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The Safeguards Mess: A Critique of WTO Jurisprudence

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The tariffs imposed by the United States on steel imports last year, and the pending challenges to them before the World Trade Organization (WTO), have brought a great deal of publicity to a subject that had already been a subject of considerable litigation within the WTO system—"safeguard measures." Such measures are taken pursuant to 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. During the Uruguay Round of GATT negotiations which led to the formation of the WTO, the obligations of Article XIX were refined and elaborated in the WTO Agreement on Safeguards.

Article XIX and the Agreement on Safeguards raise many conceptual and interpretive issues. Such issues received little attention during the long history of GATT because safeguard measures were rarely challenged, in part because they fell into disuse. The advent of the WTO has revived the use of safeguard measures, however, and numerous disputes involving them have now been brought before the WTO resulting in a number of important decisions.

I argue in this easy that the safeguards decisions to date by the WTO Appellate Body have failed to articulate any coherent doctrine as to when safeguard measures are allowable. Rather than providing useful guidance for the resolution of textual conundrums, they make it increasingly difficult for WTO members to employ safeguard measures at all. Every safeguards measure that has been challenged has been ruled to be a violation of WTO law, and there is no end in sight to this string of adverse rulings. If the WTO continues on its present course, considerable pressure may develop for a return to "extra-legal" measures such as voluntary restraint agreements, measures that the WTO Agreement on Safeguards sought to eliminate.

One can wonder whether these developments are a good thing or a bad thing. On one view, safeguard measures are simply inefficient protectionism, and any impediments to their use should be welcomed. The alternative view is that the opportunity to use safeguard measures provides important political cover to trade negotiators, who will be more reluctant to make trade concessions unless safeguard measures or some reasonably close substitute are available. Further, if formal safeguards actions become impractical because of legal impediments, WTO members may return to extra-legal alternatives, and all discipline over their magnitude and duration of protection for troubled industries will be lost. I remain agnostic as between these two points of view, but the second must certainly be taken seriously.

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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 the WTO decisions to date interpreting key provisions of law, and indicate how they routinely condemn challenged safeguard measures while offering precious little guidance to WTO members as to what the law requires.

Section III concludes with a look at the positive economics of safeguard measures, and considers the question whether economic reasoning can shed any light on the proper way forward. It argues (as have many others) that safeguards in the WTO system are not "efficient" in the usual sense of the term, and that efforts to interpret safeguards rules in accordance with conventional welfare economics are doomed to failure. Likewise, safeguards policy cannot be understood as an intelligible means for compensating the "losers" from trade liberalization. Instead, safeguards should be understood as a mechanism for the reimposition of temporary protection when commitments to liberal trade impose unexpectedly severe political burdens on officials in importing nations, and when temporary protection will impose comparatively modest political costs on trading partners. This perspective suggests some general guidance as to when safeguards should be permitted that can resolve some of the textual uncertainties that the Appellate Body has failed to address.

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

The original authority for the use of safeguard measures in product markets is found in Article XIX of the GATT. Paragraph one 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 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."

Paragraphs two and three of Article XIX further provide that a party invoking its right to suspend or modify concessions must negotiate with adversely affected parties over compensation in the form of alternative trade concession(s). If these negotiations are unsuccessful, paragraph three allows the safeguards measure to be taken nonetheless, but permits adversely affected trading partners to suspend "substantially equivalent concessions" in response.

For reasons that I will explain below, important aspects of GATT Article XIX became outmoded as the GATT system evolved, and GATT practice over the years rendered its first clause a nullity. Stripped of its first clause, however, the legal predicate for safeguard measures in Article XIX(1) became incoherent. Later, formal reliance on

Article XIX became unpopular, and various extra-legal measures became predominant. In response to this development, WTO members entered the Agreement on Safeguards. That Agreement did much to address the growth of extra-legal measures, but failed to resolve fundamental conceptual problems that had arisen under GATT and that continue to plague WTO members who wish to use safeguards.

A. Article XIX and Its Unplanned Obsolescence

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.

1. Article XIX(1) in Historical Context

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.[1]

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 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

[1]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].

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).[2] 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[3] of serious injury, or the threat thereof."[4] 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 immediately apparent, the absence of this "anchor" for the remainder of Article XIX(1) creates other problems.

2. 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."

[2] See Edmond McGovern, International Trade Regulation 2d ed. §10.211 at 291 (London: Gobefield 1986).

[3] 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).

[4] 19 U.S.C. § 2252(b)(1)(A).

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 quantity of imports will be determined by the forces of supply and demand, just like price and domestic production. 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.

