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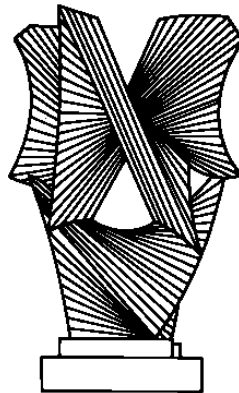
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## The Persistent Puzzle of Safeguards: Lessons from the Steel Dispute

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## The Persistent Puzzles of Safeguards: Lessons from the Steel Dispute

Alan O. Sykes\*

*Abstract. The recent WTO dispute between the United States and eight complainant nations over protective measures for the steel industry brought widespread attention to a little known area of WTO law—the rules governing "safeguard measures," the temporary protection of troubled industries against import surges. The use of safeguard measures is normatively controversial, although their welfare implications are much less clear than their critics sometimes suggest. This paper makes the point that WTO rules, as interpreted by recent Appellate Body decisions and applied by the dispute panel in the steel case, pose nearly insurmountable hurdles to the legal use of safeguard measures by WTO members. Among other things, the current interpretation of the "nonattribution" requirement for the use of safeguard measures in the WTO Safeguards Agreement obliges members to make a demonstration that is logically impossible as an economic matter. Those who believe that safeguard measures are merely wasteful protectionism may welcome such impediments to their use, but it is not obvious that the trading system will benefit in the long run, and there can be little doubt that one key objective of the Uruguay Round negotiators—to revive the use of disciplined, temporary safeguard actions—is being frustrated.*

The tariffs imposed by the United States on steel imports in 2002, and the final WTO ruling against them in November, 2003, brought enormous attention to a subject that had already been a subject of considerable controversy within the WTO system—"safeguard measures." The original authority for safeguards is Article XIX of the General Agreement on Tariffs and Trade (GATT) (the GATT "escape clause"), which permits the imposition of temporary measures to protect industries that exhibit "serious injury" or the threat of such injury due to "increased quantities" of imports. The obligations of Article XIX were refined and elaborated during the Uruguay Round in the WTO Agreement on Safeguards.

The texts of Article XIX and the Agreement on Safeguards raise difficult conceptual and interpretive issues. In a recent essay written prior to the panel and Appellate Body decisions in the steel dispute, I argued that the WTO Appellate Body has

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done a poor job of addressing these issues, ruling against every safeguard measure that had come before it while failing to articulate any coherent principles for the use of safeguard measures.<sup>1</sup> Instead of resolving the puzzles created by the treaty text, the decisions prior to the steel case simply confounded them, imposing requirements for the use of safeguards that are economically and logically incoherent and leaving WTO members with little guidance as to what will pass legal muster in the future.<sup>2</sup> In this essay, I update and revise this analysis to encompass both the panel and Appellate Body decisions in the steel dispute. As shall become clear, these recent decisions do little to alter my fundamental thesis. If WTO members are to employ safeguard measures in future without a near certainty of successful legal challenge to them, either the Appellate Body must change course and begin to resolve the conceptual muddle that the treaty text and its decisions to date have created, or WTO members must renegotiate the Safeguards Agreement.

Before proceeding, I reiterate a normative disclaimer developed at length in earlier writing on the subject: It is not obvious whether additional legal hurdles to safeguard measures are a good thing or a bad thing. Viewed narrowly and *ex post*, safeguard measures are inefficient protectionism, generally discouraging the redeployment of resources from declining industries to competitive ones. It is exceedingly difficult to defend safeguards as a sensible aid to “adjustment” or as a

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<sup>1</sup>Alan O. Sykes, *The Safeguards Mess: A Critique of Appellate Body Jurisprudence*, 2 *World Trade Rev.* \_\_\_\_ (2003). See also Alan O. Sykes, *The Safeguards Mess Revisited: A Reply to Professor Jones*, 3 *World Trade Rev.* \_\_\_\_ (2004).

<sup>2</sup>Similar themes are developed in Henrik Horn & Petros C. Mavroidis, *United States -- Safeguard Measures on Imports of Fresh, Chilled or Frozen Lamb Meat from New Zealand and Australia: What Should be Required of a Safeguard Investigation?*, in Henrik Horn & Petros C. Mavroidis eds., *The WTO Case Law of 2001* (American Law Institute Reporters Series, Cambridge Press, 2003); and in Gene M. Grossman & Petros C. Mavroidis, *United States – Definitive Safeguard Measures on Imports of Circular Welded Carbon Quality Line Pipe from Korea*, in Henrik Horn & Petros C. Mavroidis eds., *The WTO Case Law of 2002* (American Law Institute Reporters Series, Cambridge Press, forthcoming 2004).

mechanism for compensating the “losers” from trade liberalization given the availability of superior policy instruments for those purposes, among other reasons.<sup>3</sup>

But this view is too limited—even from the *ex post* perspective, one must ask what would happen in the absence of safeguards. The experience of the GATT system suggests that pressures to protect declining industries may be channeled into alternative measures that are even worse. “Gray area” measures such as orderly marketing agreements and voluntary restraint agreements, potentially unlimited in scope and duration, proliferated toward the end of GATT as safeguards fell into disuse. An effort to revive safeguards, and to prohibit gray area measures, was clearly at the heart of the Uruguay Round Safeguards Agreement. From this perspective, unwarranted legal impediments to safeguard measures risk pushing the trading community back toward the greater evil of gray area protectionism. Although the Safeguards Agreement contains language prohibiting such measures, its effectiveness in the face of pressures to resurrect them is unclear—by their nature, gray area measures share quota rents with affected exporters, and may leave no one with an incentive and the standing to complain about them.

In addition, one must consider the *ex ante* function of safeguards—their role in encouraging trade liberalization. Political leaders who anticipate pressure to aid injured industries in the face of import surges may be more willing to make trade concessions across the board if they know that they can respond to import surges by temporarily revoking concessions. It is an empirical question whether the economic gains from the enhanced trade concessions that an effective safeguards mechanism can facilitate *ex ante* will be outweighed by the economic costs of safeguard measures *ex post*. This perspective suggests an additional basis for concern about unwarranted impediments to safeguards.

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<sup>3</sup>An extended discussion of the normative economics of safeguard measures may be found in Alan O. Sykes, Protectionism as a “Safeguard”: A Positive Analysis of the GATT “Escape Clause” with Normative Speculations, 58 U. Chi. L. Rev. 255 (1991).

The work of Bagwell and Staiger suggests still another reason why safeguards may play a constructive role in the trading system. They develop an economic model in which import surges create intense political pressure for nations to cheat on their trade commitments. Parties to trade agreements can be better off by allowing each other to deviate from their commitments under such circumstances—if, instead, all deviations were considered “cheating,” the resulting retaliation and counter-retaliation might cause trade agreements to unravel.<sup>4</sup>

Given the competing considerations, I take no position on the ultimate normative question whether safeguard measures are on balance useful or unproductive. My goal is merely to survey the confusing legal landscape that has arisen, and to crystallize the issues that must be resolved if safeguards are to offer a viable (i.e., WTO legal) option for WTO members to address import surges.

Section I will lay out the key provisions of WTO law on safeguards along with their history, and note the most important interpretive issues. Section II will then discuss and critique the key Appellate Body decisions prior to the steel case. Section III concludes with a look at the steel decisions, emphasizing some interesting and important lessons from the panel decision. The Appellate Body decision, by contrast, adds little to the analysis of the panel and adds nothing to the unsatisfactory, earlier Appellate Body decisions.

## **I. The WTO Safeguards Provisions: Legal, Historical and Economic Background**

GATT Article XIX (1) provides:

“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

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<sup>4</sup>See Kyle Bagwell & Robert W. Staiger, *A Theory of Managed Trade*, 80 *Am. Econ. Rev.* 779 (1990); Kyle Bagwell & Robert W. Staiger, *The Economics of the World Trading System* 104-06 (MIT Press 2002).

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.”

An important set of interpretive problems arises under the first clause of Article XIX. It provides that safeguard measures are permissible only following “unforeseen developments” associated with “the obligations incurred by a contracting party.” What constitutes an “unforeseen development”? Unforeseen by whom, at what point in time? How does one determine the “effect of the obligations incurred?” These questions had a natural answer at the outset of the GATT system, but with time they became quite problematic.

#### **A. The Rise and Fall of “Unforeseen Developments” as a Legal Predicate**

The original GATT negotiations concluded in 1947, with the expectation that GATT would be supplanted within a few years by a new institution to be called the International Trade Organization. Political support for that organization waned, however, and GATT became the governing instrument for international trade over the long term by default. It remained in force until the creation of the WTO in 1995.<sup>5</sup>

The first clause of Article XIX has a natural interpretation in the context of a trade agreement that was expected to be short-lived. The negotiators had made a number of trade concessions to each other in 1947, and Article XIX provided for their suspension in the event that those concessions had an unforeseen, adverse impact on import-competing industries due to a surge in import competition. To the questions posed above, therefore, one might answer that an “unforeseen development” was some development that caused the increase in imports following a trade concession under the original GATT to be greater than reasonably expected. It had to be unforeseen by the GATT negotiators, at the time of the 1947 negotiations. And the import surge had to result from one of the

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<sup>5</sup>See John H. Jackson, William J. Davey & Alan O. Sykes, *International Economic Relations* 4th ed. at 211-16 (Minneapolis: West Group 2002)[hereafter Jackson, Davey & Sykes].

original GATT trade concessions, in the sense that it would not have happened *but for* some such concession.

But how does one interpret the requirements of Article XIX (1), first clause, in an agreement that is still in force after many years? Consider an import surge thirty or forty years after the agreement was drafted. What would it mean to say that such a surge resulted from the “obligations incurred,” particularly if those obligations were incurred decades earlier? Could any such surge have been “foreseen” given the passage of so much time? By whom and when? And how are the answers affected by the fact that GATT negotiations are ongoing, with new negotiating “rounds” every decade or so? The requirements of clause one no longer have a straightforward interpretation in an agreement that lasts for decades rather than a few years, and that is characterized by an ever changing set of commitments.

For these reasons, I believe, GATT practice evolved over time toward ignoring the requirements of the first clause in Article XIX(1).<sup>6</sup> National laws to authorize safeguard measures soon made no mention of them. Section 201 of the U.S. Trade Act of 1974, for example, simply requires the International Trade Commission (ITC) to determine “whether an article is being imported into the United States in such increased quantities as to be a substantial cause<sup>7</sup> of serious injury, or the threat thereof.”<sup>8</sup> There is no requirement that developments be “unforeseen” or that they result from earlier trade concessions. At this writing, this statute remains the basis for safeguard measures under U.S. law.

Such a development is an understandable consequence of the difficulties in giving content to the first clause of Article XIX in a long-lived agreement. But as shall become

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<sup>6</sup>See Edmond McGovern, *International Trade Regulation* 2d ed. §10.211 at 291 (London: Gobefield 1986).

<sup>7</sup>A "substantial cause" is a "cause that it is important and not less than any other cause." 19 U.S.C. § 2252(b)(1)(B).

<sup>8</sup>19 U.S.C. § 2252(b)(1)(A).



immediately apparent, the absence of this “anchor” for the remainder of Article XIX(1) creates other problems.

### **B. The Requirements of Serious Injury and Causation**

Under Article XIX as originally drafted, it was not enough that an unforeseen import surge results from a trade concession. The import surge must go on to cause or threaten “serious injury.” This phrasing raises other obvious interpretive issues—what is “serious injury?” How does one determine whether the “cause” of such injury (or threat thereof) is “increased quantities” of imports?

On the first question, the text appears deliberately vague. The drafters might have made reference to specifics in this regard—lost profits, unemployment, bankruptcies, and the like—but chose to leave the term undefined. Perhaps the best inference is that they did not want to constrain the concept unduly by attempting a definition, and that they would allow a variety of factors into the analysis.

On the question of causation, the logic was nevertheless fairly clear. The unforeseen import surge, resulting from the trade concession, had to be responsible for serious injury. Put differently, the serious injury had to be “caused” by the trade concession, via its effect on the level of import competition, in the usual *but for* sense of the term “cause.” Within this framework, the “exogenous” variable is the trade concession, and the “increased quantities” of imports were those resulting from that concession. Likewise, the level of imports in the absence of the trade concession serves as the baseline against which to measure the “increase.”

But now imagine reading out the first clause of paragraph one, as GATT members began to do many years ago. Then, one must simply have “such increased quantities (of imports)...as to cause or threaten serious injury.” The baseline for the “increase,” import levels prior to a recent trade concession, is no longer available. Further, the only apparent candidate for an exogenous variable is the “increased quantities” of imports, as there is no longer any background event from which these “increased quantities” result.

