in the eventual state of the world, the agreement imposed political detriment upon officials in one country or the other. In fact, as Appendix A shows formally, such an agreement is at
least as attractive as an agreement with irrevocable concessions (it usually increases and never lowers the “expected utility” of each negotiator). The reason, put simply, is that an agreement with an escape clause is more flexible. It permits the negotiators to tailor the bargain ex ante to maintain the concessions in states of the world where they are mutually advantageous ex post, and revoke one or both concessions in states of the world where their political cost proves high.

In what states of the world will the negotiators agree to allow escape? Note that the revocation of a particular concession benefits import-competing firms in the revoking country but hurts exporters abroad. Those exporters will complain to their political officials about the loss of access to their overseas market, and likely withdraw some political support from the officials who were responsible for obtaining the original concession. Indeed, depending upon the form of government, a loss of export earnings may directly reduce the welfare of officials in power. A Pareto optimal agreement will nevertheless permit “escape” only in states of the world in which the attendant political gains to officials in the importing country “outweigh” the costs to the officials in the exporting country. Suppose, for example, that in some state of the world, the concession by one country is highly disadvantageous to its officials, and the costs to officials in the other country if the concession is revoked would be modest. The parties may then benefit from an agreement to allow the first country to escape its concession in that state of the world. The quid pro quo from the perspective of officials in the other country is an agreement to let them escape their concessions in the same or some other state of the world in which they would gain considerably and the costs to officials in their trading partner would be modest.

Note that such an escape clause agreement does not in general provide for the reciprocal revocation of concessions. Some states of the world may exist in which concessions on both sides are revoked, but other states may exist in which concessions by only one country are revoked.

2. Implications: The function and structure of Article XIX.

The simple model in Appendix A makes clear how an escape clause can enhance the likelihood of initial agreement and (equivalently) promote the self-interest of the negotiators. But it does not explain why GATT should contain such a variety of ways to escape concessions and, in particular, why Article XIX is necessary given the other GATT provisions that allow concessions to be with-
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drawn. Further, the model describes an environment in which the negotiators choose an escape clause ex ante that specifies in detail the states of the world in which “escape” from each concession is allowed. In practice, however, GATT does not contain such elaborate state-contingent provisions governing the revocation of concessions but rather provides other procedures and criteria for “escape,” such as the injury test under Article XIX. These differences between the escape clause in the abstract and in practice warrant further consideration.

a) Article XXVIII: Renegotiation, compensation, and retaliation. As noted, a Pareto optimal escape clause would permit the revocation of a concession only if the political gains to the party who revokes the concession outweigh the political costs to the other party. But the transaction costs of anticipating all possible contingencies in advance, and specifying whether “escape” will be permitted under those contingencies, are no doubt prohibitive. GATT embodies thousands of concessions, and it would be a staggering task to identify all “states of the world” that bear on the political consequences of the concessions, evaluate those consequences, and agree on the proper course of action ex ante with all interested parties. It thus comes as no surprise that GATT does not incorporate a complete state-contingent “escape clause,” and that the GATT negotiators were forced to devise substitute procedures for the modification of concessions.

What possible substitutes exist? One option is to abandon any effort to establish conditions for escape ex ante and to rely solely on ex post renegotiation. Thus, GATT concessions might be deemed “irrevocable,” but with explicit or implicit recognition that a party disadvantaged by a particular concession ex post can always seek to renegotiate with interested trading partners. Escape would then be allowed if the party seeking to avoid a concession could secure permission from interested trading partners by offering a side-payment, probably in the form of compensatory trade concessions.

GATT Article XXVIII indeed provides authorization and procedures for periodic renegotiation. It has been used extensively and has provided an important vehicle for modification of tariff bindings. A possible disadvantage of exclusive reliance on Article XXVIII renegotiations, however, is that the party seeking to renegotiate may discover that others insist on large offsetting conces-

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79 See, for example, Dam, The GATT at 97-99 (cited in note 58).
sions. Even when the political costs of safeguards measures to officials in exporting countries are modest, those officials may hold out for greater compensation if they know that the political importance of escape to officials in the importing nation is great. The political gains from "escape" for officials in the importing nation may then be all but lost, and bargaining may even reach impasse, thus making "escape" effectively impossible unless a signatory is willing to breach its obligations. Such a breach, in turn, might trigger the unraveling of the entire agreement. The GATT negotiators were evidently unwilling to tolerate this possibility, and Article XXVIII provides that concessions may be revoked even if negotiations over compensatory concessions are unsuccessful.80

But such a provision creates another problem. When a concession is revoked without compensation to other signatories, the political pressures for retaliation abroad will be considerable. Moreover, no signatory can afford to develop a reputation for passivity following such revocations by others. If it does so, it will soon discover that its trading partners are willing to take advantage of that reputation. Retaliation in some form is thus inevitable. One possible retaliatory strategy is "massive retaliation," in which a signatory undertakes to develop a reputation for toughness to discourage the withdrawal of concessions in the future. But that strategy invites escalation by the other side, counterescalation, and so forth—a trade war. The GATT negotiators were apparently quite wary of that prospect following the experience of the 1930s. Hence, recognizing that retaliation was inevitable, the negotiators agreed that any response should always be "measured retaliation"—in other words, the harm inflicted through retaliation should be roughly comparable to the harm inflicted by the initial withdrawal of concessions.

Under Article XXVIII, a party that feels disadvantaged by any concession after the "state of the world" reveals itself can withdraw the concession, knowing that adversely affected parties are entitled to revoke "substantially equivalent concessions initially negotiated with" that party.81 Prior to such a retaliatory withdrawal, however, Article XXVIII requires the interested parties to negotiate to avoid retaliation when possible.