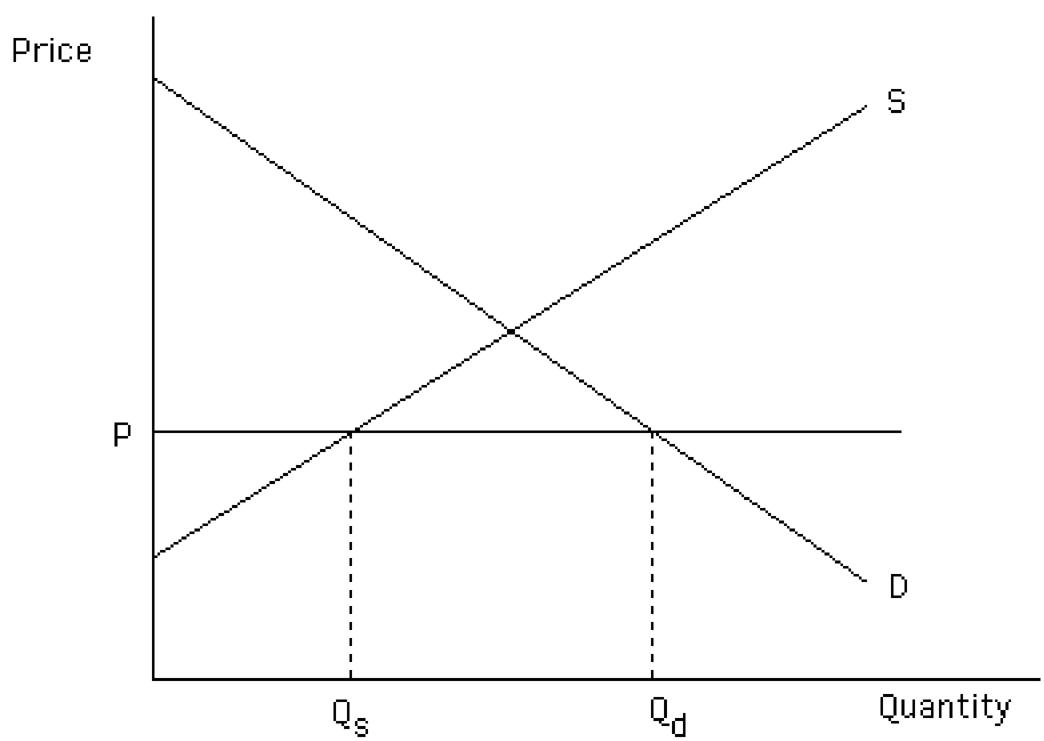

Figure A

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 <u>result</u> of the interaction of these forces; it is not a causal variable at all.

Likewise, changes in the quantity of imports will be the <u>result</u> 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 any intelligible sense of the term "cause." By hypothesis, what has changed are the costs of domestic firms, and that change <u>results</u> 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.

B. 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,[5] 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

[5] Sales No. GATT/1951-3 (Nov. 1951).

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 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.[6] 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.[7] Still others emphasized the importance of routinizing the baseline, and tended toward a somewhat arbitrary rule of thumb.[8] 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.[9] "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.[10] 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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[6]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).

[7]Id. (views of Commissioner Minchew).

[8]Id. (views of Commissioner Ablondi).

[9]Jackson, Davey & Sykes at 611.

[10]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.[11]

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 = 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 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.[12]

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

[11]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).

[12]For a recent illustration, see U.S. International Trade Commission, Lamb Meat, Inv. No. TA-201-68, Pub. No. 3176 (1999).

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 (1987) 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 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.[13]

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

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[13]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.

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 (1986) and Kelly (1988). 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.[14] 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.[15]

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 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.

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 asses 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 <u>not</u> 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

[14] See U.S. International Trade Commission, Wood Shakes and Shingles, Inv. No. TA-201-56, Pub. No. 1826 (1986)(views of Commissioners Liebeler and Brunsdale).

[15] A more detailed explanation of this approach may be found in Kelly (1988).

two approaches to causation analysis, as it is altogether unclear what "counts" as a cause other than imports.[16]

4. The Rise of Extra-Legal Measures

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." I will use the former term here for ease of exposition.

One drawback of formal safeguard measures from the perspective of an importing nation was the "compensation" requirement of Article XIX. A nation invoking Article XIX had to choose between compensatory trade concessions to affected trading partners and the retaliatory suspension of "substantially 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 response to a safeguards petition in 1984. They were extended through 1992.

[16]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.