Two considerable problems arise as a result. First, how does one now determine whether there are “increased quantities” of imports at all—against what baseline is the increase to be measured?

Second, and more fundamental, how can one treat increased quantities of imports as an exogenous or “causal” variable? Elementary economics suggests that the forces of supply and demand, just like price and domestic production, will determine the quantity of imports. If imports and domestic products are perfect substitutes, for example, then the quantity of imports will equal the difference between domestic demand and domestic supply at the equilibrium price. Figure A illustrates the point using the further simplifying assumptions that the importing nation is “small” so that it can obtain any desired quantity of imports at the “world” price  $P$ , and that no trade barriers exist to limit imports. Domestic demand is denoted by the downward sloping curve  $D$ , and domestic supply by the upward sloping curve  $S$ . At the world price, the quantity demanded by domestic consumers is  $Q_d$  and the quantity produced by domestic firms is  $Q_s$ , the difference between these quantities equaling the quantity of imports.

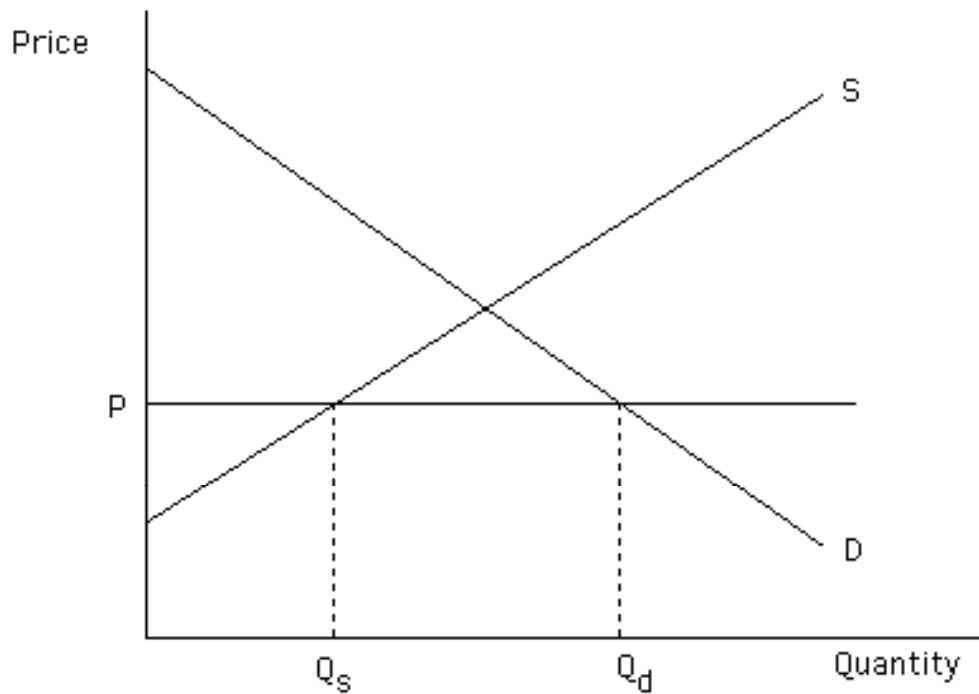


Figure A

Within this framework, the exogenous factors are the determinants of domestic supply, domestic demand, and the world price. Domestic demand is affected by such things as consumer tastes and incomes; domestic supply by the costs of inputs into production and the state of available production technology; and world price by these same matters (factors affecting supply and demand) in other countries. The quantity of imports is then a result of the interaction of these forces; it is not a causal variable at all.

Likewise, changes in the quantity of imports will be the result of changes in the determinants of domestic supply, demand and the world price. Increased quantities of imports may result, for example, from a fall in the world price due to falling input costs abroad, to improved production technology abroad, or to weakening demand abroad. Increased quantities of imports can also result from an increase in domestic demand attributable, for example, to rising consumer incomes. Finally, increased quantities of imports can result from increasing costs of domestic production reflected in a leftward shift of the domestic supply schedule.

Against this backdrop, the question “did increased quantities of imports cause serious injury to a domestic industry?” is simply incoherent. Suppose, as an illustration, that the domestic industry suffers a decline due to rising costs. As domestic production falls at the world price, imports will increase to fill the rising gap between domestic demand and supply. Are “increased quantities” of imports the “cause” of this “injury?” Certainly not in the usual sense of the term “cause.” By hypothesis, what has changed are the costs of domestic firms, and that change results in reduced domestic production and increased imports.

Hence, once the first clause of Article XIX (1) becomes a nullity, it is by no means clear how nations should operationalize their reliance on Article XIX. There is no longer any natural baseline against which to measure “increased quantities,” and there is no longer any intelligible exogenous variable to assess as potential “cause” of serious

injury. The next section will consider how these and other issues were addressed in GATT practice.

### **C. The Evolution of Safeguards in GATT Practice: The U.S. Experience**

The history of safeguards actions in the United States offers a window into the gradual obsolescence of Article XIX as originally drafted and the legal response to it by GATT members. It also illustrates the rise of “extra-legal” measures in the system, and the resulting impetus for the WTO Safeguards Agreement.

Early reliance on Article XIX by the United States proceeded in accordance with its original text. In the so-called “Hatter’s Fur” case of 1951,<sup>9</sup> for example, the United States withdrew a concession that it had negotiated in 1947 with respect to certain women’s hat bodies. A complaint about the measure was referred to a GATT working party. The United States argued that an unexpected surge in imports had resulted from its 1947 concession due to an unforeseen change in fashion that advantaged imports over domestic producers—thus, the import surge was an “unforeseen” consequence of “obligations incurred.” The working party report was inconclusive as to whether the United States had acted appropriately by this standard, but all parties agreed that the U.S. action was required to comply with it.

As time passed, however, efforts to link import surges to the unforeseen consequences of a trade concession were abandoned in the United States. U.S. law no longer requires any such linkage as noted earlier. It is instructive to consider how those charged with administering the law—principally the ITC—responded to the resulting conundrums.

#### *1. Increased Imports: The Baseline Issue*

U.S. law requires the ITC to determine “whether an article is being imported into the United States in such increased quantities as to be a substantial cause of serious

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<sup>9</sup>Sales No. GATT/1951-3 (Nov. 1951).

injury” or threat, without specifying in the statute any baseline against which to assess “increased quantities.” The ITC wrestled with the baseline issue for some time.

Some Commissioners employed an elastic conception of the proper baseline, searching for a time period that they believed was representative of long term trends rather than “abnormal economic conditions.” The result might be a baseline extending back over a decade.<sup>10</sup> Others looked to the time of the most recent trade concessions on the product in question to establish the baseline, which often (though not necessarily) would have occurred during the last GATT negotiating round.<sup>11</sup> Still others emphasized the importance of routinizing the baseline, and tended toward a somewhat arbitrary rule of thumb.<sup>12</sup> The latter view largely carried the day in the end, and it has become convention at the ITC to focus on the most recent five-year period for which data are available.<sup>13</sup> “Increased quantities” will generally be deemed to exist if imports have risen during that five-year window, although litigants remain free to argue that import trends during that period are for some reason unrepresentative of long term trends.

## *2. Serious Injury*

Like GATT Article XIX, U.S. law does not attempt to define the concept of “serious injury.” Rather, it provides a list of factors for the ITC to consider in evaluating serious injury and threat of serious injury, including the idling of productive facilities, lack of profitability in the industry, unemployment, and the like.<sup>14</sup> No guidance is provided on how much weight to give the various factors, however, except to say that no one factor is dispositive. The result is a degree of uncertainty as to how cases will be decided, although industries typically do not pursue relief under U.S. law unless they are

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<sup>10</sup>U.S. International Trade Commission, *Stainless Steel and Alloy Tool Steel*, Inv. No. TA-201-5, Pub. No. 756 (1976)(views of Commissioners Moore and Bedell). The case is also reported in 1 I.T.R.D. 5404 (1976).

<sup>11</sup>Id. (views of Commissioner Minchew).

<sup>12</sup>Id. (views of Commissioner Ablondi).

<sup>13</sup>Jackson, Davey & Sykes at 611.

<sup>14</sup>See 19 U.S.C. §§ 202 (c)(1)(A)-(B).

in a general state of malaise, which usually (though not always) will enable them to persuade the ITC that serious injury is present or at least threatened.<sup>15</sup>

### 3. *Causation*

Unlike GATT Article XIX, U.S. law requires a determination whether increased quantities of imports are the “substantial cause” of injury or threat, defined as a cause that is important and no less important than any other. The ITC is thus obligated to ascertain what other possible causes of serious injury or threat may be present, and to determine whether any of them may be more important than increased quantities of imports. The requirement that the ITC weigh the relative importance of the “causes” of injury might seem to make the analysis more complex than GATT Article XIX requires (although I will argue below that the distinction is largely illusory). Nevertheless, analysis under U.S. law is clearly beset by the same fundamental conceptual problem that plagues any reliance on Article XIX without its first clause—what does it mean to treat increased quantities of imports as a causal variable? This question has been answered in three different ways.

*Correlation*  $\Rightarrow$  *Causation*. By far the predominant response in ITC practice, which might be termed the “correlation approach,” is simply to pretend that import fluctuations “cause” changes in domestic prices and output even though such economic variables are determined simultaneously—both are “endogenous” in economic parlance. To this end, ITC Commissioners regularly search for evidence of a correlation between rising import volume or market share and measures of industrial decline (falling prices, production, employment, profits, and so on). If such a correlation is evident, the Commissioners will tend to find that imports have caused injury. Where it is lacking, they will tend to find that imports are not responsible for injury. And to decide whether

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<sup>15</sup>Compare U.S. International Trade Commission, Nonrubber Footwear, Inv. No. TA-201-50, Pub. No. 1545, 6 I.T.R.D. 1992 (1984)(no injury found) with U.S. International Trade Commission, Nonrubber Footwear, Inv. No. TA-201-55, Pub. No. 1717 (1985)(injury found in another investigation of the same industry one year later).

other possible causes of injury are more important than imports, the Commissioners will employ time series data representing those other causes, and examine the strength of the correlation between those data and indicators of industrial decline.<sup>16</sup>

The fundamental difficulty with the correlation approach, of course, is that correlation and causation are not the same. The elementary price theory that underlies Figure A above, for example, suggests an array of possible developments that can cause a decline in a domestic industry concurrent with an increase in the quantity or market share of imports. A domestic recession might cause injury to domestic firms and a simultaneous increase in the market share of imports (if U.S. firms are the marginal suppliers), while an increase in the costs of domestic producers can cause a reduction in domestic production and an absolute increase in imports. The resulting correlation between rising imports and industrial decline will be deemed “causal” by the ITC even though both the increase in imports and the decline in the domestic industry are both caused by other forces.

*Hypothetical Quotas.* Occasionally, Commissioners or litigants undertake to develop more sophisticated analyses that do not confound the concepts of correlation and causation. Pindyck & Rotemberg<sup>17</sup> conducted an econometric study of the causation issue at the behest of the Chilean copper industry in the 1984 investigation of unwrought copper imports. After estimating a reduced form model of output and employment in the domestic industry, they asked how output and employment would have been affected had imports been held to their level at the beginning of the five-year baseline used by the ITC to determine whether imports had increased. This technique might be termed the “hypothetical quota” approach to determining the impact of imports—the injury caused by “increased quantities” is the decline in industrial health that would have been avoided

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<sup>16</sup>For a recent illustration, see U.S. International Trade Commission, Lamb Meat, Inv. No. TA-201-68, Pub. No. 3176 (1999).

<sup>17</sup>Pindyck, Robert & Julio Rotemberg. Are Imports to Blame?: Attribution of Injury under the 1974 Trade Act, 30 J. L. & Econ. 101 (1987).

had a hypothetical quota frozen the quantity of imports at its baseline value. The resulting injury can then be compared to the injury caused by other potential causes of harm. Pindyck and Rotemberg posited that the other causes of injury were a general macroeconomic recession and rising domestic labor costs. Their econometric analysis suggested that rising imports—or more precisely, the absence of a quota to restrain them—were a less important cause of injury than these other factors.