An interesting analogy may be drawn to the liability regime that governs private contracts not subject to an action for specific performance. A promisor who finds contractual obligations unduly

80 GATT Art XXVIII(3).
81 GATT Art XXVIII(4)(d).
burdensome once the time for performance arrives can seek to re-negotiate them. But renegotiation is not the only avenue for the avoidance of the promise—the promisor may simply breach the contract, and (typically) pay "expectation damages" to the promisee, or perhaps "liquidated damages" set by agreement. It is well known that such contract damages payments can promote efficient breach decisions. Under GATT, parties also have the option to "breach" if renegotiation fails, and the Agreement implicitly recognizes that breach may be efficient. Thus, "damages" are not prohibitive, but are limited to the withdrawal of "substantially equivalent concessions" by others. It is perhaps instructive to view this provision as a liquidated damages clause, inserted to police inefficient "breach" but also to permit efficient "breach," much as the prospect of damages judgments serves that function for private contracts.

b) The function of Article XIX. Why is Article XXVIII not the sole method for revoking concessions? One answer is that the process of negotiation can be quite time-consuming. Further, Article XXVIII specifies that renegotiation will ordinarily commence at the beginning of periodic negotiating windows, absent a vote by the GATT membership to authorize "out of season" negotiations under "special circumstances." Quite possibly, conditions will arise in which political forces warrant more prompt action to reinstate protection. This possibility provides one obvious justification for Article XIX as a supplement to Article XXVIII, because it gives signatories the option to impose protective measures immediately, leaving until later the task of negotiating a final agreement with other signatories regarding the international consequences.

A second possible advantage of Article XIX arises when the conditions that create political pressure for protection are expected to be transitory. As noted, such pressures tend to intensify as financial conditions in an industry worsen and to abate as financial conditions improve. If a financial downturn is the result of cyclical forces, or of some other shock that is expected to abate, temporary protection may satisfy the domestic proponents of protection. And, by invoking Article XIX rather than Article XXVIII, the import-
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ing nation precommits itself only to temporary protection and thus can expect to pay a lower price, in the form of compensation or retaliation, for that protection. Of course, opportunistic use of safeguards measures to provide long-term protection can jeopardize that function of Article XIX. This observation may well explain why the draft Agreement on Safeguards introduces express time limits on safeguards actions.86

c) Injury, compensation, and retaliation under Article XIX. Interestingly, unlike Article XXVIII, Article XIX constrains the circumstances under which concessions may be revoked by requiring an “injury test.” As noted, safeguards measures are to be employed only when “increased quantities” of imports cause or threaten “serious injury” to the import-competing industry. The draft Agreement on Safeguards preserves this basic structure of the injury test.87 These features of Article XIX have a ready interpretation in light of prior analysis regarding the properties of an ex ante Pareto optimal escape clause.

Recall that such an agreement will limit escape to those states of the world in which the benefits to officials in the importing country outweigh any costs to officials in the exporting country. When complete state-contingent agreements for that purpose are too costly, an alternative is to impose general restrictions on the revocation of concessions that limit revocation to the circumstances in which it is more likely to be efficient from the negotiators’ perspective.

As noted, the political rewards to protection tend to be the greatest when the industry at issue is suffering serious financial difficulties. Hence, the “serious injury” requirement of Article XIX may be understood as an effort to limit safeguards measures to circumstances in which the ability to reinstitute protection tends to be of greater political benefit to officials in the importing nation. Likewise, the political costs of safeguards measures to officials in exporting nations are likely to be the smallest when nations’ exporters are doing well and can absorb some reduction in exports without suffering serious financial problems. The presence of “increased quantities” of imports (measured by an increase in shipments or market share) in the importing country supplies some limited evidence that exporters are doing well. Thus, the requirements of “serious injury” and “increased quantities” of imports

86 Draft Agreement on Safeguards Arts 9-10 (cited in note 17).
87 See id at Art 2.
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seemingly provide a rough first cut at identifying circumstances in which the revocation of concessions may afford net political gains to officials in the interested signatories ex ante.

But because these indicators are assuredly imperfect, the negotiators did not rely on them as the sole constraint upon safeguards action. Consequently, Article XIX requires that a party taking safeguards action at some point negotiate over the possibility of compensation. It further authorizes measured retaliation when those negotiations fail, thus utilizing the same "liquidated damages" approach as Article XXVIII. These provisions discourage resort to Article XIX unless the political gains in the importing nation are sizeable and, much like the parallel provisions in Article XXVIII, maintain harmony by encouraging compensation and limiting the retaliatory response when those negotiations fail. Article XIX is thus something of a hybrid provision, incorporating partial reliance on the identification of circumstances in which escape is likely to be Pareto optimal ex ante, and partial reliance on ex post renegotiations and accompanying provisions for restraining strategic behavior.

d) The defunct prerequisites to safeguards action. According to the text of Article XIX, the requirement that "serious injury" result from "increased quantities" of imports is not the sole prerequisite for safeguards action. The "increased quantities" must also result from "unforeseen developments" and from "the effect of obligations incurred" under the Agreement. These provisions pose interesting interpretive problems, and modern GATT practice has converged on an interpretation that renders both virtual nullities. Not surprisingly, therefore, both requirements are omitted from the draft Agreement on Safeguards. The analysis above suggests a ready explanation for this development.

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89 "Before any contracting party shall take action . . . it shall give notice in writing . . . as far in advance as may be practicable and shall afford . . . those contracting parties having a substantial interest as exporters of the product concerned an opportunity to consult with it in respect [to] the proposed action. . . . In critical circumstances, where delay would cause damage which it would be difficult to repair, action . . . may be taken provisionally without prior consultation, on the condition that consultation shall be effected immediately after taking such action." GATT Art XIX(2).

89 "If agreement among the interested contracting parties with respect to the action is not reached, the contracting party which proposes to take or continue the action shall, nevertheless, be free to do so, and if such action is taken or continued, the affected contracting parties shall then be free . . . to suspend . . . such substantially equivalent concessions or other obligations under this Agreement the suspension of which the [GATT membership as a whole does] not disapprove." GATT Art XIX(3)(a).