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.[17]

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

C. 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.[19]

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 extra-legal 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."[20] 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

[17]For historical discussion see Jackson, Davey & Sykes, pp. 400-02.

[18]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).

[19]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.

[20]Safeguards Agreement, Art. 8(1).

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.

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.”[21]

These elements of the new Agreement do much to address the problem of extra-legal 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.”[22] 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...
>
> 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

[21]Id. Art. 7.
[22]Id. Art. 2(1).

> 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 begun to find their way into WTO disputes.

II. Safeguards in Appellate Body Jurisprudence: A Policy At Sea

I now turn to an examination of the WTO decisions on safeguard measures to date, 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 non-textual 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, however, the Appellate Body took a different tack. Korea—Definitive Safeguard Measure on Imports of Certain Dairy Products, WT/DS98/AB/R (1999) 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." Id. ¶80. 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]it 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 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." Id. ¶84. 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." Id. ¶89. This line of reasoning was repeated by the Appellate Body in Argentina-- Safeguard Measures on Imports of Footwear, WT/DS121/AB/R (1999), 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—Safeguard Measures on Imports of Fresh, Chilled or Frozen Lamb Meat from New Zealand and Australia WT/DS178/AB/R (2001), 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. Id. ¶73.

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, one can certainly doubt that the drafters of the Uruguay Round Agreements had any intention of reviving the obligation—had they wished to alter established GATT practice in this respect, 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 at least undertake 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 ensures that this requirement will 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 <u>Argentina-- Safeguard Measures on Imports of Footwear</u>, WT/DS121/AB/R (1999), 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." Id. ¶130. 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." Id. ¶130. "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 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'." Id. ¶131.

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 useless. 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 <u>result</u> 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 discuss one or more of these factors in its official report on safeguard action. See <u>Argentina-- Safeguard Measures on Imports of Footwear</u>, WT/DS121/AB/R (1999), ¶121. 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. See <u>United States—Definitive Safeguard Measures on Imports of Wheat Gluten from the European Communities</u> WT/DS166/AB/R (2001), ¶55.

Otherwise, the Appellate Body has simply insisted that serious injury represents "significant overall impairment" as stated in Article 4.1 of the Safeguards Agreement.[23] It characterizes this standard as "high" and "exacting." United States—Safeguard Measures on Imports of Fresh, Chilled or Frozen Lamb Meat from New Zealand and Australia WT/DS178/AB/R (2001), ¶124. 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.'" Argentina-- Safeguard Measures on Imports of Footwear, WT/DS121/AB/R (1999), ¶139.

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. None of them, however, provides a clear answers to the conceptual difficulties identified in Section I.

Argentina—Safeguard Measures on Imports of Footwear, WT/DS121/AB/R (1999) 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." Id. ¶141. 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." Id. ¶144.

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.

[23] 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.

The other Appellate Body opinions on causal analysis focus principally on the so-called "non-attribution 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 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." 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.

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' "non-attribution analysis" on multiple occasions. In United States—Definitive Safeguard Measures on Imports of Wheat Gluten from the European Communities WT/DS166/AB/R (2001), 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. Id. ¶¶81, 84.

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 increased volume of imports. Id. ¶85. 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. Id. ¶86. 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. Id. ¶ 91.

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. Id. ¶87. 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 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." Id. ¶88. 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—Safeguard Measures on Imports of Fresh, Chilled or Frozen Lamb Meat from New Zealand and Australia WT/DS178/AB/R (2001) 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." Id. at ¶182, n. 57. 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. 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." Id. ¶181. 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—Definitive Safeguard Measures on Imports of Circular Welded Carbon Quality Line Pipe from Korea, WT/DS202/AB/R (2001), 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." Id. ¶220.

In sum, the Appellate Body decisions to date on 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 "non-attribution 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 "other factor." In other words, the Appellate Body offers no coherent guidance 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.

E. The Larger Picture

Putting the legal details to one side for the moment, it is important to focus on the fundamental problem: neither Article XIX nor the Safeguards Agreement offer a coherent foundation for safeguard measures. The Appellate Body has consistently emphasized fidelity to text in its decisions, but that approach simply cannot work when the text is so fundamentally deficient. Once recent trade concessions are eliminated as the "exogenous variable" for purposes of analysis, there is no obvious candidate to take their place. "Increased imports" are an unacceptable replacement in particular, as they are in fact endogenous and result from any number of developments that may or may not be a sensible predicate for safeguards.

In the absence of any coherent theory as to when safeguards should be allowed, it is absurd 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 non-textual ideas about their proper role in the WTO system. To this end, the next section offers some thoughts that may be pertinent.