The analysis of Pindyck and Rotemberg apparently did not convince the ITC, however, which unanimously determined that increased imports were the substantial cause of serious injury. Aspects of the hypothetical quota approach to the causal inquiry have occasionally appeared in the analysis of Commissioners, but on the whole it has had little impact.<sup>18</sup>

The hypothetical quota approach to analysis has one advantage over the correlation approach that predominates at the ITC, in that it offers an economically coherent conception of how increased quantities of imports “cause” injury. It does so by positing an intelligible exogenous variable—the removal of a hypothetical quota—and then analyzes the impact of that hypothetical policy change. Yet, it is by no means clear that this approach to causation analysis is the right one. Consider again the example of a shock to domestic costs that reduces domestic production and leads to an increase in imports. At least some of the resulting harm to domestic firms would be avoided if a quota were in place to prevent imports from increasing—the reduced domestic supply would then lead to higher prices and more revenue for domestic firms, other things being

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<sup>18</sup>See U.S. International Trade Commission, Certain Motor Vehicles, Inv. No. TA-201-44, Pub. No. 1110, 2 I.T.R.D. 5241 (1980)(views of Commissioner Alberger). Commissioner Alberger devised a technique that came to be known as “shift-share analysis.” He posited that injury to domestic automakers was due to one of two causes -- the increasing market share of imports, and the decline in U.S. consumption (sales) of new motor vehicles. Accordingly, he considered two counterfactuals, one in which import share was held constant while consumption fell as it did, and another in which consumption was held constant while import share rose as it did. Because the damage to the industry was greater in the first counterfactual than in the second, he concluded that declining consumption was a more important cause of injury. His analysis can be taken to be a variant of the hypothetical quota approach, with a counterfactual quota system that holds import market share constant.



equal. Is it proper to say that increased quantities of imports are the cause of injury under those conditions?

*The Import Supply Curve.* A third technique for analyzing the causal connection between increased quantities of imports and injury has surfaced in the reasoning of a few Commissioners, and might be termed the “import supply curve” approach. It has also found its way into some academic studies, such as that of Grossman,<sup>19</sup> Kelly,<sup>20</sup> and Irwin.<sup>21</sup> This approach draws on standard economic models of international trade to divide the potential causes of injury into three groups: forces that cause shifts in the domestic supply schedule; forces that cause shifts in the domestic demand schedule; and forces that cause shifts in the import supply schedule. Any harm to the domestic industry that can be attributed to shifts in the import supply curve will be deemed to result from “increased imports;” any harm attributable to rising domestic costs that shift the domestic supply schedule will be deemed to result from causes other than increased imports.<sup>22</sup> Likewise, harm due to shifts in domestic demand will be attributed to causes other than imports, unless the shift in demand is due to a price reduction on imperfectly substitutable imports.<sup>23</sup>

This approach also has the virtue of economic coherence, effectively rewriting the statute to ask whether changing conditions of import supply, rather than increased quantities of imports, are causally responsible for injury. Once again, however, one may reasonably inquire whether this approach is the right one. It permits safeguard measures when developments abroad are the principle source of harm to a troubled industry, but on what legal theory is that the proper way to limit them? The old Hatter’s Fur case noted above is instructive in this regard. The U.S. position in that case was that a decline in

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<sup>19</sup> Grossman, Gene M. , Imports as a Cause of Injury: The Case of the U.S. Steel Industry, 20 J. Int’l Econ. 201 (1986).

<sup>20</sup> Kelly, Kenneth, The Analysis of Causality in Escape Clause Cases, 37 J. Ind. Econ. 187 (1988).

<sup>21</sup> Irwin, Douglas, Causing Problems? The WTO Review of Causation and Injury Attribution in U.S. Section 201 Cases, NBER Working Paper No. 9815 (2003).

<sup>22</sup>See U.S. International Trade Commission, Wood Shakes and Shingles, Inv. No. TA-201-56, Pub. No. 1826 (1986)(views of Commissioners Liebel and Brunsdale).

<sup>23</sup>A more detailed explanation of this approach may be found in Kelly (1988).

domestic demand for the types of hats produced by domestic firms was the “unforeseen development” that resulted in an import surge and that justified safeguards action. The working party appeared to accept this theory, at least in principle, while quibbling as to whether the facts supported it.

In short, absent a clear legal (or economic) theory as to which economic developments should permit a safeguards response and which should not, it is difficult to assess the merits of the alternative methods of causation analysis that have emerged in U.S. practice through the years. It remains to consider whether the new Agreement on Safeguards provides additional guidance.

Before proceeding, however, I will note one other conceptual difficulty that arises under U.S. law, and that will be seen to be present under WTO law in a slightly different guise. To determine whether imports are the “substantial cause” of injury, the ITC must identify the other possible causes of injury. Implicitly, this requires the ITC to define the economic developments that will not justify safeguard measures if they prove to be the most important cause of injury. Of the three approaches to the analysis considered above, only the import supply curve approach provides a built-in answer to this question—safeguard measures may not be employed if the predominant cause of injury is a shift in domestic demand or in domestic supply. But as noted, it is by no means obvious that injury due to such developments should not be permitted to justify safeguards action, or that all developments abroad that may shift the import supply curve should be permitted to justify safeguards action. The problem becomes even more difficult under the other two approaches to causation analysis, as it is altogether unclear what “counts” as a cause other than imports.<sup>24</sup>

#### *4. The Rise of Gray Area Measures*

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<sup>24</sup>U.S. law must also confront an issue that WTO law avoids -- the proper level of "aggregation" of alternative causes. For example, should a domestic recession be viewed as a single cause, or an aggregation of various adverse events that affect macroeconomic activity? The issue is important because of the need to weigh the relative importance of alternative causes against the effect of imports. The more alternative causes are "disaggregated," the more likely that imports will prove more important. WTO law does not require this comparative weighing of causes, and thus need not confront the aggregation issue.

Given the many conundrums presented by Article XIX, the reader may wonder how the GATT system could have functioned for nearly 50 years without providing much guidance as to how these issues should be resolved. The answer, in part, is that formal reliance on Article XIX waned over time, and safeguard measures were replaced by various extra-legal arrangements. These commonly took the form of government-to-government negotiations to limit exports. The resulting arrangements were commonly termed “voluntary export restraints” or “orderly marketing agreements.” Because these arrangements did not comply with the formal requirements of Article XIX, they came to be known as “gray area” measures.

One drawback of formal safeguard measures from the perspective of an importing nation was the “compensation” requirement of Article XIX. Article XIX (2)-(3) provide that a party invoking its right to suspend or modify concessions must negotiate with adversely affected parties regarding trade compensation. If these negotiations are unsuccessful, the safeguard measure may be imposed nevertheless, but injured trading partners may suspend “substantially equivalent concessions.” Thus, a nation invoking Article XIX had to choose between compensatory trade concessions to affected trading partners and the retaliatory suspension of “equivalent” concessions. Both options could prove unpalatable. Formal safeguard measures also required industries seeking protection to proceed through an expensive administrative process with an uncertain outcome.

Against this backdrop, voluntary export restraints have obvious appeal as an alternative. Such arrangements contain built-in compensation to adversely affected nations in the form of “quota rents”—although exporting nations agree to limit their exports, they are allowed to charge what the market will bear in the importing nation for the reduced quantity. The resulting price increase (the quota rent) and higher profit margin per unit sold may more than compensate the exporting nation for the loss in volume of sales. Voluntary restraint agreements can also circumvent the legal requirements, and administrative costs, of formal safeguards proceedings.

It is perhaps unsurprising, therefore, that voluntary restraint arrangements and similar arrangements came to be quite common and to a great degree replaced safeguards actions. They emerged in a number of important industries.

Government to government agreements limiting trade have been especially important in the steel industry. The United States negotiated steel export restraint agreements with Japan and Europe in the late 1960's, and a larger network of voluntary restraint agreements was negotiated by the Reagan administration in the 1980's. They were extended through 1992.

The Multifiber Arrangement (MFA) under GATT and its predecessors in the GATT system was another important example. Textile industries in developed nations had long been beleaguered by import competition, and the MFA served as a negotiated solution to the "problem" for many years. It allocated quota shares for the major developed markets among the major developing country suppliers.<sup>25</sup>

Yet another dramatic example of how voluntary restraints came to substitute for safeguard measures arose during the Carter administration. The domestic auto industry filed a petition for safeguards relief before the ITC, and lost its case on the grounds that increased quantities of imports were not the substantial cause of injury. The Carter administration proceeded nevertheless to negotiate a voluntary restraint agreement with Japan, which remained in force for a number of years.

The growth of these arrangements, of course, imposed substantial economic costs on the importing nations that employed them. Studies suggested that the annual cost to the U.S. economy, for example, was in the tens of billions of dollars.<sup>26</sup> Further, voluntary restraint agreements and related measures were of potentially indefinite duration. Special arrangements for the steel and textile industries, in particular, spanned decades. A constituency developed during the Uruguay Round of GATT negotiations for an end to

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<sup>25</sup>For historical discussion see Jackson, Davey & Sykes, pp. 400-02.

<sup>26</sup>See, e.g., David Tarr, *A General Equilibrium Analysis of the Welfare and Employment Effects of U.S. Quotas in Textiles, Autos and Steel* (Washington: FTC, 1989).

these arrangements, and efforts to curtail them became central to the WTO Agreement on Safeguards.

#### **D. The Safeguards Agreement**

It is not obvious why trade officials in the GATT system would have regarded the growth of extra-legal measures as a terribly onerous development, and the emergence of a strong push for reform during the Uruguay Round presents something of a political economy puzzle on which I will not linger. But there can be no doubt that a principal objective of the safeguards negotiations was to put an end to extra-legal measures, and to restore formal legal discipline over the protection of troubled industries.<sup>27</sup>

The negotiations to this end were apparently successful. Article 11(1)(b) of the WTO Agreement of Safeguards provides that “a Member shall not seek, take or maintain any voluntary export restraints, orderly marketing arrangements or any other similar measures on the export or the import side.” In addition to this clear prohibition of gray area measures, the Agreement sought to remove some of the preexisting incentive to use them by altering the compensation requirement. Under the new Agreement, members using safeguards “shall endeavor to maintain a substantially equivalent level of concessions.”<sup>28</sup> But the Agreement also provides that if negotiations over compensation are unsuccessful, no right of retaliation exists during the first three years of a safeguards measure that conforms to the legal requirements of the Agreement and that follows an absolute increase in the level of imports. Thus, the “threat point” is plainly altered in the compensation negotiations, and nations adversely affected by safeguards actions must settle for less in compensation lest they walk away with nothing for three years. The political price for formal reliance on safeguard measures by an importing nation has thus been reduced.

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<sup>27</sup>Bown (2002) provides additional background on the effort to eliminate extra-legal measures in the Safeguards Agreement, as well as the puzzle as to why WTO negotiators sought to eliminate such measures.

<sup>28</sup>Safeguards Agreement, Art. 8(1).

In addition, to address concerns that measures to protect troubled industries had often dragged on for years under GATT and had become a substitute for long-term tariff protection, the Agreement introduced some bright-line time limits. Safeguards measures could last only four years, although they could be extended another four years if a formal determination was made that an extension was necessary. Once terminated, safeguard measures could not be re-applied to an industry for a length of time equal to the time that they had been in effect. Further, any safeguards measure lasting over one year was to be liberalized at “regular intervals.”<sup>29</sup>

These elements of the new Agreement do much to address the problem of gray area measures and the problem of open-ended safeguards protection, issues that were clearly important to the negotiators. But the Agreement accomplishes much less with respect to the conceptual questions posed by Article XIX.

On the basic preconditions for reliance on Article XIX, the Agreement largely parrots U.S. law in stating that a “Member may apply a safeguard measure to a product only if that Member has determined.... that such product is being imported into its territory in such increased quantities, absolute or relative to domestic production, and under such conditions as to cause or threaten serious injury to the domestic industry that produces like or directly competitive products.”<sup>30</sup> Like U.S. law, it omits any reference to “unforeseen developments” or the “effect of the obligations incurred.”

The only guidance as to the meaning of “serious injury” under this standard and the proper approach to the analysis of causation is provided by Article 4 of the Agreement, which I reproduce here in pertinent part:

1. For purposes of this Agreement:

- (a) “serious injury” shall be understood to mean significant overall impairment in the position of a domestic industry;
- (b) “threat of serious injury” shall be understood to mean serious injury that is clearly imminent...

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<sup>29</sup>Id. Art. 7.

<sup>30</sup>Id. Art. 2(1).

2. (a) In the investigation to determine whether increased imports have caused or are threatening to cause serious injury to a domestic industry...the competent authorities shall evaluate all relevant factors of an objective and quantifiable nature having a bearing on the situation of that industry, in particular, the rate and amount of the increase in imports of the product concerned in absolute and relative terms, the share of the domestic market taken by increased imports, changes in the level of sales, production, productivity, capacity utilization, profits and losses, and employment.

(b) The determination referred to in subparagraph (a) shall not be made unless this investigation demonstrates, on the basis of objective evidence, the existence of the causal link between increased imports of the product concerned and serious injury or threat thereof. When factors other than increased imports are causing injury to the domestic industry at the same time, such injury shall not be attributed to increased imports.