89 GATT Art XIX(1)(a). For full text, see note 5.
The very inclusion of the "unforeseen developments" requirement in Article XIX is puzzling. If an "unforeseen development" is simply one that has low probability ex ante, then the Article XIX requirement seems almost superfluous. The existence of a concession suggests that states of the world in which an importing country would wish to revoke it were regarded as reasonably improbable ex ante. Alternatively, if the term "unforeseen development" were interpreted to limit safeguards actions to contingencies that were truly unforeseen or unforeseeable ex ante, it would defeat the purpose of the escape clause from the negotiators' perspective. The negotiators value an escape clause precisely because they can foresee certain contingencies under which the political gains from the revocation of a concession would be great. It thus comes as no surprise that under modern GATT practice (and the draft Agreement on Safeguards), the "unforeseen developments" requirement of Article XIX has disappeared.

The requirement that "increased quantities" of imports result from GATT obligations also poses interpretive problems. Under one possible interpretation, however, this requirement is trivially satisfied in every case—the importing country simply asserts that but for the conjunction of a tariff binding under Article II, the prohibition upon quotas in Article XI, and so forth, it would have taken protective action to avert the increase in imports. Put differently, to determine whether increased imports are "caused" by GATT obligations, one might compare the actual level of imports to the level of imports that would exist in a counterfactual world in which the importing nation was not precluded by GATT from increasing the level of protection. And, because a nation seeking to impose protection under Article XIX can surely claim with credibility that it would impose protection if GATT did not exist at all, such a test for the causal relation between GATT obligations and the increase in imports would be trivially satisfied.

GATT practice has converged on this interpretation, and the draft Agreement on Safeguards thus omits any requirement of linkage between increased quantities and GATT obligations. Such a development is also readily explicable. The political rewards to officials who supply protection to a domestic industry seemingly bear little or no relation to the nature or magnitude of prior changes in the level of protection during GATT negotiating.

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91 See Jackson, World Trade and the Law of GATT § 23.3 at 559-60 (cited in note 49).
92 See Edmond McGovern, International Trade Regulation § 10.211 at 291 (Gobefield, 2d ed 1986).
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rounds. Even if accession to GATT does not result in a reduction in the level of protection for a particular industry, for example, the political rewards from a future increase in protection may be great. Thus, unless the requirement of linkage between increased imports and GATT obligations is interpreted so as to be trivially satisfied in every case, it would undercut the political utility of the escape clause.

III. Normative Speculations: An Assessment of Current Reform Proposals and the Response of the Draft Agreement on Safeguards

Unquestionably, important differences exist between the idealized escape clause of the formal model and the provisions of Articles XIX and XXVIII. “Escape” in practice requires signatories to pay a price ex post, for example, while an optimal ex ante agreement would not—compensation would be paid ex ante in the form of reciprocal promises to allow escape in specified states of the world. Nonetheless, because the negotiators anticipate the ability to revoke concessions under Articles XIX and XXVIII, they enjoy some assurance that particular commitments can be avoided when the political stakes are high, using protective measures that do not breach the agreement and hence do not seriously jeopardize the larger network of reciprocal concessions. This assurance makes trade concessions more attractive ex ante. Thus, Dam was surely correct that the existence of Article XIX increases the chances of initial agreement on concessions.

On the premise that trade concessions enhance social welfare, therefore, does it follow that Article XIX enhances social welfare? The answer is “perhaps,” and depends on one’s benchmark.

The proposition that trade concessions enhance social welfare implies that the “first-best” world is one in which negotiators make irrevocable commitments to liberalization regardless of the impact on their self-interest. Then, and rather trivially, an escape clause in any form is not “first-best.”

A more interesting inquiry is whether Article XIX is in some sense “second-best.” One possible benchmark is simply the overall level of protection. More precisely, one might define Article XIX as “second-best” if its presence in GATT reduces the deadweight costs of protection to the GATT community relative to a counterfactual world in which Article XIX was omitted from GATT.

The effect of Article XIX on the economic costs of protection is in theory ambiguous, however, because negotiators can reach
agreement on many concessions even in the absence of an escape clause. In such cases, an escape clause simply creates the possibility that concessions will at some point be revoked and increases the expected deadweight losses from protection. Thus, even though an escape clause likely results in a greater number of concessions, it also facilitates the revocation of concessions that would have been made anyway in the counterfactual world with no escape clause. The net impact on the level of protection and the attendant deadweight losses are thus theoretically indeterminate.

Empirically, however, the fact that Article XIX has been invoked relatively infrequently in relation to the total number of GATT concessions perhaps suggests that the presence of Article XIX is indeed beneficial. Further, retaliation in response to safeguards actions has been rare. Signatories usually avoid such retaliation either by offering compensatory concessions or by “bribing” other signatories with quota rents under voluntary export restraint arrangements. When signatories make compensatory concessions, the effects of the safeguards action on the overall economic costs of protection may, as a first approximation, be small. Hence, if Article XIX has indeed facilitated a significant number of concessions—a plausible though unverifiable proposition—its overall effect on the welfare costs of protection may well have been favorable.

But can Article XIX be improved? To some degree, this question is uninteresting, as the public choice perspective suggests that Article XIX will remain a device for the politically expedient

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83 Between 1950 and 1986, Article XIX was invoked 132 times. See note 6. By contrast, GATT tariff concessions number in the tens of thousands. See Dam, The GATT at 106 (cited in note 58).
84 See id at 99, 106-07. This observation is potentially misleading. A single action under Article XIX can encompass a vast array of products imported from many signatories—the restraints on U.S. steel imports offer a clear example. Further, it is quite unclear how many concessions would have been thwarted by the absence of Article XIX, especially given the presence of Article XXVIII and other provisions for the withdrawal or modification of concessions.
85 See McGovern, International Trade Regulation § 10.213 at 294 (cited in note 92).
86 See Jackson and Davey, Legal Problems of International Economic Relations at 607 (cited in note 11).
87 As noted earlier, for example, the current system of protection for U.S. steel producers takes the form of voluntary export restraints. Under such restraint agreements, the governments of exporting nations agree to limit their exports to the protected market. The price in the protected market rises, and exporters capture the price increase on their allowed shipments. Thus, although the actual quantity of shipments for exporters declines, the profit per unit rises. The net result assuredly cushions the adverse effects of protection on the profits of foreign exporters and, indeed, in some cases exporters may come out ahead.
avoidance of concessions. The prospects for high-minded reforms thus appear poor. Nevertheless, reform proposals abound, and the public choice perspective has something to say about their wisdom.