III. The Positive Economics of Safeguards Measures and Its Implications

Having criticized the Appellate Body for its failure to provide sensible guidance for the use of safeguards, I now turn to the considerably harder task of offering some guidance myself. I will stipulate that the analysis is somewhat speculative and may ultimately rest on premises that others find unacceptable, but it is the sort of exercise that cannot be avoided if a rational safeguards regime is to evolve.

I suggested earlier that the situation confronting WTO members in their use of safeguards is somewhat analogous to the early days of American antitrust—a statute existed on the books, but it was so vague that it befell the courts to make sense of it and to give it meaningful content through the years. After a long evolution, American antitrust policy has largely yielded to the "Chicago School" argument that it should promote economic efficiency, a principle that now pervades judicial opinions and decisions by enforcement authorities.

Unfortunately, any efforts to pursue the same end in the safeguards area would be at best problematic. Safeguards measures involve the imposition of trade protection for industries that have difficulty competing with their foreign counterparts.[24] They delay the contraction of industries in which comparative advantage is lacking, reducing the gains from trade and the overall prosperity of the trading community. Viewed narrowly, such protection is surely a source of economic inefficiency.

From a <u>normative</u> economic standpoint, therefore, it is tempting to say that safeguard measures are undesirable. The gains from trade will be larger and, *a fortiori,* the distortions that result from the protection of inefficient industries will be smaller, when troubled industries are allowed to contract at a rate dictated by the market in the face of more efficient foreign competition. If this observation is correct, however, a puzzle arises from a <u>positive</u> economic standpoint—why does the WTO system provide for safeguard measures if they are undesirable? Put differently, if trade negotiators are able to reduce ordinary tariffs and quotas through reciprocal commitments, why have they not also agreed to eliminate inefficient safeguards actions to protect troubled industries?

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[24]For now, I will put to the side the possibility that nations imposing safeguards measures will "compensate" affected trading partners by lowering other trade barriers at the same time, or that affected trading partners may "retaliate" by raising trade barriers of their own. Plainly, the overall welfare economics of safeguards actions turns importantly on whether they are accompanied by other such changes in the trade policies of WTO members. Note that the WTO Safeguards Agreement encourages but does not clearly require compensation, and affords no authority for retaliation during the first three years of safeguards measures if they meet certain conditions. See WTO Safeguards Agreement, Article 8.

Commentators have suggested three types of answers to this puzzle. One is the suggestion that safeguard measures can be justified as a device for compensating the "losers" from trade liberalization. Another is the suggestion that safeguard measures may be economically efficient after all, at least in a "second-best" sense, perhaps as a response to certain "adjustment costs" in declining industries. The third is the suggestion that safeguard measures serve a valuable political function even if they are unproductive from the standpoint of conventional welfare economics. I will briefly review these ideas in this section, and suggest that only the third is at all convincing. I then discuss its possible implications for the interpretation of WTO law.

A. Safeguards as "Compensation"

Economic commentators broadly agree that the case for free trade is compelling, but concede that the distributional consequences of trade liberalization are uneven. Some groups will benefit, and others will lose, even if the aggregate effect is positive. Putting it slightly differently, trade liberalization is efficient in the Kaldor-Hicks sense, but by itself is not a Pareto improvement. Accordingly, it is sometimes suggested that a mechanism for compensating some of the groups disadvantaged by trade concessions is required, and that safeguards may provide such a mechanism.[25]

I reject this theory as an explanation for safeguard measures in the WTO/GATT system on several grounds. First, trade protection is an extremely costly and clumsy device for compensating the "losers" from trade liberalization. To a great extent, it may simply line the pockets of diversified shareholders in protected industries, doing little for individuals whose job have been sacrificed for the broader public good. Targeted unemployment and retraining programs seem a much more tailored response, providing income and transition assistance to those who plausibly require it.

Second, and related, it is not clear that safeguard measures will "compensate" for trade-related dislocation in any meaningful sense. Depending on how they are implemented, they may simply postpone the burden of dislocation rather than reduce it—the discussion below of safeguards and the adjustment cost problem will have more to say about this issue.

Finally, it seems clear from the text of Article XIX that safeguards were not conceived as a general compensation mechanism. They were to be employed only when "unforeseen developments" led to import-related dislocation. In perhaps most cases, however, the dislocation associated with trade liberalization is quite expectable, and indeed it is the anticipated competitive advantage from trade concessions that leads exporters to encourage their political officials to secure better access to foreign markets. If distributional equity were the goal of safeguards, I can see no reason why measures to achieve it should be limited to the situations in which dislocation was unforeseen.