Plainly, this provision does not seriously address, let alone resolve, the conundrums presented by modern GATT practice under Article XIX. It does not provide any guidance, for example, on what it means to say that increased imports are a causal variable, or any guidance on what is meant by “factors other than increased imports...causing injury to the domestic industry at the same time.” The concept of “serious injury” is left quite vague, and members must simply “evaluate” relevant factors. Further, although the Agreement nowhere refers to “unforeseen developments” and the “effect of the obligations incurred” as a predicate to safeguard measures, it does not specifically provide that Article XIX(1), first clause, may henceforth be ignored.

Hence, fundamental questions regarding the legal prerequisites for safeguard measures remain unanswered by the WTO Agreement on Safeguards. These unresolved issues have found their way into WTO disputes.

## **II. Safeguards in Appellate Body Jurisprudence Prior to the Steel Case**

I now turn to an examination of the WTO decisions on safeguard measures, which are unsatisfactory in a number of respects. The problem lies largely in the fact that the WTO Appellate Body engages in textual interpretation to the exclusion of anything else, yet the WTO text on safeguard measures is anything but satisfactory for the reasons noted above.

The situation is somewhat reminiscent of early American antitrust law. The Sherman Act of 1890 prohibited combinations and conspiracies in restraint of trade, without defining or otherwise making clear what constitutes a “restraint of trade.” The requirements of antitrust law have become reasonably clear over time only through a process of common law adjudication that has considered the legality of various business practices with the aid of nontextual theorizing about their desirability. Absent a thorough renegotiation of the Safeguards Agreement, such a process is also required here, but the Appellate Body has steadfastly refused to embark on it.

#### **A. The Resurrection of Article XIX(1), First Clause**

As indicated, GATT practice evolved toward ignoring the first clause of Article XIX. The Safeguards Agreement says nothing about “unforeseen developments” or the “effect of the obligations incurred,” and national laws have ignored these requirements for many years.

In its first important ruling in a safeguards dispute—*Korea—Dairy*<sup>31</sup>—the Appellate Body took a different tack. It overruled the findings of the dispute panel in the case to the effect that formal compliance with Article XIX(1), first clause, is no longer required. The Appellate Body instead held that a treaty interpreter “must give meaning and effect to all the terms of the treaty. An interpreter is not free to adopt a reading that would result in reducing whole clauses or paragraphs of a treaty to redundancy or inutility.<sup>32</sup>” Article XIX and the Safeguards Agreement are to be read cumulatively it says, and the first clause of Article remains a binding obligation.

As for the proper interpretation of the obligation imposed by Article XIX(1), first clause, the Appellate Body opined: “[I]t seems to us that the ordinary meaning of the phrase ‘as a result of unforeseen developments’ requires that the developments which led to a product being imported in such increased quantities and under such conditions as to

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<sup>31</sup>*Korea—Definitive Safeguard Measure on Imports of Certain Dairy Products*, WT/DS98/AB/R (1999).

<sup>32</sup>*Id.* ¶80.



cause or threaten to cause serious injury to domestic producers must have been ‘unexpected’. With respect to the phrase ‘of the effect of the obligations incurred by a Member under this Agreement, including tariff concessions’, we believe that this phrase simply means that it must be demonstrated, as a matter of fact, that the importing Member has incurred obligations under the GATT 1994, including tariff concessions.<sup>33</sup>” The Appellate Body went on to endorse the reasoning of the working party report in the old GATT Hatter’s Fur case, which stated: “... ‘unforeseen developments’ should be interpreted to mean developments occurring after the negotiation of the relevant tariff concession which it would not be reasonable to expect that the negotiators of the country making the concession could and should have foreseen at the time when the concession was negotiated.<sup>34</sup>” This line of reasoning was repeated by the Appellate Body in *Argentina—Footwear*,<sup>35</sup> which also overruled the dispute panel in the case.

Thus, the Appellate Body has fully revived the first clause of Article XIX, and has held in these and subsequent decisions that national authorities have failed to demonstrate their compliance with it. *United States—Lamb*,<sup>36</sup> in particular, holds that WTO members must demonstrate their compliance with the Article XIX(1), first clause, prior to the time that a safeguards measure is undertaken. The U.S. ITC’s failure to consider the matter in its lamb investigation was “not surprising” given the absence of any reference to it in the governing U.S. statute, but that was no defense for the United States under WTO law.<sup>37</sup>

One can certainly quarrel with the legal soundness of these decisions. Given the uniform practice of ignoring Article XIX(1), first clause, during the latter years of GATT, and its omission from the Safeguards Agreement, it is questionable whether the drafters of the Uruguay Round Agreements had any intention of reviving the obligation—had

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<sup>33</sup> Id. ¶84.

<sup>34</sup> Id. ¶89.

<sup>35</sup> *Argentina—Safeguard Measures on Imports of Footwear*, WT/DS121/AB/R (1999).

<sup>36</sup> *United States—Safeguard Measures on Imports of Fresh, Chilled or Frozen Lamb Meat from New Zealand and Australia* WT/DS178/AB/R (2001).

<sup>37</sup> Id. ¶73.

they wished to alter established GATT practice in this respect, one might argue, they would have so indicated with clarity. The difficult interpretive issues that the clause raises in a long-lived agreement, which led to its irrelevance in GATT practice, might also have been noted as a basis for letting it remain dormant.

Having embraced the opposite view, the Appellate Body might have undertaken to explain coherently what Article XIX(1), first clause, now requires. At what point in time must the events in question have been unforeseen—the time of the last tariff concession? What if the last concession on the product in question was decades ago—could anything today have been foreseen? What if the product has been the subject of numerous tariff concessions over time—are expectations associated with the last concession the only relevant ones? Why or why not? How does one establish the expectations of trade negotiators as an evidentiary matter? What if there are many negotiators and their accounts of their expectations are incongruent? What if most of them are dead? This list of questions is assuredly incomplete, and the Appellate Body has yet to afford any meaningful guidance regarding the answers.

With regard to the “effect of the obligations incurred,” by contrast, the Appellate Body apparently offers a construction which enables this requirement to be trivially satisfied in every case—a member simply needs to show that it has incurred some obligations with respect to the product in question. It is hard to imagine how a dispute could arise without such an obligation, since a member with an unbound tariff could always raise it unilaterally without any need to rely on a safeguard measure. The Appellate Body evidently does not require members to demonstrate that “increased quantities” of imports are attributable directly to any recent trade concession. It suffices for them to argue that in the absence of a tariff binding, they would be able to raise tariffs to eliminate the import surge.

## **B. Increased Quantities**

As noted, Article XIX originally contemplated that “increased quantities” of imports would be measured against baseline levels prior to 1947 GATT concessions. Having revived Article XIX(1), first clause, therefore, one might perhaps have expected the Appellate Body to require a similar approach to establishing the baseline against which the existence of “increased quantities” is assessed, perhaps by looking to import levels prior to the most recent concession on the product in question. But it has not taken that approach

In *Argentina—Footwear*,<sup>38</sup> the Appellate Body considered a case in which Argentina had adopted the approach embraced some years earlier by the U.S. ITC—a five year “rule of thumb” for establishing the import baseline. The dispute panel in the case concluded that it is “reasonable to examine the trend in imports over a five-year historical period.”<sup>39</sup> But the Appellate Body focused on language from the second clause of Article XIX(1) and its counterpart in Article 2.1 of the Safeguards Agreement: “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 to cause serious injury.” The phrase “is being imported,” according to the Appellate Body, “indicates that it is necessary for the competent authorities to examine recent imports, and not simply trends in imports during the past five years—or, for that matter, during any other period of several years.”<sup>40</sup> “In our view, the determination of whether the requirement of imports ‘in such increased quantities’ is met is not a merely mathematical or technical determination. In other words, it is not enough for an investigation to show simply that imports of the product this year were more than last year—or five years ago. Again, and it bears repeating, not just *any* increased quantities of imports will suffice. There must be ‘*such* increased quantities’ as to cause or threaten to cause serious injury to the domestic industry in order to fulfill this requirement for applying a safeguard measure. And this

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<sup>38</sup>*Argentina—Safeguard Measures on Imports of Footwear*, WT/DS121/AB/R (1999).

<sup>39</sup>*Id.* ¶130.

<sup>40</sup>*Id.*

language in both Article 2.1 of the *Agreement on Safeguards* and Article XIX:1(a) of the GATT 1994, we believe, requires that the increase in imports must have been recent enough, sudden enough, sharp enough, and significant enough, both quantitatively and qualitatively, to cause or threaten to cause ‘serious injury’.<sup>41</sup>”

Thus, the Appellate Body insists that imports must have increased “recently.” But how recently, and in what amount? The phrase “recent enough, sudden enough, sharp enough, and significant enough, both quantitatively and qualitatively, to cause or threaten to cause ‘serious injury’” hardly provides useful guidance. The insistence on “not just any increase” but “such increased quantities” as to cause injury is equally unhelpful. And one must again confront the fundamental issue that all of this verbiage avoids—what does it mean to say that increased quantities of imports “cause” injury when they are, as an economic matter, a result of a variety of possible developments? Far from lending badly needed clarification, the Appellate Body’s treatment of the “increased quantities” requirement only adds to the confusion.

### **C. Serious Injury**

Like Article XIX and the Safeguards Agreement, the Appellate Body has not attempted to define “serious injury” with any precision. Its focus has been primarily on the text of Article 4.2, which simply provides: “the competent authorities shall evaluate all relevant factors of an objective and quantifiable nature having a bearing on the situation of that industry, in particular, the rate and amount of the increase in imports of the product concerned in absolute and relative terms, the share of the domestic market taken by increased imports, changes in the level of sales, production, productivity, capacity utilization, profits and losses, and employment.” According to the Appellate Body, the text requires that all of the listed factors be “evaluated” in every case, and it has found safeguard measures wanting under WTO law whenever a member has failed to

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<sup>41</sup> Id. ¶131.

discuss one or more of these factors in its official report on safeguard action.<sup>42</sup> The Appellate Body has further held that the obligation to evaluate “all relevant factors” may extend to factors not raised by any of the parties to the safeguards investigation.<sup>43</sup>

Otherwise, the Appellate Body has simply insisted that serious injury represents “significant overall impairment” as stated in Article 4.1 of the Safeguards Agreement.<sup>44</sup> It characterizes this standard as “high” and “exacting.”<sup>45</sup> It is not necessary that every “relevant factor” reflect industrial decline, however, for serious injury to be present—“a certain factor may not be declining, but the overall picture may nevertheless demonstrate ‘significant overall impairment.’”<sup>46</sup>

On the whole, therefore, the Appellate Body has provided relatively little guidance on the meaning of “serious injury,” a situation that is perhaps understandable given the vagueness of the pertinent textual obligations. Beyond a requirement that all factors listed in the Safeguards Agreement be “evaluated” in each case, it remains unclear what conditions will support a finding of serious injury or threat, and what degree of deference on the matter will be afforded to national authorities.

#### **D. Causation**

The Appellate Body has addressed the causal relationship between increased quantities of imports and serious injury in several opinions prior to the steel case. None of them, however, provides a clear answers to the conceptual difficulties identified in Section I.

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<sup>42</sup>See Argentina—Safeguard Measures on Imports of Footwear, WT/DS121/AB/R (1999), ¶121.

<sup>43</sup>See United States—Definitive Safeguard Measures on Imports of Wheat Gluten from the European Communities, WT/DS166/AB/R (2001), ¶55.

<sup>44</sup>To date, the Appellate Body has largely refrained from detailed commentary on the reasoning behind findings of “serious injury” by national authorities. The most notable exception is United States -- Safeguard Measures on Imports of Fresh, Chilled or Frozen Lamb Meat from New Zealand and Australia WT/DS178/AB/R (2001). The U.S. ITC had found lamb prices in the United States to be “depressed” even though they were generally higher than four or five years earlier. And it had found a threaten of serious injury even though prices had risen toward the end of its period of investigation. The Appellate Body held these findings to be insufficient to support the ITC determination. *Id.* ¶¶157-59.

<sup>45</sup>United States—Safeguard Measures on Imports of Fresh, Chilled or Frozen Lamb Meat from New Zealand and Australia WT/DS178/AB/R (2001), ¶124.

<sup>46</sup>Argentina—Safeguard Measures on Imports of Footwear, WT/DS121/AB/R (1999), ¶139.