A. Proposals to Tighten the Prerequisites for “Escape”

A number of commentators, the author included, have proposed additional restrictions on the circumstances in which Article XIX may be invoked. Such proposals often focus on the concept of “serious injury” and urge that this prerequisite be more precisely and narrowly defined. For example, one group of proposals would limit findings of “serious injury” to cases of extensive unemployment or underemployment in the import-competing industry. To date, such proposals have had little influence within GATT, and the draft Agreement on Safeguards imposes no meaningful constraints upon the ability of signatories to interpret the “serious injury” requirement as they wish.

The welfare impact of additional restrictions on escape is difficult to assess. On the one hand, Appendix A suggests that incremental restrictions on escape are likely beneficial. To see why, consider another possible benchmark for the “second-best” escape clause: one might define it as the one that minimizes the expected welfare costs of protection, recognizing that an unduly restrictive escape clause will thwart agreement between the negotiators and thus increase the expected costs of protection. Only on rare occasions will this second-best escape clause correspond to the escape clause that the negotiators will choose for themselves. And, on the premise that “escape” is detrimental to social welfare ex post, the difference between the “second-best” escape clause and the one that the negotiators select will be systematic—the negotiators will allow themselves to avoid their commitments “too often.” Appendix B provides a formal illustration. Intuitively, this proposition follows from the fact that the politically Pareto optimal escape clause will typically yield to the negotiators greater expected utility than is necessary to induce them to enter the agreement. Con-

See Richardson, Safeguards Issues in the Uruguay Round and Beyond, in Baldwin and Richardson, eds, Issues in the Uruguay Round at 33-34 (cited in note 13) (arguing that, in light of their growing diversification and multinational characteristics, firms should no longer be considered domestic producers of goods, and the availability of safeguards should depend on injury to domestic workers, communities, and immobile owners of resources, rather than to “firms,” thus narrowing the concept of “serious injury”); Sykes, GATT Safeguards Reform, in Trebilcock and York, eds, Fair Exchange at 226 (cited in note 14).

** Article 6(c) of the draft Agreement on Safeguards (cited in note 17) defines “serious injury” as a “significant overall impact on the condition of a domestic industry.”
sequently, agreement could still be reached even with a more restrictive escape clause that reduced the negotiators' expected utilities and the level of ex post protection. Such analysis suggests that incremental restrictions on the "states of the world" in which Article XIX may be invoked can reduce the amount of protection that results from Article XIX ex post without destroying its ability to facilitate trade concessions ex ante. Proposals to confine the concept of "serious injury" offer one way to impose such incremental restrictions, and thus have some appeal.

On the other hand, results derived from the model in the Appendix are subject to an important caveat. That model considers negotiations over a single pair of reciprocal concessions. But GATT embodies thousands of concessions and only a single Article XIX "escape clause," again no doubt a reflection of the transaction costs of bargaining. The distinct possibility arises that some concessions are "marginal," in the sense that negotiators are just barely willing to make them given the existing structure of the GATT escape clause. If so, any additional restrictions on the ability of signatories to escape ex post may thwart some concessions ex ante, and the ex ante costs may exceed the ex post gain. The end result of the analysis is thus quite inconclusive, and one cannot be sure that incremental restrictions upon the concept of serious injury would lower the overall costs of production.

B. Remedy, Compensation, and Retaliation

Several recent proposals for reform of safeguards policy would prohibit discrimination in the remedies that a signatory may employ under Article XIX. Other proposals would abandon in part the current provisions requiring the importing nation to provide compensation or else suffer measured retaliation after a safeguards action. Such changes to the safeguards regime are potentially detrimental, however, because they may reduce the ability of Article XIX to facilitate trade concessions ex ante and unduly increase the number of safeguards actions ex post.

1. Selectivity.

The most prominent issue in the current Uruguay Round negotiations over safeguards policy is "selectivity." The dispute concerns the question whether Article XIX allows or should allow

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signatories to “escape” not only from tariff bindings and prohibitions upon quotas and other quantitative restrictions, but also from GATT Articles I and XIII, which require signatories to apply protective measures on a nondiscriminatory or “most-favored nation” (MFN) basis. If the MFN principle applies to safeguards measures, then all foreign suppliers must be treated similarly—any tariff rate increase must apply equally to imports from every nation, and any quota must be allocated among nations based on their pre-quota market shares.\(^{101}\) If the MFN principle does not apply, by contrast, then tariffs, quotas, and other protective measures may be applied “selectively.”

GATT scholars have debated for a number of years whether Article XIX implicitly embodies a prohibition on selectivity.\(^{102}\) Whatever the proper resolution of that debate, many nations have complained through the years that safeguards measures in fact discriminate against them,\(^ {103}\) and various proposals have emerged during the Uruguay Round (and before) to prohibit selectivity.\(^ {104}\) Defenders of selectivity argue in response that protective measures under Article XIX should apply primarily to the “guilty” nations—those that have increased their exports and have caused the injury.\(^ {105}\)

The draft Agreement on Safeguards does not resolve the issue definitively. It provides that safeguards measures shall apply to products “irrespective of their source,” except under “exceptional circumstances.”\(^ {106}\) The “exceptional circumstances” language is enclosed in brackets, to indicate its controversial and unsettled status among the negotiators and the need for further high-level political discussions.

