INTRODUCTION

What do Argentine shoes, Indian tire rubber, Korean garlic and American wheat gluten have in common? Although some are final consumer goods while others are intermediate inputs and they differ in terms of their market structures, production technologies, cost structures, and capital intensities, they share a common situation in the WTO trading system. All were temporarily shielded from foreign competitors by measures under the WTO’s Agreement on Safeguards. Table 1 (found at the end of the chapter) describes the countries that have most frequently implemented safeguard measures under the GATT and WTO regimes.

Because safeguard measures have been used only rarely in the past, many policymakers and industry representatives are unfamiliar with them. In the world of temporary trade protection, antidumping duties have stolen the stage, though safeguards could become more prominent in the future. If the WTO's antidumping code is reformed, safeguards are the next logical choice for a country that needs a temporary shield against imports. Moreover, the rules regarding the use of safeguard measures in the GATT are
biased towards favoring the same industries that currently seek protection under antidumping laws.

What is a safeguard measure? A safeguard measure is a temporary restriction on trade - either a tariff or a quota - that is used to protect a domestic industry from fair foreign competition. In contrast and as discussed at length in other chapters of this volume, antidumping duties offset what is deemed to be unfair pricing by foreign exporters, while countervailing duties “level the playing field” between a foreign government-subsidized exporter and a domestic producer. In general, a safeguard measure can be used to restrict imports of a particular good as long as imports of that good have increased and the higher level of imports has caused or threatens to cause some harm to the domestic industry. For example, if several firms in the American shoe industry were about to go bankrupt because Americans started to substitute their purchases toward imported shoes from a new, highly-efficient Argentine shoe company, the American industry would be eligible for a safeguard measure under the WTO rules.

The fact that Article XIX of the General Agreement on Tariffs and Trade, together with the WTO Agreement on Safeguards (“AS”), allows countries to arbitrarily restrict trade may seem surprising. After all, the preamble to the Uruguay Round Agreements identifies the WTO’s primary objective as “expanding the production of and trade in goods and services” by forming an agreement “directed to the substantial reduction of tariffs and other barriers to trade”. Why, therefore, does the WTO allow the use of safeguard measures?

From an economist's point-of-view, there are two ways to approach this question. First, an economist could argue that, somehow, despite our understanding that countries

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gain from trade and that trade restrictions can make all countries that belong to the WTO better off. At first glance, this seems to contradict the teachings of every undergraduate course on international trade: freer trade is supposed to improve upon the welfare of all countries that embrace it. However, in the real world, countries interact repeatedly, comparative advantages change as workers acquire skills, and international prices fluctuate unexpectedly in response to everything from scientific discoveries to changes in the weather. When such realities are taken into consideration, it may actually be possible for all countries to benefit from temporary trade restrictions, relative to a scenario in which temporary trade restrictions were explicitly prohibited.

On the other hand, an economist might explain the presence of safeguard measures on a combination of both economic and political-economic grounds. The use of safeguards certainly will have consequences for income distribution, making some countries, industries, and factors of production better off even though they cause harm to others. In this case, safeguards may be permitted under the WTO to provide governments with a means to address their redistributive motives, or to demonstrate favor to politically preferred interest groups if those groups have more power than those that are harmed by the potential use of safeguards.

In this chapter, we will consider both economic and political-economic reasons for policymakers to use safeguard measures. In Part I we start from the evolution of safeguards from the 1947 GATT, before turning in Part II to the Uruguay Round reforms leading to the Agreement on Safeguards. In Part III we consider the economic effects of

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2 This also requires that governments fail to have access to other policy instruments to redistribute income that would be more efficient than trade restrictions, a point that we will return to below.
safeguards, before turning in Parts IV and V to a discussion of some possible reforms to the Agreement on Safeguards and also suggestions on areas in which further research is needed.