B. "Efficiency" Rationales for Safeguards

Restoring Competitiveness. Industries seeking protection in the form of safeguard measures rarely portray themselves as suffering an inevitable long-term decline. Rather,

[25]See Jackson, Davey & Sykes, at 611. See also Deardorff (1987).

they usually claim that they are viable industries besieged by foreign competition, and seek a respite to restore their "competitiveness." They commonly suggest that additional capital investments are needed to that end, and that a period of higher prices supported by trade protection is needed to permit them to raise the internal capital necessary for such investments.

Economists typically regard such arguments as highly suspect. If investments to restore competitiveness are really justified in the sense that they yield a positive net present value, why do the capital markets not finance them without any need for trade protection? Implicitly, the argument for protection to restore competitiveness rests on some capital market imperfection that interferes with the ability of firms to raise external capital, thereby necessitating an infusion of internal capital. It is not clear why such capital market imperfections should arise. Moreover, even if capital markets imperfections exist, the logical government response would not likely be protective tariffs or similar measures. A superior policy would be to subsidize borrowing by the firms in question, to the extent of removing any unjustified premium in the cost of capital to the industry—this policy would allow worthwhile investments to be financed through borrowing, without introducing the deadweight costs of protectionism. Finally, nothing in WTO law or national law on safeguard measures requires any demonstration of capital market imperfections as a predicate to them.

Accordingly, notwithstanding the rationale offered for safeguard measures by many of the industries that seek them, it is difficult to imagine that the function of safeguards in the WTO system is to address capital market imperfections that stand in the way of valuable investments to "restore competitiveness." In the main, industries that are declining due to import competition are inefficient, and an exit of resources from those industries is generally desirable. Any additional investments in such industries that are economically justified can and will be made without a period of trade protection.

Adjustment Costs. An "efficiency" rationale for safeguard measures that has received somewhat greater credence from economic commentators is the possibility that they may afford a sensible way to address "adjustment costs" in declining industries. This thesis is put forward recently in Horn and Mavroidis (2003), and to some degree by Sykes (1990). Horn and Mavroidis focus on the costs of unemployed factors of production (most notably labor), and suggest that measures to slow the pace of industry contraction may, under certain conditions, reduce these costs. They begin by acknowledging that nothing is gained by a safeguards measure that simply postpones the costs of adjustment without reducing them, incurring the economic costs of protectionism in the process. But it is possible to imagine that protection can reduce adjustment costs and not merely postpone them. As an example, they posit a declining industry in which 12,000 workers will lose their jobs each month. They further imagine that suitable positions for those workers will open up in another industry, but only at the rate of 6,000 per month. By slowing the rate of layoffs in the declining industry to 6,000 per month in this scenario, safeguard measures can avoid the unemployment that results when 12,000 laid-off workers a month have only 6,000 new jobs open to them.

Horn and Mavroidis concede that such problems will only arise under limited conditions. In particular, why do workers in the declining industry suffer unemployment if they have no alternative job opportunity, rather than taking whatever wage cuts are necessary for them to retain their positions? And if the supply of unemployed workers to other industries is greater than the demand at current wages, why do wages in other industries not fall to accommodate more hires? In a well-functioning labor market with wage flexibility, unemployment should reflect an efficient period of job search rather than an inefficient idling of resources. But there are reasons why wage adjustments may not clear the labor market efficiently. Horn and Mavroidis note the possibility that labor unions may resist wage cuts. Another possibility is that government safety net programs provide income subsidies that discourage workers from seeking new jobs as quickly as they might. One can perhaps imagine other reasons, and thus it is certainly possible in theory that industries may contract "too quickly" and that measures to slow the rate of contraction may be useful, other things being equal.

It would not necessarily follow that safeguard measures are the best policy response, however, as Horn and Mavroidis also acknowledge. Various other policy instruments might be employed to address the problem, such as subsidies to encourage the hiring of the unemployed. But all instruments are imperfect, and it is perhaps conceivable that measures to protect a declining industry that slow its rate of contraction may at times be the best option.

Does this possibility afford a convincing account of the safeguards provisions in WTO law? In my judgment, the answer is no. The reason, quite simply, is that nothing in the structure of the safeguards rules (or in the laws that implement them at the national level) limits safeguard measures to circumstances in which they might usefully slow the process of contraction. Sykes (1990) makes the point that U.S. law permits safeguards in a far broader set of circumstances, and it is clear that WTO law does as well. Neither body of law requires any showing that an industry is exhibiting inefficiently high levels of unemployment of labor or any other factor of production, much less evidence that temporary protection can do more than merely postpone the problem.