Because of the linkage between the opportunities to escape ex post and the level of trade concessions ex ante, the effects of selectivity upon the economic welfare of the GATT community are unclear. The reason relates to the fact that discriminatory safeguards measures may at times be optimal ex ante. As noted, an optimal agreement from the perspective of the negotiators will permit the

\(^{101}\) GATT Art XIII.

\(^{102}\) Excerpts from a number of writings on the subject may be found in Jackson and Davey, Legal Problems of International Economic Relations at 595-606 (cited in note 11).

\(^{103}\) See Sampson, Safeguards, in Finger and Olechowski, eds, The Uruguay Round at 148 (cited in note 6).

\(^{104}\) See, for example, 6 Intl Trade Rptr (BNA) 869 (cited in note 6).

\(^{105}\) See Sampson, Safeguards, in Finger and Olechowski, eds, The Uruguay Round at 148 (cited in note 6).

\(^{106}\) Draft Agreement on Safeguards Art 5 (cited in note 17).
revocation of concessions when the gains to officials in the importing nation exceed the costs to officials abroad. There is no reason to suppose that the political consequences of protection are comparable for officials in all exporting nations, and an optimal agreement might then concentrate the effects of protection on those nations where the adverse political consequences are the smallest. Because safeguards measures tend to be less politically harmful to officials in exporting countries where the exporters are doing relatively well (or perhaps where exporters have less political voice), discrimination against those countries may tend to be politically optimal ex ante. Signatories that confront a likelihood of discrimination against them ex post can be compensated ex ante with concessions on other matters. It follows that the opportunity for signatories to utilize selective safeguards measures may facilitate trade concessions, and that a prohibition on selective action might thwart some concessions ex ante. Likewise, the practice of restricting most sharply the imports from nations that have recently increased their exports may sometimes be an appropriate way to discriminate.

Yet, as many economists have noted, considerable economic benefits ordinarily flow from adherence to the MFN principle. If country A imposes a 10 percent tariff on widgets from country B and a 20 percent tariff on widgets from country C, and if the market for widgets in country A is substantial, then the result may be to encourage investment in widget production in country B even though producers in country C are more efficient. Considerable deadweight losses may result. A uniform tariff preserves the relative competitive positions of foreign suppliers and avoids encouraging such inefficient investments. Further, safeguards measures that discriminate against nations that increase their exports tend to penalize precisely those exporters that have done the most to improve their efficiency, thus lessening the incentive to become more efficient. While selectivity may have favorable ex ante ef-

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107 Discrimination in international trade has become increasingly important generally with the formation of customs unions such as the European Community and free trade agreements such as the one between the United States and Canada. Useful economic references on the theory of customs unions and their welfare consequences include R.G. Lipsey, The Theory of Customs Unions: A General Survey, 70 Econ J 496 (1960); and Bhagwati and Srinivasan, Lectures on International Trade at 271-90 (cited in note 28).

108 To be sure, the significance of discrimination through temporary protective measures should not be exaggerated. If protection is temporary (and anticipated to be temporary at the time of its imposition), then the effect of discriminatory measures on investment incentives abroad will be more modest. Selective safeguards measures thus likely impose
fests on the level of trade concessions, therefore, its ex post welfare effects are more unfavorable than the effects of nondiscriminatory measures. The net impact of selectivity on the economic welfare of the GATT community thus appears ambiguous.

2. Compensation, retaliation, and the proliferation of VERs.

Recent commentary is increasingly hostile to the compensation and retaliation provisions of Article XIX. The compensation requirement is said to be too onerous for importing nations, thus encouraging them to circumvent GATT by negotiating VERs outside the auspices of GATT. Such agreements, the argument runs, distort trade more severely than do measures taken in compliance with Article XIX because of their selectivity and their typically open-ended duration. To reduce the incentive for signatories to circumvent Article XIX, therefore, some commentators urge the elimination of the compensation and retaliation provisions, at least under certain conditions.109

The draft Agreement on Safeguards affords an interesting response to these proposals. Initially, it preserves the existing compensation and retaliation structure of Article XIX, affording signatories the right to withdraw “substantially equivalent concessions” if negotiations over compensation fail.110 If the duration of the safeguards action is less than three years, however, the right to “suspend” concessions is withheld, although the requirement to negotiate over compensation remains.111 Additional bracketed (unsettled) language embodies a prohibition on trade restrictions that do not conform with the provisions of the Agreement on Safeguards, or other provisions of GATT.112 Although no sanctions for failure to comply are included, this language is plainly an effort to eliminate VERs that operate outside the formal ambit of Article XIX.113 The draft agreement permits quantitative restrictions as a

109 See, for example, Lawrence and Litan, Saving Free Trade at 102-03 (cited in note 15) (arguing for the suspension of the compensation requirement “when member countries establish quasi-legal procedures for determining whether domestic industries are entitled to temporary relief,” and when “the form of relief is limited to declining and nondiscriminatory tariffs . . . ”); Richardson, Safeguards Issues in the Uruguay Round and Beyond, in Baldwin and Richardson, eds, Issues in the Uruguay Round at 28-27 (cited in note 13); Hufbauer, Trade Policy for Troubled Industries at 60-61 (cited in note 15); Jackson, The World Trading System at 185 (cited in note 59).

110 See draft Agreement on Safeguards Arts 17-18 (cited in note 17).

111 Id at Art 19.

112 Id at Arts 24-25.

113 It is questionable whether such prohibitions will have much effect. VERs represent a substantially smaller welfare losses on the trading community than lasting violations of the MFN principle.
safeguards remedy, however, which in effect allows signatories to utilize VERs subject to the time limits applicable generally to safeguards measures.