I. BACKGROUND

Historically, safeguard measures permitted under Article XIX and the Agreement on Safeguards have been distinguished from other GATT-sanctioned trade protection - antidumping duties, countervailing duties and balance of payments exceptions - by the trade problems they were used to remedy. Safeguard measures trace their roots to the United States-Mexico trade agreement of 1942. Fearing that the lowering of a tariff on some particular good could result in a larger-than-expected import-surge that would hurt domestic firms, the U.S. government insisted that the agreement include a provision permitting it to re-institute tariffs in the face of large import-surges.

Foreseeing that the same problem could arise in the multilateral trading system, the framers of the GATT incorporated the use of temporary trade restrictions into the agreement in the form of Article XIX. Article XIX provides that safeguard measures can be used when an increase in imports resulting from a tariff-cut harms domestic firms producing the same or a similar product. Over time, the GATT stopped enforcing the

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3 There are other places under the GATT aside from Article XIX where countries can implement safeguard-type measures such as Article XXVIII for permanent protection, Articles XII or XVIII:b for balance of payments problems, Article XXI or XX for national security or other general exceptions, and Article XXV for the granting of waivers. While we will focus on Article XIX, for a discussion of these other areas see John H. Jackson, Safeguards and Adjustment Policies, in THE MULTILATERAL TRADING SYSTEM: ANALYSIS AND OPTIONS FOR CHANGE (R.M. Stern ed. 1993) and J. Michael Finger, GATT Experience with Safeguards: Making Economic and Political Sense out of the Possibilities that the GATT Allows to Restrict Imports, POLICY RESEARCH WORKING PAPER 2000, DEVELOPMENT RESEARCH GROUP, WORLD BANK, (1998).
requirement that the use of safeguards be tied to tariff-cuts. Today, under the Uruguay Round's Agreement on Safeguards, safeguard measures can be used whenever a government sees that a domestic industry is suffering serious harm under the burden of increased imports that arise due to “unforeseen developments.” They can be applied for an initial four-year period with the possibility for a maximum additional four-year extension.

In keeping with the GATT's guiding principle of nondiscriminatory treatment for all its members, safeguard measures were intended to be applied to all members equally. When an importing country imposes a safeguard tariff, it raises the tariff on imports from all source countries, even those with only a very small presence in the importing country's market. Moreover, while the GATT has traditionally had a strong preference that countries use tariff measures when imports must be restricted, prior to 1994, countries often used quotas and tariff-rate-quotas to protect themselves temporarily from imports. Such quantitative restrictions are undesirable for a variety of reasons, including the fact that though governments may try to allocate quota rights fairly, quantitative restrictions are fundamentally discriminatory and, thus, at odds with the GATT's guiding principle of equal treatment for all countries.

To the GATT framers, a safeguard was the reinstatement of a tariff that had been removed or lowered during a trade negotiation. Thus, the GATT of 1947 required countries that imposed safeguards to offer compensation to the exporting countries that lost some of their export market. With the GATT focus on trade liberalization, the preferred form of compensation was that affected exporting countries would be afforded tariff reductions on some other product. However, if countries could not agree on

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4 With limited exceptions, quantitative restrictions were generally prohibited under the GATT Article XI.
compensation, the GATT could authorize an exporting country to retaliate against the safeguard measure with its own tariff increase as a last resort.

Under the GATT 1947, retaliation against a safeguard measure was explicitly authorized under Article XIX:3(a). While affected countries may not have frequently resorted to retaliation, perhaps more importantly, many economists believe that the threat of retaliatory tariffs probably led countries to avoid using formal safeguard measures when the conditions otherwise may have been appropriate to do so.

Although compensation for safeguard measures was often negotiated in the 1960s and 1970s, as tariff rates fell and more products came to be freely traded, as a practical matter, it became difficult for countries to agree on compensation packages. This undoubtedly contributed to the rise of voluntary export restraints (“VERs”), export restraint agreements (“ERAs”), and orderly marketing agreements (“OMAs”) in the 1980s. The GATT did not explicitly prohibit these measures, but it did not specifically allow their use either. Consequently, they came to be called “grey-area measures.”