C. The "Political" Rationale for Safeguards

A more convincing explanation for the role of safeguard measures in the WTO/GATT system, in my view, proceeds from a contractarian perspective blended with political economy. A formal model developing this analysis in greater detail may be found in Sykes (1991).

The analysis begins with the proposition that the political officials who enter trade agreements, much like the parties to private contracts, seek to use the agreements to promote their mutual welfare. For most such officials, their welfare metric is a political one, and they will seek to design trade agreements that enhance their political fortunes by attracting voters, campaign contributions, or other manifestations of political support. Such political gains from trade agreements result in the main from market access commitments that benefit domestic exporters and lead them to reward the officials who obtain those commitments. To some extent as well, officials reap political benefits when imports become cheaper for politically efficacious consumers and consuming industries. These benefits must be balanced against the political costs of trade agreements, however, which stem primarily from reduced barriers to imports and the attendant opposition to trade agreements from import-competing industries. An ideal trade agreement from the standpoint of political officials will maximize the net political gains relative to political costs, allowing the officials to achieve their Pareto frontier.

Just as the parties to private contracts face uncertainty about the future, so do the officials who become parties to trade agreements. It is accordingly necessary for them to contemplate trade concessions under conditions where the political costs and benefits to them are somewhat unpredictable. A "first-best contingent contract" would provide for the revocation or modification of any trade commitments that prove to be a net detriment after uncertainty resolves—that is, anytime the political costs of a concession to the party that makes it prove greater than the political benefits it confers on other parties.[26] It is difficult to specify in advance all of the circumstances in which this problem may arise, however, and so the parties to trade agreements must develop other strategies for facilitating the modification of the bargain as new information comes to light. One option, of course, is simply to renegotiate, and the WTO/GATT system has always contained legal provisions for renegotiation. Another strategy is to provide authority for the revocation of modification of concessions in specified classes of cases where concessions have become a net burden politically.

Concessions can prove quite burdensome on officials in importing nations when an import-competing industry is in severe decline. It is a commonplace that declining industries invest more resources in the pursuit of protection and often secure it (witness steel and textiles in the United States). This phenomenon has a clear economic explanation. Declining industries have made sunk investments on which the rates of return are generally below competitive levels. Consequently, if they are able to obtain protection, much of the increase in the rate of return will be retained by existing firms—no new entry will occur until returns exceed the competitive level. In addition, declining industries tend to exhibit significant unemployment, with workers forfeiting their returns ("quasi-rents") to industry-specific human capital investments. They will lobby aggressively for policies that restore those quasi-rents, and the prevalence of unemployed workers may also make the broader population more sympathetic to protective measures. These considerations suggest an explanation as to why Article XIX affords assistance to industries that exhibit "serious injury."

The fact that an industry is in serious decline, however, is insufficient to explain why a trade agreement would permit importing nations to afford new protection to it. The costs of such measures to other parties must also be taken into account, in particular the costs to adversely affected exporters and the political officials that represent them. The circumstances where restraints on exports do relatively less damage to exporters (and their political representatives) are, not surprisingly, much the opposite of those in which

[26]This rough characterization can be made more precise in a formal model—in any contract that achieves the Pareto frontier for political officials, a "shadow price" exists that allows the welfare of each official to be compared to that of the others. A "first-best" trade agreement would provide for the revocation of any trade concession which, ex post, causes one official to lose more welfare than the others gain from it, converting the welfare of each official into a common metric using the proper shadow prices. See Sykes (1991).

import-competing industries lobby most heavily for protection—the harm will likely be the smallest when exporters are prosperous and expanding. Restrictions on exports can then be absorbed without reducing rates of return to exporters much, if at all, below competitive levels, and may simply discourage new entry that would have dissipated supracompetitive returns anyway. Likewise, restrictions on exports can typically be absorbed under these circumstances without producing significant unemployment, and the attendant political pressures to address it noted above.