*Argentina—Footwear* briefly addresses the proper method for determining whether imports are the “cause” of injury. The dispute panel in the case had indicated that “if causation is present, an increase in imports normally should coincide with a decline in the relevant injury factors.”<sup>47</sup> The Appellate Body agreed with the panel that “in an analysis of causation, ‘it is the *relationship* between the *movements* in imports (volume and market share) and the *movements* in injury factors that must be central to a causation analysis and determination.’ Furthermore, with respect to a ‘coincidence’ between an increase in imports and a decline in the relevant injury factors, we note that the Panel simply said that this should ‘normally’ occur if causation is present.”<sup>48</sup>

Hence, in its first important statement on the subject, the Appellate Body seemingly endorses what was termed the “correlation approach” to causation analysis in Section I. In so doing, it tips its hat to the notion that correlation and causation are not the same, but implies that they “normally” go hand in hand. One has no sense that the Appellate Body is aware of (or at least troubled by) the profound conceptual difficulty in confounding the two in a setting where the ostensible “causal” variable is in fact endogenous.

The other Appellate Body opinions on causal analysis focus principally on the so-called “nonattribution requirement” of Article 4.2 of the Safeguards Agreement. It provides that safeguard measures may not be employed unless the “investigation demonstrates, on the basis of objective evidence, the existence of the causal link between increased imports of the product concerned and serious injury or threat thereof. When factors other than increased imports are causing injury to the domestic industry at the same time, such injury shall not be attributed to increased imports.” One question raised by this language during the course of various disputes has been whether the harm “caused” by increased imports (again suspending the issue of what it means to treat

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<sup>47</sup>*Argentina—Safeguard Measures on Imports of Footwear*, WT/DS121/AB/R (1999), ¶141.

<sup>48</sup>*Id.* ¶144.

increased imports as causal) must by itself suffice to cause serious injury, or must simply contribute to serious injury, perhaps along with other factors. To this ill-posed question, the Appellate Body has responded that “the *Agreement on Safeguards* does not require that increased imports be “sufficient” to cause, or threaten to cause, serious injury. Nor does that Agreement require that increased imports “alone” be capable of causing, or threatening to cause, serious injury.<sup>49</sup>”

Although increased imports need not account for all of the serious injury, the Appellate Body nevertheless underscores the importance of ensuring that injury caused by “factors other than increased imports” “not be attributed to increased imports.” To make sense of these dual principles, one can only assume that the Appellate Body is concerned about situations in which increased imports have not made any causal contribution to serious injury, and where serious injury is nevertheless wrongly “attributed” to imports.

It has found fault with members’ “nonattribution analysis” on multiple occasions. In *United States—Wheat Gluten*<sup>50</sup>, the volume of imports had risen 38 percent during the five-year period of investigation employed by the ITC. Over the same period, U.S. productive capacity had grown 68 percent. Capacity utilization at U.S. firms had fallen considerably along with profits, however, and the U.S. ITC had linked the decline in profitability to declining capacity utilization rates.<sup>51</sup>

One issue before the Appellate Body was whether the U.S. ITC had incorrectly “attributed” injury caused by the expansion of U.S. capacity to rising imports. On this question, the Appellate Body noted that had U.S. capacity not risen over the period of investigation, its capacity utilization rate would have fallen only modestly even with the

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<sup>49</sup>United States—Safeguard Measures on Imports of Fresh, Chilled or Frozen Lamb Meat from New Zealand and Australia WT/DS178/AB/R (2001), ¶170. See also United States—Definitive Safeguard Measures on Imports of Wheat Gluten from the European Communities WT/DS166/AB/R (2001), ¶70.

<sup>50</sup>United States—Definitive Safeguard Measures on Imports of Wheat Gluten from the European Communities WT/DS166/AB/R (2001).

<sup>51</sup>*Id.* ¶¶81, 84.

increased volume of imports.<sup>52</sup> Further, had imports maintained their market share over the period of investigation, capacity utilization rates still would have fallen significantly due to the increased capacity brought on line.<sup>53</sup> In the face of this evidence, the Appellate Body concluded that the U.S. ITC had not “adequately evaluated the complexities” and had not ensured that injury attributable to other factors is not attributed to imports.<sup>54</sup>

The Wheat Gluten opinion is problematic in a number of respects. First, as with the other Appellate Body opinions on causation, it does nothing to help with the question of how to conceptualize imports as a causal variable. Second, taking seriously for a moment the notion that imports are “causal,” it was undisputed in the case that they had risen substantially during the period of investigation, while the profitability of domestic producers had fallen. Given the Appellate Body’s earlier pronouncements that a correlation of this sort is “normally” present when a causal connection exists, and that imports need not account for all serious injury, one wonders why this evidence was not enough. The logic of the Appellate Body opinion seems to suggest that the problems suffered by U.S. producers were caused by two factors—rising imports, and investment in new capacity that proved unnecessary. In the absence of either factor, U.S. producers would have been considerably more profitable. Why, then, is it inappropriate to attribute at least part of the “serious injury” to imports?

Finally, and as the United States had argued, much of the increase in capacity was put in place before imports began to increase.<sup>55</sup> The sequence of events thus suggested that U.S. producers had invested in new capacity in anticipation of growth opportunities, but that imports had increased to capture those growth opportunities and render the new investment uneconomical. It could thus be argued that the unexpected surge in imports was the real “problem,” and that investments in capacity were not a conceptually distinct

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<sup>52</sup>Id. ¶85.

<sup>53</sup>Id. ¶86.

<sup>54</sup>Id. ¶ 91.

<sup>55</sup>Id. ¶87



cause of injury but rather a background predicate for the injury caused by imports. To this line of argument, the Appellate Body Responded: “[T]he relevance of an ‘other factor’, under Article 4.2(b), depends on whether that ‘other factor’ was, or was not, ‘causing injury’ ‘at the same time’ as increased imports. Therefore, the possible relevance of the increases in capacity added during the period of investigation does not depend on the moment in time when the increases in capacity occurred, but on when the effects of those increases are felt, and whether they are ‘causing injury’ ‘at the same time’ as increased imports.<sup>56</sup>” This response simply begs the question as to why domestic investments in new capacity should be considered an “other factor” distinct from imports as a cause of injury, if indeed the anticipated recoupment of those investments was frustrated by an unexpected import surge. The U.S. ITC had treated capacity investments as an alternative cause of injury to be sure (and dismissed them as less important), and the Appellate Body simply seemed to accept it as an “other factor” without reflection.

The decision in *United States—Lamb*<sup>57</sup> is similar in this last respect. The U.S. ITC had considered six factors other than increased imports that might have contributed to serious injury: “the cessation of subsidy payments under the National Wool Act of 1954; competition from other meat products, such as beef, pork and poultry; increased input costs; overfeeding of lambs; concentration in the packing segment of the industry; and a failure to develop and maintain an effective marketing program for lamb meat.<sup>58</sup>” The Appellate Body again seemed to accept these factors uncritically, and simply inquired whether the United States had done enough to ensure that injury caused by these factors was not “attributed” to imports. Once again it found the analysis of the ITC wanting, suggesting that it consisted of conclusory assertions without reasoned explanation.<sup>59</sup>

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<sup>56</sup>Id. ¶88.

<sup>57</sup>United States—Safeguard Measures on Imports of Fresh, Chilled or Frozen Lamb Meat from New Zealand and Australia WT/DS178/AB/R (2001).

<sup>58</sup>Id. at ¶182, n. 57.

<sup>59</sup>Id. ¶¶185-86.

Along the way it added: “We emphasize that the method and approach WTO Members choose to carry out the process of separating the effects of increased imports and the effects of the other causal factors is not specified by the *Agreement on Safeguards*. What the Agreement requires is simply that the obligations in Article 4.2 must be respected when a safeguard measure is applied.<sup>60</sup>” Evidently, members can use any analytical method they wish that complies with Article 4.2, yet the Appellate Body offers no counsel as to what the set of permissible methods might include.

Finally, in *United States—Line Pipe*,<sup>61</sup> the U.S. ITC had considered the possibility that decreased oil and gas drilling was a more important cause of injury than increased imports, and had concluded to the contrary. Once again, however, its analysis was deemed insufficient—the “cited parts of the USITC Report do not *establish explicitly*, with a *reasoned and adequate explanation*, that injury caused by factors other than the increased imports was not attributed to increased imports. The passage on page I-30 of the USITC Report highlighted by the United States is but a mere assertion that injury caused by other factors is not attributed to increased imports.<sup>62</sup>”

In sum, the Appellate Body decisions prior to the steel case regarding the causal analysis required by the Safeguards Agreement suggest the following principles: (a) correlation is typically the best evidence of causation; (b) the “other factors” considered by national authorities during the course of their investigations will be accepted uncritically without any reflection as to their logical relevance; and (c) the Appellate Body will not tell nations how to conduct their “nonattribution analysis,” but will insist that it contain “reasoned and adequate explanation,” which has so far been lacking in every case. Thus far, the Appellate Body offers no theory as to how imports are to be viewed as causal, or as to how members should determine what constitutes a potential

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<sup>60</sup> Id. ¶181.

<sup>61</sup> United States—Definitive Safeguard Measures on Imports of Circular Welded Carbon Quality Line Pipe from Korea, WT/DS202/AB/R (2001).

<sup>62</sup> Id. ¶220

“other factor.” In other words, the Appellate Body offers no useful guidance on this front as to when safeguards are permissible and when they are not. It faults the lack of “adequate explanation” in the decisions of national authorities, yet its own explanation of the permissible role for safeguard measures could hardly be less instructive.

### **III. The Steel Dispute**

The recent steel dispute raised all of the issues noted above, and others. The panel decision hints at a partial resolution of the "unforeseen developments" puzzle, but makes little progress on other fronts. The Appellate Body decision breaks no new ground at all, and holds the steel safeguards imposed by the United States to be illegal for predictable reasons in light of the prior cases.

#### **A. Background to the Dispute**

The steel investigation was initiated by the ITC at the request of the United States Trade Representative (USTR) in June, 2001. The request covered four broad categories of steel products, which were divided into thirty-three categories by the ITC for purposes of data collection. Ultimately, the ITC defined twenty-seven separate "industries" producing steel products within the scope of the investigation. For each of these industries, the ITC proceeded to determine whether imports had increased, and if so, whether increased imports were a substantial cause of serious injury or threat of injury. This analysis resulted in negative determinations for fifteen industries, affirmative determinations for eight industries, and "divided" determinations (a 3-3 vote) for four industries.<sup>63</sup>

Under U.S. law, a negative determination by the ITC precludes any action by the President to impose a safeguard measure. Affirmative determinations and divided

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<sup>63</sup>USITC, Certain Steel Products, Inv. No. TA-201-73, (USITC Pub. No. 3479, December, 2001), Vol. I (hereafter USITC Report).

determinations are forwarded to the President for consideration of possible relief, along with remedial recommendations which the President is not bound to follow. As to some products, the ITC recommended that imports from nations with which the United States has preferential trading arrangements—including Canada, Mexico, Israel and Jordan—be exempted from any safeguard measures.

After the conclusion of an inter-agency review process, the President instituted ten distinct safeguard "measures" covering various steel products, which generally excluded imports from preferential trading partners. Eight WTO members (including the European Community) challenged the measures pursuant to the WTO dispute resolution process, and the proceedings were consolidated before a single panel. The panel ruled against the United States on all of the challenged measures, on multiple grounds. The Appellate Body affirmed the ruling in considerable part, leading to the eventual dismantling of the measures in December, 2003.

## **B. The Panel Decision**

The challenges to the U.S. steel safeguard measures collectively attacked every aspect of their legal basis. The panel exercised judicial economy to avoid reaching arguments regarding the definition of "industry" in the U.S. investigation and the existence of serious injury. Its findings instead focused on four areas: the existence of "unforeseen developments" as a predicate for safeguards; the question whether steel imports had increased in "such increased quantities" as to permit safeguards; the causal link between increased imports and injury; and the lack of "parallelism" between the injury analysis and the remedial measures.<sup>64</sup>

### *1. Unforeseen Developments*

U.S. law has yet to be amended to require that increased imports result from unforeseen developments, and the initial ITC decision in the steel case predictably paid

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<sup>64</sup>United States -- Definitive Safeguard Measures on Imports of Certain Steel Products, WT/DS248-49, 251-54, 258-59/R (July 2003) (hereafter Panel Rep.).

little heed to the issue. But prior to the imposition of the steel safeguard measures in March 2002, the USTR requested additional information from the ITC regarding unforeseen developments, and received a supplemental report on that issue in February. Based in large part on this supplemental report, the United States argued before the panel that four unforeseen developments had contributed to the influx of imports that had injured the U.S. steel industry: the Asian financial crisis; the drop in demand for steel due to the dissolution of the Soviet Union; the unexpected strength of U.S. demand for steel; and the persistent appreciation of the U.S. dollar.<sup>65</sup> Among other arguments, the complainants urged that none of these events were "unforeseen," and questioned whether they had resulted in increased imports sufficient to justify safeguards.