Under a grey-area measure like a VER, an importing country asks exporting countries to voluntarily accept a quantitative restriction on exports. The restriction causes the price of the good in the importing country to rise. The difference between the price the good would sell at under free trade and the higher price it sells at under the quota is known as the “quota rent.” Under a standard quota system that is administered by the importing country, the importing country's government can receive the equivalent monetary value of the quota rents by arranging for a competitive auction for the licenses.

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5 Of the 150 formal GATT appeals to the safeguards provisions between 1947-1994, there were eleven instances in which an affected country either cited Article XIX:3 or made a formal appeal for retaliation. WTO, *Analytical Index: Guide to GATT Law and Practice*, Vol II (1995), at 539-559.
that give agents the right to import. Under a simple tariff system, the quota rents are equivalent to the tariff revenue received by the import-restricting country’s government.

The basic difference between a VER arrangement and a quota or tariff is that in the former case the exporting countries' firms get the quota rents. Because VERs both restrict imports and compensate foreign firms, both domestic firms and foreign firms often prefer such an arrangement to a similar trade-restricting quota or tariff policy. However, VERs distort world-wide trade flows and, consequently, can harm the well-being of other countries. Moreover, consumers in importing countries are forced to pay very high prices on the products in question. One of the most famous examples of a VER was the United States-Japan automobile VER of 1981. This VER raised the price of Japanese cars in the United States 14% each year in 1983 and 1984.

Procedurally, Article XIX permitted the use of safeguards if there were (1) an increase in imports and (2) serious injury to the domestic firm or industry caused by the increase in imports. As a practical problem, under Article XIX there was a high degree of variation across countries as to how they enforced these injury rules. Jackson quotes an unidentified European trade official as saying “we can always find 'injury' whenever we need to for political purposes.” At the other extreme, Baldwin describes how the narrow definition of injury in the US Trade Act of 1962 made it virtually impossible for U.S. domestic producers to receive safeguard protection.

Going into the UR, a number of problems with Article XIX were evident. (1) Countries were using quotas and tariff-rate quotas instead of tariffs when they

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implemented safeguards; (2) discriminatory, non-MFN application of safeguards was
distorting worldwide trade flows; (3) compensation and retaliation provisions were
leading countries to use grey-area measures that automatically provided compensation to
exporting firms; (4) policymakers feared that “temporary” safeguards might be applied
“permanently;” and (5) the injury criteria were vague.

Furthermore, concurrent with the rise of VERs, countries were using unfair trade
laws to restrict trade far more frequently than the vast majority of economists thought
reasonable. During the 1980s and 1990s it became apparent that importing country
governments were using unfair trade remedies not as protection against the anti-
competitive practices of foreign firms, but as safeguard measures. Unfair trade remedies
were a desirable form of protection because they did not require compensation and they
could be targeted against specific foreign exporters and thus even more discriminatory
than the application of a safeguard measure. Given the relationship between safeguard
measures and these other forms of protection, reforms of other areas and rules of the
GATT outside Article XIX could also have a profound effect on the way countries use
safeguards under the WTO.

With these numerous problems in mind, the UR negotiators undertook the
important task of reforming the use of safeguards.