These observations suggest an explanation for why Article XIX requires increased imports as a predicate to safeguard measures, since circumstances in which imports are increasing into the nation contemplating safeguards can serve as a rough marker for instances in which the exporters responsible for the increase are prospering. But that correspondence is surely imperfect. Imports may be rising for a number of reasons that do not necessarily reflect circumstances in which the exporters are prosperous. The additional requirements found in the original text of Article XIX—to the effect that the increase in imports must represent the unforeseen consequences of a trade concession—tend to ensure a better fit with the cases in which safeguards will yield net political benefits. The unforeseen developments requirement makes clear that Article XIX was only meant to facilitate the withdrawal of concessions that prove unexpectedly harmful politically, consistent with the idea that safeguards exist to address the problem of contractual uncertainty. And the requirement of linkage between increased imports and a trade concession tends to ensure that the exporters who will be harmed by safeguards are prospering. For if their exports are growing with unexpected rapidity as a result of a trade concession, chances are they are doing well.

To be sure, such conditions are not the only ones where net political benefits may arise from protection. The logic here suggests that net benefits may result any time that unexpected developments produce the <u>combination</u> of a severe decline in an import-competing industry, along with growth and prosperity for its foreign competitors. The next section will suggest how these conditions may arise from other events, and thereby suggest some possible guidance for the proper use of safeguards when imports surges cannot be linked to the unexpected effects of a trade concession.

This line of analysis also provides an explanation as to why Article XIX should be designed to provide temporary rather than permanent protection for declining industries. Declining industries will tend to become a less potent political force for protection over time as long as protection does not induce new investment. As exiting physical and human capital depreciates, the quasi-rents on sunk investments that are lost due to foreign competition will diminish and the political demand for protection will decline. Protection that is temporary, and that phases out over time, is thus a politically savvy response to the problem of declining industries. It addresses the political exigencies in the short term, but allows the joint political benefits of reciprocal trade agreements to be realized in the long term.

In sum, the contractarian perspective suggests that Article XIX was simply a device for dealing with the political uncertainty associated with the original GATT agreement, defining circumstances in which the temporary suspension of concessions was jointly optimal in a political sense for the officials that entered the GATT. I believe that this perspective allows us to explain all the important features of Article XIX(1)—the serious injury requirement, the requirement of increased imports, the requirement that the increase be unforeseen and attributable to a trade concession, and the requirement that safeguard measures be temporary. On this account, there is no clear or necessary connection between safeguards actions and the promotion of economic welfare or efficiency as conventionally defined, and it should then come as no surprise that efficiency explanations for safeguards are unconvincing.

Nevertheless, as argued in Sykes (1991), it is possible that Article XIX is welfare enhancing, for two reasons. First, by allowing officials to reduce the danger that trade concessions will prove a net political detriment after the fact, they become more willing to make them The costs of protection under Article XIX *ex post*, therefore, must be balanced against the additional trade concessions that it facilitates *ex ante*. It is not clear, and probably not knowable, whether the net welfare impact in this respect is positive or negative. Second, the welfare consequences of Article XIX also depend importantly on the extent to which nations negotiate trade compensation following safeguards actions, or instead engage in trade retaliation. The former possibility obviously ameliorates or eliminates adverse welfare consequences, while the latter possibility exacerbates them.

D. Possible Implications for WTO Law

Because I believe that the compensation and efficiency rationales for safeguards are unconvincing, however, I will not dwell on their implications here. Instead, I will focus on the implications of the contractarian perspective on safeguards.

Not only does the contractarian perspective explain the important features of Article XIX as originally drafted, but it suggests a basic principle to govern safeguards in the modern context where import surges are no longer linked to recent trade concessions. In particular, it suggests that safeguards are more likely to promote the joint political interests of WTO members under circumstances where an import-competing industry suffers an unexpected, severe decline due to developments that concurrently produce a period of growth and prosperity for their foreign competitors. In such cases, the political pressures for protection to restore lost quasi-rents in the importing nation can become intense, while the attendant detriment of protection to officials whose exporters are enjoying an unexpected period of prosperity will tend to be more modest—temporary protection while sunk investments depreciate in the importing nation may then produce net political gains. It is perhaps useful to illustrate the implications of this perspective with some examples.

(i) Trade Concession Produces an Unexpected Surge in Imports

This situation presents the paradigm case for safeguards action, and was of course the scenario contemplated by the original text of Article XIX. Here, a severe decline in the import-competing industry is directly attributable to a change in trade policy that confers an unexpected advantage on foreign competition. The reason for the unexpected advantage may vary—an unexpectedly high cross-elasticity of demand between imported and foreign goods would suffice, for example, or some other concurrent development in domestic supply or demand conditions that leads the concession to have a larger impact than anticipated. The old Hatter's Fur case under GATT illustrates the latter sort of possibility, where an unanticipated change in consumer tastes favoring the imported product produced an increase in demand for the imported good and a corresponding decrease in demand for the domestic substitute. Whatever the reason, a severe decline in the import-competing industry will most often be accompanied by prosperity and growth for its foreign competitors.