In assessing these issues, the panel began by noting that the parties agreed that "the point in time at which developments should have been unforeseen is that of the completion of the Uruguay Round."<sup>66</sup> The panel allowed that the Asian financial crisis could constitute an unforeseen development "since it took place after the United States last negotiated its tariff concessions on the steel products covered by the investigation."<sup>67</sup> The same was true of the consequences for the steel market of the dissolution of the Soviet Union, even though that process had begun prior to the end of the Uruguay Round. The ongoing strength of the U.S. economy and the U.S. dollar were harder to regard as unforeseeable, but the panel concluded that these factors were not viewed by the ITC as unforeseen developments in themselves, but simply circumstances that contributed to the increase in imports that resulted from the developments in Asia and the Soviet Union. Thus, the United States prevailed on the proposition that unforeseen developments had affected the steel market to some degree.

According to the text of GATT Article XIX, however, the unforeseen developments must produce increased imports that cause serious injury or threat. It was

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<sup>65</sup>Id. ¶10.40.

<sup>66</sup>Id. ¶10.74.

<sup>67</sup>Id. ¶10.80.

on this issue that the United States failed to persuade the panel, in part because the ITC findings of injury were all contained in the original ITC report rather than its supplemental report—at no time prior to its affirmative injury findings did the ITC identify the increased imports that had resulted from the unforeseen developments and analyze their impact on the domestic industry. Such analysis was required, according to the panel, for every line of steel products (every "industry") in which a safeguard measure was taken.<sup>68</sup> Instead, the ITC had simply asserted in its supplemental report, after the original injury findings had been made, that unforeseen developments had affected the steel market in a general way—as the panel stated, "in light of the complexity of the matter, a more sophisticated and detailed economic analysis was called for."<sup>69</sup>

*Analysis.* The panel's treatment of the unforeseen developments issue is helpful in suggesting how to operationalize this requirement in practice, but at the same time underscores that it is a potentially severe hurdle for any nation that seeks to employ safeguard measures. As to the questions posed earlier in this essay—unforeseen by whom? at what point in time?—the panel suggests that the relevant actors are trade negotiators, and that the relevant time is the point when the member seeking to use safeguards "last negotiated its tariff concessions on the...products covered by the investigation." The end of the Uruguay Round may be taken to have "reset the clock" on this latter issue, as GATT members formally withdrew from their old GATT obligations at the end of the Round and entered a new (WTO) treaty, even if the tariff bindings on many products did not change.

In deciding whether events were "unforeseen" by the negotiators at the relevant time, the focus in the first instance will be on whether the events in question took place before or after the conclusion of the negotiations. One can thus imagine the rules here

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<sup>68</sup>Id. ¶ 10.128.

<sup>69</sup>Id. ¶0.125.

evolving in a manner that is roughly consistent with the rules in nonviolation cases—a presumption might arise that negotiators foresee the results of events that take place before the conclusion of negotiations, and do not foresee the results of events that take place later.<sup>70</sup> As tariffs decline to minimal levels and more and more time passes since the last concession, the set of "unforeseen" events will presumably expand and unforeseen developments should become easier to identify.

But the requirement of linkage between unforeseen developments and particular import increases, and the further requirement that these imports be linked to serious injury or threat, pose substantial analytical challenges. It is hardly clear what sort of "more sophisticated and detailed economic analysis" will suffice. Consider the steel case itself: By the panel's reasoning, the United States should have ascertained precisely how much U.S. imports had increased, in each of twenty-seven steel "industries," as a result of the Asian financial crisis and the drop in demand for steel inside the old Soviet Union. It should then have analyzed whether this increase caused or threatened to cause serious injury to the relevant industry (as well as provide a convincing "nonattribution" analysis, discussed further below). On the surface, such an analysis seems to call for a global general equilibrium model of each segment of the steel market, so that the effect of events in particular overseas markets such as Asia and the former Soviet Union can be simulated with precision. If that sort of analysis is indeed required, the time and expense involved could be enormous. The accuracy of such exercises is also subject to considerable doubt because the results often turn on controversial assumptions. And for many industries, the data necessary to estimate the parameters for such models will be lacking, and modelers would have little choice but to fall back on simulations that rest on seat of the pants guesses about relevant supply and demand elasticities, cross-elasticities of demand, and the like. The potential boon for consulting economists is readily

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<sup>70</sup>See Japan -- Measures Affecting Consumer Photographic Film and Paper, WT/DS44/R (1998), ¶10.79.

apparent, but one must harbor no illusions that the task of undertaking such analysis is straightforward—if done properly, it is expensive, time-consuming, and inevitably fraught with the potential for serious error. Perhaps a future reviewing panel would be satisfied with something less daunting (and thus less rigorous and even more error prone), but the question of what will suffice as a "reasoned and adequate explanation" of the linkage between unforeseen developments and injury remains unclear at best.

To be sure, the great virtue of requiring a linkage between unforeseen developments and injury, via the effect of unforeseen developments on import quantities, is that a coherent exogenous variable thereby resurfaces in the analysis—one asks not whether "increased imports" have caused injury in the abstract, but whether particular unforeseen developments have caused injury, via an effect on the relative competitive position of imported and domestic goods. The question that national authorities are asked to answer is once again economically intelligible, as it was at the outset of GATT.

The problem of "nonattribution" might also appear to become more tractable—one might say that as long as the unforeseen developments cause increased imports, in turn resulting in injury or threat, then by definition injury has not been "attributed" to any factor other than imports. The task of identifying the other factors to which import-related injury must not be "attributed," and of assessing their impact, could arguably be put to the side. Conceptual issues still remain, however, as to what is permitted to "count" as an unforeseen development. Imagine, for example, an "unforeseen" shock in the domestic market for inputs into steelmaking that raises the cost of steel production in the United States. U.S. steelmakers raise their prices to cover costs, and imports flood into the U.S. market to undercut the price increases and market shares of domestic firms. Such "increased imports" may surely be said to cause injury (relative to a counterfactual world in which the imports are not permitted to increase), and to result from the unforeseen developments in the domestic input market. But are safeguard measures appropriate when the root cause of injury is a shock in the domestic economy? Or would safeguards



to remedy such injury be impermissible because the injury caused by the domestic shock is wrongly "attributed" to imports? Nothing in the WTO decisions thus far afford much help with such matters, an issue about which I will say more below in connection with the "nonattribution" problem.

## *2. Increased Imports and the Baseline Question*

Taking its cue from earlier Appellate Body decisions, the panel held "that the use of the present tense in the verb phrase 'is being imported' in both Article 2.1 of the Agreement of Safeguards and Article XIX:(1)(A) of the GATT 1994 indicates that it is necessary for the competent authorities to examine recent imports and that the increase in imports was 'recent'."<sup>71</sup> Further, "the emergency nature of safeguard measures calls for an assessment of whether imports increased suddenly so that the situation became one of emergency."<sup>72</sup> And finally, "[i]n light of the Panel's above conclusion that the competent authority must have determined that imports increased suddenly and recently, the Panel will generally focus its analysis on the situation of imports in the more recent period that preceded the end of the period of investigation."<sup>73</sup>

The panel then proceeded to examine the data on import trends for each of the ten product categories covered by the challenged measures. In most instances, the panel generated a graph representing the import volume and market share data over the five-year period of investigation employed by the ITC. Because the panel's focus was on the "more recent period that preceded the end of the period of investigation," the graph for each product category says much about how the panel came out in each case. I reproduce four of the graphs below for purposes of illustration:

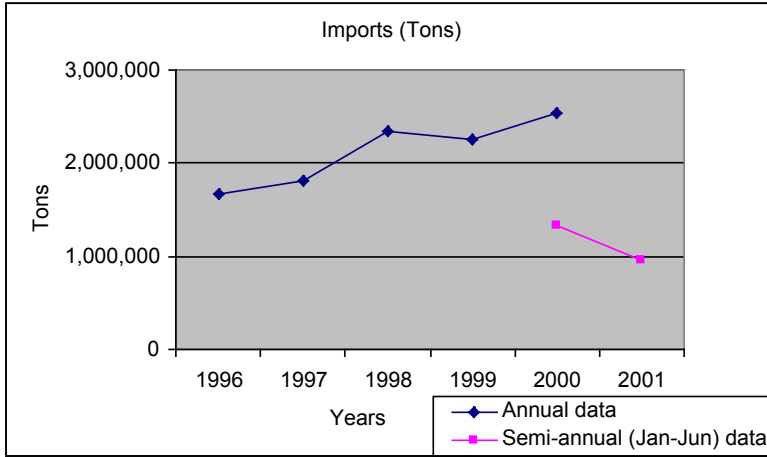
### HOT-ROLLED BAR

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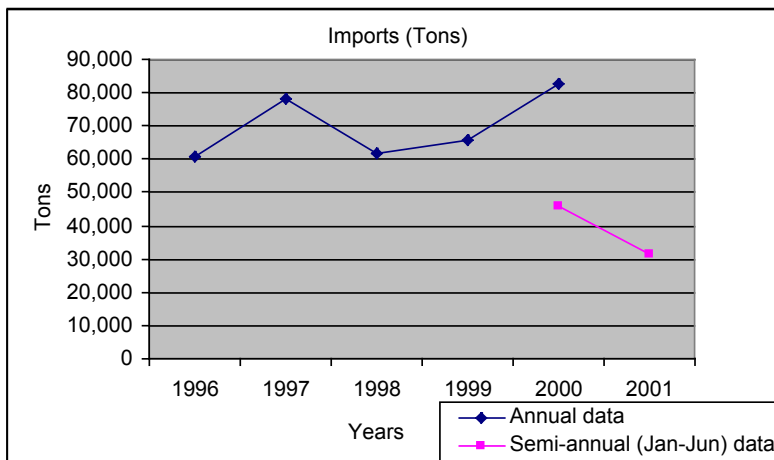
<sup>71</sup>Panel Rep. ¶10.159.

<sup>72</sup>Id. ¶10.166.

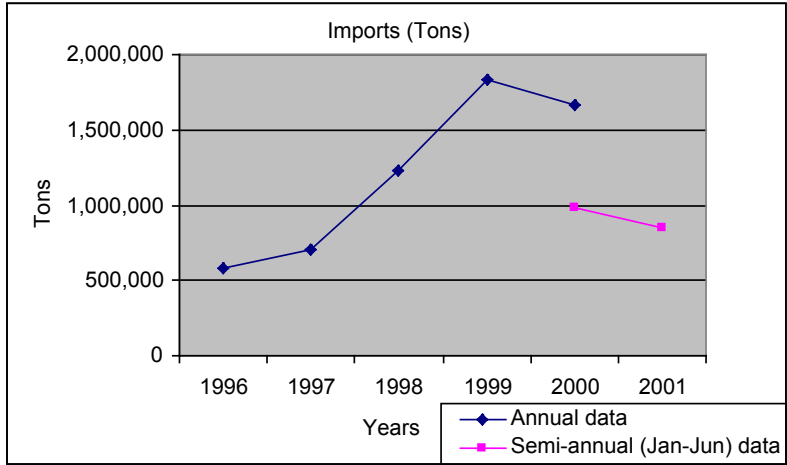
<sup>73</sup>Id. ¶ 10.175.