II. URUGUAY ROUND REFORMS AFFECTING SAFEGUARDS

The Uruguay Round reforms amplified the GATT Article XIX escape clause
provisions into the WTO Agreement on Safeguards, and Jackson notes that they were “a

9 Jackson, supra note 7, at 210
substantial achievement, and indeed a heroic statement of principle.” In this part we focus on the UR reforms affecting the economic incentives facing countries that consider the implementation of a safeguard measure. To do so, we first address areas of reform of the AS itself. At the end of this part, we turn to other UR reforms and rules that affect a government’s incentives to use a safeguard measure.
A. Reforms to the Agreement on Safeguards

1. Available Policy Instruments

The first area of reform is the decision of which policy instruments that countries implementing safeguard measures shall have at their disposal. As suggested in Section I, under the GATT, countries often implemented safeguard measures through use of tariffs, quotas, tariff-rate quotas, and the popular VERs. Under the AS, countries can implement protection through either tariffs, quotas or tariff-rate quotas. Although the lack of reform that might eliminate the use of quantitative restrictions is disappointing, one substantial reform changes the way the WTO treats VERs, OMAs, and ERAs, as they are now expressly prohibited under Article 11:1(b). This decision to permit quotas, tariff rate quotas and similar quantitative restrictions does have an important economic impact that we will further describe in Part III below.

2. MFN versus Specificity

A second reform of the escape clause involved the question of whether use of safeguard protection can be country-specific, or whether a safeguard-imposing country must follow the non-discrimination rules of the most-favoured-nation (“MFN”) clause. The basic agreement requires safeguard measures to be imposed on an MFN basis, as stated in Article 2:2, “[s]afeguard measures shall be applied to a product being imported irrespective of its source,” and in the case of a quantitative restriction, Article 5:2(a)
states that the quota shares should be allocated based on the share of the market that exporters had in a prior representative period.

However, there are two situations in which the MFN rule apparently does not have to be followed. First, Article 5:2(b) allows countries to depart from the principle if “clear demonstration is provided to the Committee [on Safeguards] that…imports from certain Members have increased in disproportionate percentage in relation to the total increase of imports of the product concerned in the representative period.” Second, the Agreement does not allow restriction of imports from developing country that have less than three percent of total imports, unless the aggregate share of all such countries is more than nine percent (AS, Article 9:1).

3. Compensation and Retaliation

A major reform of the Uruguay Round was the provision that countries facing absolute import surges would not be required to offer compensation for the first three years during which safeguard measures are imposed, as provided in Article 8:3. Although the general rule of the WTO under Article 8:2 is that compensation must be offered to affected countries after a safeguard measure has been implemented, this important exception means that in practical terms, it rarely is.

As we suggested in Part I, compensation for implemented safeguard measures can take the form of additional liberalization by the protection-implementing country. If no agreement on compensation between the safeguard-implementing and the exporting country is reached, Article 8:2 sanctions the withdrawal of “substantially equivalent
concessions,” or an increase in a foreign tariff based on the rule of reciprocity, as was the case under GATT Article XIX.

One intent of the reform which limits compensation was arguably to make use of safeguards relatively more attractive in “legitimate circumstances,” relative to the alternative popular policy instruments whose use had far out-paced the escape clause - such as anti-dumping duties, protection for balance of payment purposes, VERs or other “grey-area” measures. On the other hand, the removal of compensation makes it more likely that a country who might not have imposed safeguard measures at all may be induced into doing so, because now the costs of doing so are less than would otherwise be the case.

As suggested in the last part, a second and popular means of compensation under the escape clause, or the implicit compensation of “quota rents” embodied in the policy of a VER, was also outlawed by the AS. At the least, this serves to eliminate a useful, and arguably efficient compensation mechanism for instances in which a country that implements a safeguard measure does not face an “absolute surge in imports” and thus must compensate affected trading partners in some manner.

4. Procedural Reforms

The last set of reforms accomplished by the UR negotiations were primarily procedural in nature. These included formally defining the injury requirement, establishing a surveillance monitoring body, and specifying the maximum length that a safeguard measure can be in place.
An important procedural improvement over Article XIX was the establishment of a more precise definition of “injury.” Under the WTO it is now defined as a “significant overall impairment in the position of the domestic industry.” (AS, Article 4:1(a)). The AS also included a more explicit determination of the data to be used to measure injury: “the rate and the 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” (AS, Article 4:2(a)).