(ii) Reduced Costs of Production Abroad or a Shift in Tastes Favoring Imports Produce an Unexpected Surge in Imports

Even in the absence of a recent trade concession, an unexpected reduction of production costs for exporters or an unexpected change in taste that favors their goods can produce the same political circumstances. The prices of imports fall, inducing a shift of customers from domestic goods to imports. When such a development produces a severe decline in the fortunes of import-competing firms, it is also likely to be accompanied by prosperity for their foreign competitors.

(iii) Unexpected Increase in Costs of Domestic Firms Produces a Surge in Imports

This illustration presents a similar though not perfectly analogous case, subject to some caveats noted below. An increase in costs for domestic firms for any reason—rising input prices, new regulations, declining subsidies, etc.—will necessitate an increase in domestic prices that the suppliers of imports need not match. Imports will increase and a severe decline may result in the domestic industry. The new-found cost advantage for foreign producers will afford them a period of relative growth and prosperity.

(iv) Domestic Recession Produces an Unexpected Rise in Import Share

Suppose that the demand for imported and domestic goods alike declines because of a macroeconomic downturn. If no other event coincides with it, sales of both imported and domestic products will decline, but the market share of imports may rise. In a market where domestic goods and imports are perfect substitutes, for example, domestic firms may have relatively higher costs and may reduce production more than proportionately to the overall market decline. Although the domestic industry may face a severe decline in this scenario, foreign competitors also confront weak economic conditions and restrictions on their exports would exacerbate them. Indeed, the use of trade protection in response to domestic macroeconomic decline may have the highly undesirable effect of exporting domestic recessions, much as is commonly said to have happened in the 1930's with the Smoot-Hawley tariff. It seems much less likely that trade protection under these conditions will be a source of net political gains.

(v) A Recession Abroad Produces an Unexpected Surge in Imports

Similarly, imports may surge because demand abroad suffers a serious decline. Foreign producers may then turn to markets where demand remains relatively strong, and offer to sell in those markets for lower prices than before. The volume and market share of imports will rise, and import-competing domestic firms may suffer severe decline as a consequence. This case presents another scenario in which trade protection will simply exacerbate the weak economic conditions confronting foreign firms, and is less likely to be a source of net political gains.

* * *

It should be noted that the examples here suggest a possible approach to safeguard measures that is at odds with <u>all</u> of the analytical approaches to causation analysis—correlation, hypothetical quotas, and import supply curve—discussed in Section I. Illustrations (iv) and (v), for example, suggest how safeguard measures may be quite undesirable even though a strong correlation may exist between conditions of industrial decline and increasing imports. They also present cases in which a hypothetical quota may eliminate a significant portion of the "injury," and thus where the hypothetical quota approach to the analysis will credit imports with an important causal contribution. And illustration (vi) describes a case in which the import supply curve will have shifted to the detriment of domestic firms, yet one can certainly doubt that safeguard measures yield net political benefits.

It is also important to note some other considerations that may bear on the use of safeguards in these scenarios. With regard to illustration (iii), for example, many of the events that produce cost increases for domestic firms are within the control of their government or the firms themselves. Governments are responsible for such matters as new regulations and changes in subsidies policy, while firms are responsible for such matters as wage concessions to unions. If cost increases due to such events become a predicate for safeguard measures, a kind of "moral hazard" is created that may seem quite undesirable—governments and firms can create the conditions that disadvantage domestic firms, and then invoke trade protection in response. As suggested in Horn and Mavroidis (2003), safeguard measures should perhaps be prohibited in such cases. The "unforeseen developments" requirement of Article XIX may afford a useful legal check in this regard, as it is difficult to characterize events within the control of import-competing industries and their governments as "unforeseen."

Conclusion

At this writing, press reports indicate that the United States has lost its case before the WTO dispute panel in the recent steel matter, on multiple grounds. This is just the latest instance of safeguard measures failing to pass muster in the WTO dispute resolution process, and indeed no such measure has yet survived challenge. It remains entirely unclear what WTO members must do to fix their national safeguards rules, however, and it is important for the WTO Appellate Body to begin to provide some useful, affirmative guidance on the key issues if the WTO safeguards regime is to hold together. This essay has suggested some of the important issues that require attention, and offered some possible directions in which to proceed. Whether or not the suggestions herein are followed, the need for the dispute resolution process to articulate a coherent conception of the proper role of safeguards in the system is abundantly clear. To date, it has failed quite miserably in that task.

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