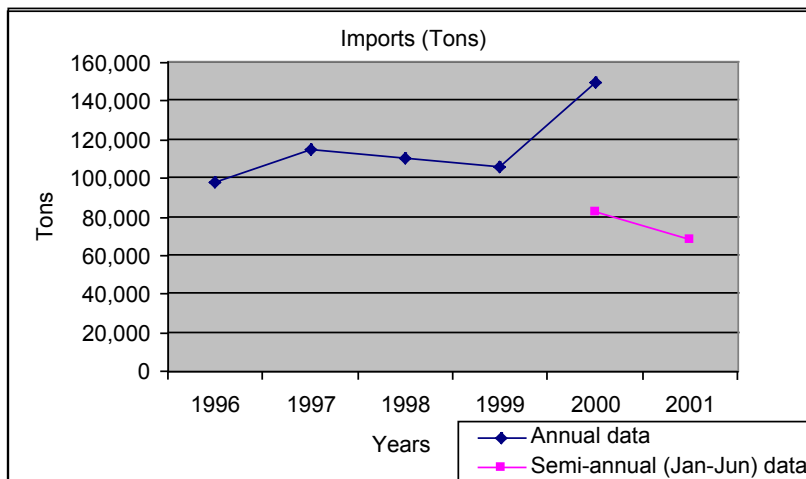
STAINLESS STEEL ROD



REBAR



## STAINLESS STEEL BAR



For both hot-rolled bar and stainless steel rod, the panel found that the ITC report did not contain a "reasoned and adequate" explanation of why imports had increased. Regarding hot-rolled bar, the panel focused on the ITC's "failure to account for the most recent data from interim 2001...The decrease from interim 2000 (1.34 million tons) to interim 2001 (952,392 tons) represented a decrease by 28.9%, whereas the increase in the year-to-year period before (1999 to 2000) that was characterized as "rapid and dramatic" was merely 11.9%. In light of this decrease in the most recent period, the Panel does not believe that the trend of imports from 1996 to 2000 (an increase by 52.5%) is sufficient to provide a basis for a finding that, at the moment of the determination, hot-rolled bar 'is being imported in such increased quantities.'"<sup>74</sup>

The analysis was similar in many respects for stainless steel rod. "The USITC relied on the increase occurring between 1996 and 2000, with the largest increase from 1999 to 2000 (25%). The decline between interim 2000 and interim 2001 was acknowledged, but the USITC did not give an explanation why it nevertheless found that there was an increase of imports in absolute numbers. This failure is particularly serious

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<sup>74</sup>Id. ¶10.205.

since this decrease (by 31.3%) was sharper than the preceding increase, and, as a matter of proportion, offset the increase of the two preceding years."<sup>75</sup>

For rebar, by contrast, the panel accepted the ITC finding of increased imports: "In light of the tripling of imports, the decrease over the last 18 months is not significant enough in order to stand in the way of a conclusion that rebar "is being imported in such increased quantities".<sup>76</sup> Likewise, as to stainless steel bar, the panel found that "in the light of the significant increase from 1999 to 2000 (19.3 percentage points), the decline by 3.3 percentage points from interim 2000 to interim 2001 is, contrary to what the European Communities has stated, insignificant. It simultaneously does not detract from a finding that imports, relative to domestic production, remain at high levels so that stainless steel bar 'is being imported in (such) increased quantities.'" <sup>77</sup>

For two product categories, tin mill products and stainless steel wire, the panel ruled that the United States failed to demonstrate the presence of increased imports because it had relied on the separate opinions of ITC Commissioners who had defined the relevant "industries" in different ways. For example, some treated "tin mill products" as a separate industry, while another included tin mill products in a broader industry. The panel was of the view that the separate findings reached in such fashion could not collectively constitute a "reasoned and adequate" explanation for the finding of increased imports.

*Analysis.* The panel's reasoning focused on two issues in each instance; whether imports had risen substantially over the entire period of investigation (the five-year period ordinarily used by the ITC as its baseline), and whether any *recent* downtrend in imports had undercut the finding of an overall increase. Implicitly, recent trends carry more weight than the five -year trend, but a modest recent decline in imports would not

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<sup>75</sup>Id. ¶10.267.

<sup>76</sup>Id. ¶10.225.

<sup>77</sup>Id. ¶10.254.

prevent a finding of increased imports if the five-year trend was more dramatically upward.

The panel's approach is at least somewhat puzzling. Having held earlier that the United States should have linked import increases to the Asian financial crisis and the dissolution of the Soviet Union, one might have expected the panel to suggest that the timing of those events defines the baseline for measuring the increase in imports. Instead, as under longstanding U.S. practice, the panel (and the complainants) seems to accept that the arbitrary five-year baseline is permissible in principle: "The complainants do not challenge the choice of a five-year period of investigation *per se*. Complainants rather disagree with the fact that, generally, the USITC did not focus sufficiently on the situation of imports in the latest part of the period of investigation."<sup>78</sup>

The great emphasis on the most recent year or months of data is peculiar in another respect. The time series for imports of any good may exhibit significant volatility for a variety of reasons, and the notion that WTO members would wish to condition the right to use safeguards heavily on the most recent import fluctuations, which may be quite unpredictable when an investigation is initiated, seems odd even if it has some arguable textual basis. The preamble to the Agreement on Safeguards emphasizes the importance of "structural adjustment," much as U.S. law has long set forth the alternative goals of promoting industrial competitiveness or facilitating an orderly industrial contraction.<sup>79</sup> If these stated goals are to be taken seriously, they concern measures to address long-term structural trends. Likewise, Article 7 of the Safeguards Agreement provides that safeguard measures may be imposed for four years, with the possibility of an extension to eight years. The potential duration of the measures is also suggestive of the notion that they address long-term trends in industrial competitiveness. If this is right, why should the opportunity to utilize safeguard measures turn critically on recent import

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<sup>78</sup>Id. ¶10.160.

<sup>79</sup>See 19 U.S.C. §2251(b).

fluctuations rather than long-term import trends? One wonders whether the panel here, and the Appellate Body generally, has turned the matter completely on its head.

### *3. Causation and the "Nonattribution" Problem*

The panel found fault with the ITC analysis of causation for nine of the ten "industries" covered by the U.S. safeguard measures. In each instance, it held that the ITC failed to demonstrate a causal link between increased imports and injury, that it failed to ensure that injury caused by other factors was not "attributed" to imports, or both.

#### *a. Demonstrating the Causal Link to Imports*

Again taking its cue from prior decisions, the panel suggested that a causal linkage between increased imports and injury might be established in one of two ways: through a "coincidence" analysis, or through an analysis of the conditions of competition. A coincidence analysis examines the "temporal relationship between the movements in imports and the movements in injury factors."<sup>80</sup> Such coincidence is "normally" evident "if causation is present,"<sup>81</sup> although the suggestion that a temporal lag may exist between import increases and injury "may have merit in certain cases."<sup>82</sup> Where a clear coincidence exists, "no further analysis is required of the competent authority," save for a careful nonattribution analysis.<sup>83</sup> Where coincidence is lacking or an analysis of coincidence has not been undertaken, the competent authority must explain its absence and must show causation convincingly through other means.

An analysis of the conditions of competition requires the competent authority to consider the factors enumerated in Article 4.2(a) of the Safeguards Agreement: changes in import volume, import market share, domestic sales, production, productivity, capacity utilization, profits and losses, and employment. Other unenumerated factors may also be

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<sup>80</sup>Panel Rep. ¶10.299.

<sup>81</sup>Id. §10.300.

<sup>82</sup>Id. ¶10.310.

<sup>83</sup>Id. ¶10.307.

relevant.<sup>84</sup> Further, "price...in the Panel's view, is an important, if not the most important, factor in analysing the conditions of competition in a particular market...we consider that relative price trends as between imports and domestic products will often be a good indicator of whether injury is being transmitted to the domestic industry...given that price changes have an immediate effect on profitability, all other things being equal."<sup>85</sup>

Against this backdrop, the panel proceeded to consider the analysis of the ITC as to each of the challenged measures. In the important category of certain carbon flat-rolled steel (CCFRS), for example, it found "that there was no coincidence between, on the one hand, import trends and the situation of the domestic industry of CCFRS, as reflected in data for production, net commercial sales, productivity and capacity utilization of the domestic CCFRS. We have also found that there was a lack of coincidence between import trends and declines in domestic operating margin...We did discern coincidence, albeit lagged, between increased imports, on the one hand, and employment, on the other hand...Having taken into consideration all of the foregoing, in the Panel's view, overall, coincidence did not exist."<sup>86</sup> "Given a lack of coincidence between import trends and the injury factors, it was for USITC to provide a compelling explanation as to why a causal link was considered, nevertheless, to exist."<sup>87</sup>

The ITC's analysis of the conditions of competition for CCFRS was then found deficient as well. The panel first suggested that the product category might be too broad for such an analysis to be undertaken at all in convincing fashion. Further, the ITC apparently relied heavily on evidence of import underselling and downward price trends for both imports and domestic products for two sub-products in the CCFRS category, without explaining "why pricing data for the other three items that constituted CCFRS were not specifically considered." And, "while some of the domestically produced

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<sup>84</sup>Id. §10.318.

<sup>85</sup>Id. ¶10.320.

<sup>86</sup>Id. ¶¶10.374-75.

<sup>87</sup>Id. ¶10.376.



constituent items were undersold by the import counterparts at particular points during the period of investigation, this was not necessarily the case for the entire period of investigation."<sup>88</sup> Thus, the conditions of competition analysis failed to support the existence of a causal link between increased imports and injury.

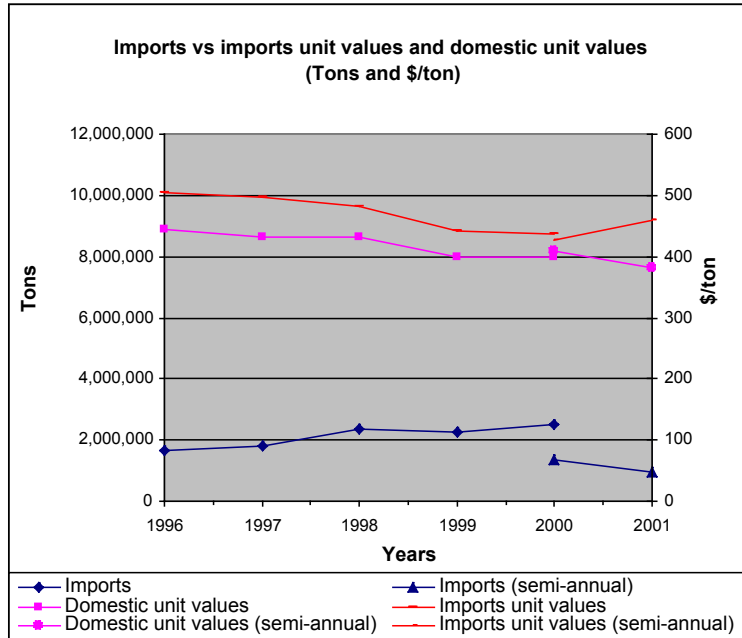
As to other product lines, the panel found the ITC's analysis more convincing. For fittings, flanges and tool joints (FFTJ), the panel examined the relation between imports and indicators of injury, and noted that "clear coincidence exists between the upward trend in imports and the downward trend in the injury factors, except for productivity." Because the ITC report had not analyzed this coincidence in detail, however, the panel also found that a conditions of competition analysis was required to support the ITC's finding of a causal link.<sup>89</sup> In that regard, the panel reviewed data assembled by the ITC showing that imported products significantly undersold domestic products during the period of investigation, and on that basis concluded that the conditions of competition analysis supported the existence of a causal link.

In the case of hot-rolled bar, the panel noted that the ITC had not undertaken a coincidence analysis. But as part of its analysis of the conditions of competition, the ITC assembled data on market penetration by imports along with import and domestic prices. The data were presented in the following graph:

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<sup>88</sup>Id. ¶10.379.

<sup>89</sup>Id. ¶10.516.



Based on these data, the panel concurred that a causal link was present—"[t]he USITC explained that domestic prices declined in an effort to mitigate the erosion of market share....On the basis of the foregoing, overall, we find that the USITC's conditions of competition analysis was compelling."<sup>90</sup>

*Analysis.* It would be unfair to fault the panel for following the analytic lead of the Appellate Body and the ITC, but in doing so it followed them to the land of economic gibberish. The panel insists that the linchpin in the search for *causation* is a search for *coincidence*. The irony of that phrasing is glaring—the Random House English dictionary defines "coincidence" as "a striking occurrence of two or more events at one time apparently by mere chance." The most elementary statistics class teaches that correlation is not causation, and the problem is not ameliorated by relabeling correlation as coincidence.

Further, as explained earlier, the problem is actually much more fundamental. It is not disreputable to examine correlation as an aid to an exploration of causation with appropriate caveats. But one can only do so when one variable is a logical candidate for

<sup>90</sup>Id. ¶¶10.429-30.

the cause of the other. Import quantities do not *cause* anything—they are simultaneously determined along with prices, domestic output, domestic employment, and so on. It makes no more sense to say that increased imports caused a decline in domestic production, for example, than to say the exact opposite.

The "conditions of competition" analysis that serves as an alternative to coincidence analysis is no more comforting. To the extent that the panel, like the ITC, finds evidence of import "underselling" to be persuasive evidence of causation, an economist would respond that persistent underselling by imports is simply evidence that they are of lower perceived quality for some reason. It says nothing about a causal link between anything and anything else. Likewise, to the degree that a high degree of correlation exists between the price series for imported and domestic goods, that fact is some evidence that the goods are reasonably close substitutes in consumption. Again, no inference of "causation" is supported, as indeed there is no intelligible causal variable under examination.

To be sure, cases will arise in which "coincidence" is relatively stronger or weaker. Cases will arise in which imported goods undersell domestic goods, and many cases will arise in which import and domestic price trends are highly correlated. It will thus be possible for importing nations to demonstrate "causation" with some regularity using the tests that the panel applies. But if any relationship exists between that set of cases, and the set of cases in which safeguard measures are appropriate on some principled basis, it will arise only by "coincidence."