Like the reforms discussed earlier, the merits of the various proposals to relax the compensation and retaliation requirements and the tentative response to them in the draft Agreement on Safeguards are difficult to assess. To be sure, the economic critique of VERs is compelling. Because VERs allocate quantitative limits on exports among participating countries and do not afford them an opportunity to compete on equal terms as would a nondiscriminatory tariff, the investment-distorting consequences of discriminatory protection usually follow. Further, unlike formal measures under Article XIX, VERs are of open-ended duration, which exacerbates the welfare consequences of the protection that they afford and any discrimination that accompanies it.

But it does not follow that elimination of the compensation and retaliation requirements of Article XIX will improve matters, even if the result is diminished resort to VERs in favor of formal safeguards action. Recall the justification for a compensation requirement suggested by the earlier model of the escape clause. If state-contingent “escape” agreements were costless to negotiate, a requirement of ex post compensation would be unnecessary. Negotiators would simply specify in detail ex ante the circumstances under which permanent or temporary avoidance of GATT obligations would be permitted. But such detailed agreements are costly, and general guidelines for “escape” such as the “serious injury” and “increased quantities” requirements are highly imperfect substitutes for detailed state-contingent provisions. Consequently, Article XIX does not permit the avoidance of obligations without ex post penalty. This system assuredly differs from an idealized ex form of renegotiation under GATT that will be difficult to avoid under any circumstances. Officials in importing nations seek VERs for political gain and may well continue to do so regardless of the provisions of a final Agreement on Safeguards. Exporting countries receive a bribe for entering VERs in the form of quota rents, and may thus be quite content to enter them. In the end, regardless of the letter of GATT, VERs are most difficult to police because often there is no one to complain. This observation explains why proposals aimed at reducing the use of VERs often rely on the “carrot” rather than the “stick,” as by eliminating the compensation and retaliation provisions of Article XIX to make formal safeguards action more attractive.

Draft Agreement on Safeguards Art 8 (cited in note 17).

The negotiators have not resolved the issue of the time limits, and bracketed language suggests that a controversy remains as to whether the total duration of safeguards action including extensions shall be limited to five years or eight years. Id at Art 11. Under present U.S. law, for example, an eight-year limit is imposed. See 19 USC § 2253(e)(1)(a).

As Jackson notes, “the international rules, centered in GATT, concerning so-called
Protectionism as a Safeguard ante agreement but is perhaps the best that can be designed under the circumstances to ensure that signatories do not take opportunist advantage of the escape clause ex post by revoking concessions when the political costs to officials in exporting nations exceed the political gains to officials in importing nations.

The elimination of penalties for the avoidance of obligations would increase the propensity of signatories to make opportunist use of Article XIX. The number of protective actions ex post would increase, along with the deadweight costs of protection. Likewise, because of the prospect of heightened opportunism, the ex ante value of trade concessions would diminish, thus reducing the returns to the negotiation process and potentially reducing the number of reciprocal concessions.

VERs, by contrast, provide exporting nations with some compensation. The typical VER utilizes quotas that provide the exporting country with quota rents on allowable sales. These rents partially or fully offset the loss of profits due to the reduction in the volume of exports. The presence of such implicit compensation helps to maintain harmony and reduces the prospect of trade wars. Indeed, it explains why exporting nations are willing to enter the agreements in the first place. Further, the loss of quota rents is a burden on the economy of the importing nation and creates some disincentive to take protective action, the magnitude of which depends on the incidence of the burden on various interest groups. This disincentive, like the compensation and retaliation provisions of Articles XIX and XXVIII, tends to discourage protection, un-

safeguards and the problems of economic 'structural' adjustment, are too weak and ambiguous to provide an effective level of discipline . . . although some measure of discipline through the GATT system and its 'compensation rules' has been effective.” Jackson, The World Trading System at 184 (cited in note 59).

Recent U.S. experience is illustrative. The United States invoked Article XIX when it negotiated a network of voluntary restraint agreements on steel imports, and negotiated restraints upon Japanese automobile imports outside the formal ambit of Article XIX. See sources cited in notes 7 and 10. In both cases, trading partners ultimately acceded to U.S. pressure to restrict their exports without retaliating against the United States on other products.

In contrast, the United States in 1986 imposed a 35 percent protective tariff (decreasing progressively to 8 percent after five years) on red cedar shakes and shingle imports from Canada. Because the tariff was not bound under GATT, the U.S. did not need to invoke Article XIX. See President Orders Higher Tariffs on Shakes, Shingles From Canada, Modifying ITC Proposal, 3 Intl Trade Rptr (BNA) 708 (1986). It offered no compensation to Canada, with the result that Canada retaliated by increasing tariffs (estimated at $80 million yearly) on a variety of U.S. exports. See Duties on U.S. Computer Parts, Publications Imposed in Retaliation For Shingle[s], Shakes, 3 Intl Trade Rptr (BNA) 734 (1986).
less it affords considerable political gains to officials in the importing nation.

Another virtue of the compensation and retaliation provisions under Article XIX is that they often result in compensatory trade concessions. Plainly, the adverse welfare effects of safeguards measures ex post are reduced or even eliminated when trade barriers on some products decline as the quid pro quo.

Thus, even accepting the premise that the compensation and retaliation provisions of Article XIX encourage resort to VERs, the abandonment of those provisions might actually make matters worse. These provisions are important to control opportunistic behavior and to maintain harmony within the GATT system. VERs, with their implicit compensation in the form of quota rents, have much the same virtue, whatever their vices. Despite the extensive criticism of the compensation and retaliation provisions and the various proposals for their modification or abandonment, therefore, it is neither surprising nor clearly unfortunate that the draft Agreement responds to those proposals rather tentatively.

CONCLUSION

The economic case for free trade is compelling, but Article XIX cannot be condemned simply because it affords some opportunity for protective actions. Trade policy is formulated by self-interested political officials acting under conditions of uncertainty; the opportunity to revoke trade concessions if the political gains are great will increase the willingness of officials to make concessions in the first instance. Some manner of escape clause is an understandable and potentially desirable component of trade-liberalizing agreements.