Second, the new AS also provides for surveillance with the establishment of a Safeguards Committee whose charge it is to monitor and oversee use of the AS provisions by WTO members. For example, Article 12 of the AS states that members must notify or consult with the Committee on Safeguards if they initiate a safeguard investigation and then make any decision on imposing or extending safeguard protection. Under Article 13, the Committee is also charged with overseeing use of the agreement and compliance with its procedural elements.

Finally, Article 7 established the maximum duration that a safeguard measure could be in place and the conditions necessary for the initial period of the safeguard application to be extended. First, Article 7:1 limits the continued application of a safeguard measure to the length of time necessary to prevent serious injury and facilitate adjustment, and at a maximum, the “period of initial application and any extension thereof, shall not exceed eight years.” (AS, Article 7:3) In order to extend a safeguard measure beyond its initial four-year maximum, the WTO member imposing the safeguard must also show evidence that the industry being protected by the measure is adjusting, and in cases in which safeguards have been applied for longer than one year, the Member
“shall progressively liberalize [the measure] at regular intervals during the period of application.” (AS, Article 7:4).

These procedural reforms could have an economic impact on various stages of a country’s safeguard process; for example, both at the petition initiating stage and at the domestic government's accept/reject stage. First, if the safeguard process is bureaucratic (or a-political) in nature, a clearer definition of what constitutes “injury” would be expected to affect the pattern of petitions that industries initiate. With a well-defined criterion of what would make a “successful” petition, an industry may tend to alter the pattern of initiated petitions to those that fit that criterion. The effect could work in either direction – industries that think they are injured but that do not satisfy the better defined criteria may be less likely to petition, and industries that did not understand the earlier criteria now with the clarification may be more likely to initiate and put pressure on the domestic government.

Second, at the domestic safeguard authority’s decision-making stage, the pattern of accepted versus rejected petitions may change, relative to the pre-UR case. But again the reduced uncertainty could have an economic impact that would go in either direction – leading to either more or fewer acceptances. For example, domestic governments may have been likely to accept a weak safeguard petition under the GATT, but would no longer feel comfortable accepting the same petition given the clearer definition of injury established by the UR reforms. This increased transparency also reduces some of the discretion it may have enjoyed earlier. For the case of the United States, the government may no longer be able to hide behind the argument that a petition does not satisfy the injury requirement (when that requirement was ill-defined), and therefore if it chooses not to protect it will have to come up with other reasons why. Politically, this may be
more difficult. On the other hand the United States may now be able to erect credible arguments that other petitions fail to satisfy the injury requirement so that they can now more credibly rely on the WTO for commitment power to not implement protection in other situations.

B. Reforms Captured in Other UR Agreements that Affect the Use of Safeguards

Given that countries can implement trade policy restrictions by substituting between policy instruments, reforms of other areas of the GATT also have an impact – whether intended or unintended - on use of the AS.

One example of an important reform was captured in the WTO’s new Dispute Settlement Understanding (“DSU”) and relates to the compensation available to affected trading partners should countries fail to bring their policies into conformity with their WTO obligations. In trade disputes where countries are unable to negotiate mutually agreeable compensation, the DSU has established a level of permissible retaliation in recent trade dispute cases (e.g. *EC – Bananas* and *EC – Beef Hormones*\(^{10}\)) that is similar to the level of retaliation authorized by the AS.

To consider the impact that this has on a country’s potential use of the AS, take the extreme case in which a country wishes to offer protection to a domestic industry that was injured by imports, but there was no “absolute surge in imports.” Thus, the country will have to offer compensation under the AS. Moreover, suppose there is no evidence of dumping. The country must choose between implementing a safeguard and offering

compensation or implementing an illegal antidumping duty and facing possible DSU-authorized retaliation. If the retaliation that can be authorized under both the AS and the DSU is identical, there is little economic incentive for the country to use the legal safeguard provisions. Even if the country were to impose an ADD and the affected trading partner filed a dispute, in the worst-case scenario that the ADD-imposing country lost the dispute, it would only have to yield the same compensation as it would have faced under the safeguard provisions. In this case, if there is even a tiny chance that the ADD-imposing country could win the dispute, then the country is clearly better off "cheating" and using the AD measure rather than the safeguard provisions, even when there is no evidence of dumping or injury.