*b. The Nonattribution Problem*

Following the lead of the Appellate Body, the panel makes clear that the presence of a "causal link" between imports and injury, established as above, is not enough to satisfy the requirements of the Safeguards Agreement. If other factors have also contributed to injury, the "competent authorities must separate and distinguish the

injurious effect of the increased imports from the injurious effects of the other factors."<sup>91</sup> This exercise is required even though imports need not be solely responsible for injury, but must merely have contributed to it. A proper nonattribution analysis also determines the permissible scope of the safeguard remedy—the Appellate Body had ruled in *United States—Line Pipe* that safeguard measures may only remedy the injury attributable to increased imports, not that attributable to other factors.<sup>92</sup>

For a number of product lines, the panel found the ITC's nonattribution analysis to be lacking. The panel's approach, as in previous cases, was simply to accept at face value the "other factors" put forth by the respondents at the ITC, with no discussion as to how or why they are appropriate or inappropriate. The panel would then check to see whether the ITC had confidently distinguished the injury attributable to the factor in question, and ensured that such injury was not attributed to imports.

I offer one illustrative example of the analysis: In the case of hot-rolled bar, as noted above, the panel accepted the ITC's analysis of the conditions of competition as a basis for finding a causal link between increased imports and injury. But the respondents argued before the ITC that injury was caused, *inter alia*, by increased input costs for domestic producers, what the panel termed increases in the costs of goods sold (COGS). The ITC acknowledged that COGS had risen during part of the period of investigation, but argued that import competition had suppressed prices and prevented domestic firms from recouping their higher costs. On that basis, the ITC concluded that imports were the more important cause of injury. The panel evidently considered this analysis too cursory, thus falling short of a "reasoned and adequate" explanation. The panel hinted, however, that if the ITC had gone further in its analysis, it might have been able to defend its conclusion. In particular, the panel noted that there was a general lack of "coincidence" between changes in COGS and operating margins for domestic producers. Had changes

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<sup>91</sup>Id. ¶10.329.

<sup>92</sup>Id. ¶10.338.

in COGS "played a significant role in the situation of the domestic industry, one would have expected operating margins to increase while COGS was decreasing."<sup>93</sup>

*Analysis.* The panel's discussion of the nonattribution requirement suffers from the same logical flaws as the treatment of the issue in prior cases. Its analysis of the COGS factor for hot-rolled bar illustrates the fundamental problem. An increase in input costs for domestic firms will lead them to institute price increases if they can. But, as may have been the case in the hot-rolled bar market, import competition may prevent such price increases. The price increases that are attempted by domestic firms, caused by rising input prices, may thus be the *cause* of greater import volumes, which restrain price increases and leave domestic firms in a weakened financial situation.

The panel insists, however, that the injury attributed to rising COGS must be distinguished from the injury attributed to imports. As the above discussion makes clear, this task is **logically impossible**. The imports themselves result from increases in COGS, and so how can the effects of the two possibly be distinguished? Putting it differently, the causal variable in this scenario is an increase in domestic input costs. The *result* is both an increase in imports, and a weakened financial situation for domestic firms. For the same reason, the proposition that a permissible safeguard measure can address the injury caused by increased imports, but not the injury caused by rising COGS, is also fundamentally incoherent.

The panel's suggestion that one can analyze the importance of COGS by looking at the coincidence between changes in COGS and operating margins is silly. Other things being equal, increases in COGS will surely tend to lower operating margins, but many other factors in the market are variable over time, and the absence of a "coincidence" between changes in COGS and operating margins simply indicates that other things are happening simultaneously—a clear demonstration of why "coincidence" and causation are two different things. Obviously, the presence of other factors varying simultaneously

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<sup>93</sup>Id. ¶10.440.

cannot negate the fact that increases in input costs, other things being equal, are disadvantageous for domestic producers.

The ultimate issue here is a simple one—should safeguard measures be permitted when the cause of injury to a domestic industry, and the cause of rising imports, is a shock to the cost structure of domestic firms? There may be good reasons to answer this question yes or no, but the analysis of the panel merely masks and confuses it.

#### *4. Parallelism*

The "parallelism" requirement stems from the decision in *Argentina—Footwear*. The Appellate Body there held that a correspondence must exist between the imports included in the analysis that led to the injury determination, and the imports covered by the safeguard measure.<sup>94</sup> Thus, for example, if imports from Canada were part of the data on which the injury finding rests, imports from Canada cannot be exempted from any subsequent safeguards remedy.

The legal basis for the parallelism requirement is shaky. In a recent article in this journal, Joost Pauwelyn criticizes it and argues forcefully that the real issue is whether Article XXIV of GATT, pertaining to the formation of customs unions and free trade areas, either requires or permits members of such entities to exempt imports from other members from safeguard measures.<sup>95</sup> This question thus far has no clear answer—for a thoughtful discussion of the issues I refer the reader to Pauwelyn's article.

Whatever its merits, the parallelism requirement is established in the cases, and the United States undertook to argue that it had complied. The original ITC determination had aggregated imports from all sources, however, while the eventual safeguard measures had largely excluded imports from NAFTA countries, Israel and Jordan. The ITC was asked to revise its analysis to exclude these imports in its supplemental report to USTR. It did so, and reached the same conclusions for each industry.

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<sup>94</sup>Id. ¶10.590-91.

<sup>95</sup>Joost Pauwelyn, *The Puzzle of WTO Safeguards and Regional Trade Agreements*, 7 J. Int'l Econ. L. 109 (2004)

The panel took issue with the analysis for several reasons. In several instances, the ITC had not made clear that it had properly excluded imports from Israel and Jordan in its revised analysis. The ITC also failed to explain to the panel's satisfaction why its findings remained the same despite the fact that a smaller quantity of imports was involved after the parallelism adjustments. In addition, the panel held that the ITC was obliged to repeat its nonattribution analysis based on the revised import totals, and that it had failed to do so in the supplemental report.

*Analysis.* In the interest of parallelism, the panel would have the ITC revise its import data, and then undertake the same conceptually flawed analyses of coincidence, conditions of competition, and nonattribution. The excluded imports would become an “other factor” to which injury from the included imports could not be attributed. Such exercises are no more valuable with the revised data than with the original.

It is also somewhat peculiar that neither the panel nor the prior pertinent decisions draw any connection between the parallelism issue and the unforeseen developments issue. If the United States is obliged by Article XIX to draw a connection between injury and developments in Asia and the former Soviet Union, is it not possible that such injury was transmitted through an effect on imports from particular sources, rather than an effect on all imports or on world prices? Does the answer to that question have any implications for the permissible scope of the safeguard remedy, or for the possible exclusion of imports from particular sources?

Were the parallelism issue to be approached in an economically intelligible fashion, either the hypothetical quota approach to injury analysis set out in Section I.C above, or the import supply curve approach to injury analysis, could be employed to inquire whether developments relating to some subset of import suppliers had caused injury. Such an inquiry would further increase the complexity of the economic analysis required in these cases, but is at least possible in principle. Until a logically sound approach to the question of causation is articulated by the Appellate Body or in a

renegotiated Safeguards Agreement, however, the requirement of parallelism is just a sideshow.

### **C. The Appellate Body Decision**

The Appellate Body affirmed the panel in most pertinent respects, or exercised judicial economy to avoid reaching the issues raised.<sup>96</sup> With respect to the unforeseen developments issue, it concurred with the panel that a member proposing to invoke safeguards must demonstrate that unforeseen developments led to increased imports for each “industry” covered by a safeguard measure.<sup>97</sup> It likewise concurred that the ITC had failed to make such a showing with a “reasoned and adequate” explanation.<sup>98</sup>

On the question of increased imports, the Appellate Body concurred with the panel’s findings on particular products to the extent that they were challenged by the United States, with two exceptions. With regard to tin mill products and stainless steel wire, the Appellate Body disagreed with the panel that the findings of different Commissioners, who had defined the industries in varying ways, could not individually or collectively suffice as a “reasoned and adequate” explanation for a finding of increased imports.<sup>99</sup> Thus, the panel was reversed for failing to consider the matter further, although it was unnecessary for the Appellate Body to complete the panel’s analysis because it found the safeguard measures for tin mill products and stainless steel wire to be illegal on other grounds.<sup>100</sup>

Regarding the parallelism issue, the Appellate Body agreed with the panel that the ITC had not shown that it had properly excluded imports from Canada, Mexico, Israel and Jordan in reaching its findings. It emphasized especially that the ITC had not

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<sup>96</sup> 96United States -- Definitive Safeguard Measures on Imports of Certain Steel Products, WT/DS248-49, 251-54, 258-59/AB/R (November 2003) (hereafter App. Body Rep.).

<sup>97</sup> Id. ¶319.

<sup>98</sup> Id. ¶ 326.

<sup>99</sup> Id. ¶¶416, 429.

<sup>100</sup> Id. ¶431.



considered the excluded imports as an “other factor” in a proper nonattribution analysis.<sup>101</sup>

Finally, because its rulings on the unforeseen developments, increased imports and parallelism issues sufficed for finding that each of the ten challenged measures violated WTO law, the Appellate Body declined to consider the panel’s analysis of the causation issue.

*Analysis.* Unlike its prior rulings in the Safeguards area, the Appellate Body ruling in the steel dispute broke little new ground. To the extent that any important new law was made, it consisted of affirming the reasoning of the panel on certain key points that have already been discussed extensively above. Nothing in the opinion resolves any of the conundrums raised by prior Appellate Body decisions.

What emerges from the steel dispute is a renewed sense of how difficult it will be for WTO members to use safeguards going forward without a prospect of near certain defeat when a complaint is brought against them. Members must demonstrate the existence of unanticipated developments, persuade that they were “unforeseen,” convincingly trace their impact on increased imports, demonstrate that much of the import surge is sufficiently “recent,” convincingly show the relation between the imports and serious injury, and convincingly show that “other factors” have not caused the injury attributed to increased imports (in some cases a logical impossibility for the reasons discussed above), all in a way that will stand up to analytic quibbles on review. And let us not forget the issues that neither the panel nor the Appellate Body chose to reach—the challenges brought by complainants regarding the existence of serious injury and the definition of “industry” for purposes of the injury analysis. In the face of all these hurdles to the opportunity to employ safeguards, one might hope for some clear guidance as to what is required to pass muster on each of them. Instead, the decisions to date—including

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<sup>101</sup> Id. ¶¶456.

those in the steel case—simply find that the analysis of national authorities is not “reasoned and adequate,” without saying what alternative reasoning will suffice.

The opinions hint, although do not state explicitly, that nothing short of sophisticated economic modeling for every relevant “industry” will be required to distinguish the effects of the various factors in play in each case. Yet, even where the construction of such models is feasible given cost and data considerations, they cannot by themselves address the fundamental task of separating the effect of “imports” from the effect of “other factors.” Until law is made as to what economic forces fall into each category, even the most sophisticated style of economic analysis cannot go forward—the questions to be answered have simply not been posed intelligibly.

### **Conclusion**

In the absence of any coherent standards as to when safeguard measure are permissible, it is unrealistic to expect WTO members to produce a “reasoned and adequate explanation” as to how their measures are in compliance with the law. It should come as no surprise that every measure brought before the WTO has been struck down in this environment, and one is at a loss as to how to advise member nations to fix the problem. It will also come as no surprise if WTO members eventually throw up their hands and revert to extra-legal alternatives. Absent a thorough renegotiation of the Safeguards Agreement, perhaps the only way out of the current predicament is for the Appellate Body to take the lead in fashioning a sensible common law of safeguards, drawing on nontextual ideas about their proper role in the WTO system. In my prior writings on the subject, I suggest some possible directions for such nontextual theorizing.

<sup>102</sup> Whether or not those suggestions are persuasive, the steel dispute, like its predecessors in the safeguards area, makes clear how further guidance is absolutely

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<sup>102</sup>See especially Alan O. Sykes, *The Safeguards Mess: A Critique of Appellate Body Jurisprudence*, 2 *World Trade Rev.* \_\_\_ (2003).

essential on a number of issues if WTO-legal safeguard measures are to play any role in the world trading system.

I close with a return to the normative agnosticism of the introduction. To those who see safeguard measures as no more than wasteful protectionism for declining industries, many of which (such as the U.S. steel industry) have already been to the well quite often, insurmountable legal impediments to safeguards may seem welcome. But the systemic consequences of eliminating safeguards as a viable option may be less benign than this view suggests. The political pressures to protect troubled industries through trade policy will remain regardless of the state of the law, as will their potential to cause mischief.

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