A politically Pareto optimal escape clause would not allow parties to revoke concessions at will, but constrains escape to circumstances in which the gains to the party avoiding concessions exceed the costs to its trading partners. The most prominent features of Article XIX—the injury test and the compensation and retaliation provisions—constitute efforts to impose such a con-
straint in a contracting environment where complete state-contingent contracts are too costly. Not surprisingly the draft Agreement on Safeguards embodies much the same approach.

Recommendations for reform of Article XIX must be evaluated in light of this understanding of the function of the escape clause. The wisdom of the reforms suggested by various commentators depends to a considerable degree on whether the reforms would unduly restrict the ability of trade policy officials to avoid specific GATT obligations when the political stakes are especially high, or undermine efforts to discourage opportunistic escape. These judgments are difficult to make, and are perhaps best made elsewhere in the course of future GATT negotiations. The analysis in this Article simply cautions that any reforms in safeguards policy can have important consequences "ex ante" as well as "ex post," and must be evaluated accordingly.
A simple model can illuminate the effects of the escape clause on trade negotiations and suggest the properties of a politically Pareto optimal escape clause. To minimize complexity, the model suppresses the distinction between Article XIX and other methods for the revocation of concessions under GATT.

The model requires no assumptions about the form of government in each country, only an assumption that governing officials suffer political losses from increased import competition, ceteris paribus, and reap political gains from increased exports. The model also suppresses all hierarchy and division within the governments of the negotiating countries, and any attendant agency issues. Thus, for example, differing preferences between a legislative and executive branch are ignored, as is the problem of motivating the negotiator to pursue the interests of political superiors. These obvious simplifications do not destroy the usefulness of the model as long as the negotiators are at least somewhat responsive to the political interests of superiors, and the negotiators’ various “principals” have some mutual political interests that the bargain can promote.

Consider then a bilateral negotiation between representatives of countries A and B to reduce the tariff rates on two products, one exported from country A to country B, and one exported from country B to country A. For simplicity, let the negotiators face a dichotomous choice between “protection” (the status quo) and a reciprocal agreement for “no protection.”

Each negotiator has a utility function ($u_A$ and $u_B$, respectively), the units of which might be, for example, dollar campaign contributions or votes—the exact nature of the utility functions is unimportant here. Both negotiators are expected utility maximizers. Assume further for simplicity that an agreement to eliminate protection will be reached if both negotiators are indifferent between the agreement and the status quo ante.

Let the utility from the status quo ante equal $X$ for country A’s negotiator, and $x$ for country B’s negotiator. If they agree to eliminate protection, each country’s negotiator will enjoy an incremental increase in utility because home market exporters will increase their sales abroad. Let this gain equal $Y$ for country A’s negotiator and $y$ for country B’s negotiator. For simplicity, $X$, $x$, $Y$, and $y$ are assumed to be known with certainty.

The reciprocal concession also results in an incremental loss of utility for each negotiator because import-competing firms in the
home market face greater competition. But the exact magnitude of this utility loss is uncertain at the time of the negotiations. It depends upon the eventual “state of the world,” a random variable \( \theta \), which has a probability distribution known to both negotiators. Define the utility loss due to increased import competition in the home market as \( C(\theta) \) for country A’s negotiator and \( c(\theta) \) for country B’s negotiator.\(^1\)

In the absence of an escape clause, country A’s negotiator would agree to eliminate protection if and only if the expected utility from the agreement at least equals the utility of the status quo ante—that is, if and only if:

\[
E_\theta u_A = E_\theta [X + Y - C(\theta)] \geq X
\]

Likewise, country B’s negotiator would agree if and only if:

\[
E_\theta u_B = E_\theta [x + y - c(\theta)] \geq x
\]

Quite possibly, one or both conditions will not be met, and the negotiators will not reach an agreement.

Now consider the role of an escape clause, which may be formalized as follows. The escape clause is a set of functions \( e(\theta) = [e_A(\theta), e_B(\theta)] \) which the negotiators select during the course of their negotiations, and which determines whether each concession will be revoked or not after the “state of the world” is revealed. Each function has a value equal to zero or one—when \( e_i(\theta) = 0 \), the agreement by country \( i \) to eliminate protection remains in place; when it is equal to one, the agreement is revoked. Assume for simplicity that “escape” from either concession simply eliminates the political cost of the concession to officials in the importing country (eliminates \( C(\theta) \) or \( c(\theta) \) as the case may be), and eliminates the political gain to officials in the exporting country (\( Y \) or \( y \) as the case may be).

Plainly, the escape clause facilitates initial agreement. From the perspective of country A’s negotiator, expected utility with an escape clause is equal to:

\[
E_\theta u_A = E_\theta \left\{ X + [1-e_B(\theta)]Y - [1-e_A(\theta)]C(\theta) \right\}
\]

For country B’s negotiator, expected utility is equal to:

\[
E_\theta u_B = E_\theta \left\{ x + [1-e_A(\theta)]y - [1-e_B(\theta)]c(\theta) \right\}
\]

Thus, imagine a choice of \( e(\theta) \) such that \( e_A(\theta) \) and \( e_B(\theta) \) both equal

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\(^1\) This formulation, with \( c(\theta) \) a function of a random variable and \( y \) known with certainty, entails no loss of generality. If one supposes that the political gains on the export side (\( y \)) are also uncertain, one can simply incorporate the stochastic component of \( y \) into \( c(\theta) \).

\(^2\) The term “\( E \)” is the expectation operator, so that the expression \( E_\theta x \) means “the expected value of \( x \), taken over the probability distribution of the possible states of the world \( \theta \).”
1 for every state of the world in which \( Y-C(\theta)<0 \) or \( y-c(\theta)<0 \).