Furthermore, we also expect that the procedural reforms that have served to essentially define the minimum length of the dispute settlement process to have an effect on the duration of application of a particular safeguard measure. Under the GATT regime, due to the fact that individual countries (including the defending country) had the power to veto the process at any stage, the length and even conclusion of a trade dispute was uncertain and even indeterminate. However, under reforms to the DSU, maximum time limits for different phases of the process have been adopted – initial consultations will last no more than sixty days, the period from the establishment of a panel to the circulation of its report will take no longer than nine months, etc. Petersmann suggests that the DSU “will be the quickest worldwide system for the settlement of disputes among states.”

11 See the Uruguay Round Understanding on the Rules and Procedures Governing the Settlement of Disputes for the time limits for each phase of the WTO’s dispute settlement process.

Recall that the change in compensation requirements under the AS gives a government the right to impose safeguard measures as a response to an “absolute increase in imports” without having to provide compensation for three years. We argued that the likely impact of this reform is that governments will typically design safeguard measures that respond to an “absolute increase” to tend to be no longer than three years in length in order to avoid the compensation requirement. In a similar manner, once the minimum length of the full dispute settlement process is established, this can also affect the way in which a domestic policymaker designs or chooses to implement a dubious safeguard measure that knowingly does not satisfy the criteria set out in the AS. Given that retaliation (compensation) cannot be applied retroactively and must end once a WTO-illegal policy has been removed, policymakers can implement an illegal safeguard measure for the anticipated length of the dispute settlement process.

A second important reform introduced by the UR Agreements that may be having an impact on the way countries use the AS relates to the issue of VERs. Under the WTO Agreement on Antidumping, price undertakings are explicitly allowed and arguably are even encouraged as a means for countries to resolve an AD case. Price undertakings refer to an explicit agreement between the investigating AD authority and the foreign exporting firm that is the subject of the AD investigation where the foreign firm agrees to

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13 The US steel safeguard applied in March 2002 was imposed for three years and one day.
14 Note, however, that if a government implements a safeguard measure that does not satisfy the “absolute surge in imports” requirement, provided the WTO Council for Trade in Goods does not disapprove, the government may not need to wait until the completion of the panel process of a formal DSU dispute to obtain compensation in the form of authorized retaliation. For an example, see the EU’s response to the U.S. steel safeguard measures implemented in March 2002, Immediate Notification Under Article 12.5 Of The Agreement On Safeguards To The Council For Trade In Goods Of Proposed Suspension Of Concessions And Other Obligations Referred To In Paragraph 2 Of Article 8 Of The Agreement On Safeguards European Communities. G/SG/43, May 15, 2002, and G/SG/43/Suppl.1, June 20, 2002. Furthermore, there are also DSU “urgency” exceptions that countries may resort to, perhaps in order to help prevent trading partners from drawing out the length of the dispute settlement process in order to keep a temporary protective measure in place.
raise its price to a level that eliminates the “dumping margin” established by the domestic AD authority. However, such a price increase will typically decrease imports, thus the foreign firm’s “voluntary” price increase leads to an outcome (in terms of welfare) quite similar to that generated by a VER.

The economic impact of this reform for the AS, is that if a country seeks to protect a domestic industry by “managing trade”, this is explicitly encouraged under the Agreement on Antidumping and explicitly prohibited under the AS. All else equal, this flexibility may lead to more antidumping activity and less safeguard activity.