Such an escape clause guarantees the willingness of both negotiators to sign the agreement by ensuring them an expected utility at least equal to what they receive in the status quo ante.\(^a\)

Equally clearly and, indeed, equivalently, the introduction of an escape clause allows the negotiators to achieve a Pareto improvement over an irrevocable commitment to liberalize trade, for an irrevocable commitment is equivalent to an escape clause with \( e_{i}(\theta)=0 \), all \( \theta \), \( i=A,B \). The opportunity to vary the \( e_{i}(\theta) \) with \( \theta \) can only benefit the negotiators.

To provide further characterization of the Pareto optimal escape clause, let \( \theta \) have a continuous probability distribution \( F(\theta) \) with density function \( f(\theta) \). A Pareto optimal agreement represents a choice of \( e(\theta) \) to:

\[
\text{Max } E\theta u_A \\
\text{subject to } E\theta u_B \geq x \\
e_i(\theta)=0 \text{ or } e_i(\theta)=1, \ i=A,B
\]

To solve this problem, it is useful to suppose counterfactually that the \( e_i(\theta) \) may assume fractional values between zero and one, and thus to replace the last constraint by \( 1 \geq e_i(\theta) \geq 0, i=A,B \). The problem thus formulated is a familiar one in control theory.

Define \( \Delta_A(\theta) \equiv C(\theta)f(\theta) - \lambda yf(\theta) \), and define \( \Delta_B(\theta) \equiv -Yf(\theta) + \lambda c(\theta)f(\theta) \), where \( \lambda \) is a constant. The expression \( \Delta_A(\theta) \) may be interpreted as the net effect of "escape" from country A's concession in state \( \theta \) upon the expected welfare of the negotiators: The term \( C(\theta)f(\theta) \) is simply the effect of escape on the utility of country A's negotiator multiplied by the probability of state \( \theta \). The term \( -Yf(\theta) \) has a corresponding interpretation as the effect of escape on the expected utility of country B's negotiator, multiplied by \( \lambda \), which is the "shadow price" of utility to country B's negotiator in units of the utility function for his counterpart from country A. The expression \( \Delta_B(\theta) \) has a corresponding interpretation as the effect of "escape" from country B's concession in state \( \theta \) upon the expected welfare of the negotiators.

The solution to the problem has the following properties: For \( \theta \) for which \( \Delta_A>0 \), \( e_A(\theta)=1 \); for \( \theta \) for which \( \Delta_A<0 \), \( e_A(\theta)=0 \); and for \( \theta \) for which \( \Delta_A=0 \), all values of \( e_A(\theta) \) between zero and one are non-

---

\(^a\) Of course, it is possible that such an escape clause would allow escape from both concessions in every state of the world, and thus be equivalent to the absence of an agreement. But assuming that trade negotiations are worth initiating in the first place, some states of the world will typically exist in which the negotiators benefit from leaving one or both concessions in place.
uniquely optimal. A corresponding condition holds for $\Delta_B$, substituting $e_B(\theta)$ for $e_A(\theta)$. And, because each control function $e_i(\theta)$ always has an optimal value of zero or one for each $\theta$ (although sometimes either value may be non-uniquely optimal), the counterfactual formulation of the constraint on the $e_i(\theta)$ does not produce an infeasible solution.

---

This Appendix utilizes the model developed in Appendix A to illustrate why incremental restrictions on "escape" will not usually thwart agreement, and thus suggests that such restrictions can enhance welfare. For simplicity, assume that the social welfare gain to each nation from each trade concession is the same in all states of the world, and that the welfare loss from the revocation of each concession is the same in all states of the world. Assume further that each country enjoys a welfare gain as a result of its own concession exactly equal to the welfare gain that it enjoys as a result of the other country's concession, so that the revocation of its own concession carries the same welfare cost as the revocation of the other country's concession. Thus, for both countries, one might define the "second-best" escape clause as one that minimizes the sum of the probabilities of "escape" for the two concessions, subject to the constraint that escape not be made so difficult that the negotiators refuse to strike the initial agreement to liberalize trade. Such a "second-best" escape clause would represent the solution to:

\[
\begin{align*}
\min & \quad E_\theta [e_A(\theta) + e_B(\theta)] \\
\text{subject to} & \quad E_\theta u_A \geq X \\
& \quad E_\theta u_B \geq x
\end{align*}
\]

The sum of the probabilities of escape under such a "second-best" escape clause is almost certainly lower than under the escape clause that the negotiators will choose for themselves, given that the negotiators have no desire to minimize the sum of these probabilities, but only to maximize their political self-interest. Formally, let \(\hat{e}(\theta)\) solve this second-best problem, and let \(\bar{e}(\theta)\) be Pareto optimal from the negotiator's perspective. Assume, as will typically be the case, that the negotiators enjoy strictly greater expected utility under \(\hat{e}(\theta)\) than under \(\bar{e}(\theta)\). It is then often possible to modify \(\bar{e}(\theta)\) by setting \(\bar{e}_A(\theta)\) and \(\bar{e}_B(\theta)\) equal to zero for some state or states \(\theta\), while still allowing both negotiators to enjoy at least the utility that they enjoy in the status quo ante. The sum of the probabilities of escape under such an appropriately modified version of \(\bar{e}(\theta)\) would be less than the sum under \(\bar{e}(\theta)\) itself. It follows that the sum of the probabilities under \(\hat{e}(\theta)\) will be less than the sum of the probabilities under \(\bar{e}(\theta)\).

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1 In other words, the welfare gain to each country from the lowering of barriers to its exports equals the welfare gain from reducing its own barriers to imports.

2 Here, because \(e_i(\theta)=1\) in the event of "escape" and zero otherwise, the probability of escape from the concession by country \(i\) is simply the expectation of \(e_i(\theta)\).
In short, if it were possible to impose a slightly more restrictive escape clause on the negotiators, social welfare could be enhanced. Agreement could still be reached, yet the probabilities of "escape" would decline. Put differently, the escape clause could be modified so that trade liberalization would occur to the same extent ex ante, and the revocation of concessions would occur to a lesser extent ex post.