There are separate safeguards provisions for many of the “new” areas of trade brought into GATT discipline with the establishment of the WTO: agriculture, apparel, textiles and clothing and services. Each of these areas of trade has a distinct UR Agreement which has its own safeguard provision therein, for example, see Article 6 of the Agreement on Textiles and Clothing, and Article 5 of the Agreement on Agriculture. Furthermore, Article X of the General Agreement on Trade in Services calls for negotiations on services safeguards and provided a one-time three year window for modification or withdrawal of commitments.

The final point that we should make is that there was virtually no reform to another Agreement on Safeguards alternative, Article XXVIII. While in practice Article XXVII has been rarely used, for countries that seek to protect an industry permanently, they are still able to do so just as they were under the GATT regime.
III. ECONOMIC EFFECTS

Because safeguard measures have been rarely used, does this imply that their economic effect is small? Here we argue that such a conclusion is faulty, as in order to accurately assess the role of safeguards in the world trading system, we need to compare the economic outcome of a world in which safeguards are permitted to the economic outcome in a world in which they are not allowed. To simply assess them by measuring the costs and benefits on the few occasions in which they have been used captures only a small part of the picture. In this part, we will review two broad categories of economic research, the theoretical research that analyzes the difference between a world with safeguards and a world without safeguards and the empirical research that measures the costs and benefits of safeguard measures that have been used in the past.

From the perspective of policymakers who must determine the details of how policies are designed and implemented, some of the most important economic research will be focused on the specifics of safeguard measures. Are tariffs better than quotas? For whom? Should protection last three years or eight? If a country faces higher imports of bicycles from China, but not from Mexico, should a safeguard tariff be imposed against China, or both China and Mexico? If French cheesemakers suffer a significant loss when the United States institutes a safeguard measure against cheese, should the United States be made to compensate France? If so, how?

An increasing number of economic researchers have examined safeguard measures from a variety of angles. The theoretical research papers typically address the common question: why does the WTO allow the use of safeguards?
Essentially, there are two categories of answers in the economics literature. The first argument is that safeguard measures can create a net benefit for the world as a whole. The safeguard may make some countries better off and others worse off, but if we add up the gains and losses to everyone in the world, the sum total is positive. In other words, the gains of temporary trade protection outweigh the losses. We pursue this argument in the next two sections. In the third section, we turn to another argument justifying safeguard measures – that its presence is motivated by the interests of importing countries, and in particular, import-competing industries in those countries. In Section D we explore some of the economic arguments that seek to explain why safeguards are used or not-used relative to other policy instruments that have similar features to the safeguard provisions. Finally, in Section E we turn to other related (and future) empirical work on safeguards.

A. Does the Inclusion of Safeguards Result in More or Less Liberalization Overall?

Perhaps the most widely cited argument for safeguards is that they can facilitate greater tariff liberalization by governments during trade negotiations. Because a government has an escape valve if a tariff reduction causes pain to its own producers, it has more freedom to make larger and potentially more risky tariff reductions. Because there are large gains from permanent tariff reductions and relatively small costs from imposing temporary safeguards in a few sectors, the world gains by having safeguards in a trade agreement, even when they are not actually used. Jackson provides an intuitive discussion of this.\footnote{Jackson, \textit{supra} note 7}
Ethier asks: how does the interaction between unilateralism and multilateralism affect the pace of trade liberalization? His central concern is to analyze a trading system like the GATT/WTO which is characterized by the general practice of negotiating tariff reductions to benefit all members and the occasional use of temporary unilateral tariff increases through safeguards or antidumping duties. He develops a multi-country model in which countries grow at different rates. He shows, first, the pace of trade liberalization is constrained by the slowest-growing countries in the world. He then illustrates how allowing these countries to temporarily raise their tariffs can accelerate the pace of worldwide trade liberalization. The key insight is that when countries negotiate tariff reductions, they do not know if their growth will be fast or slow. In a trade agreement that does not allow temporary tariff increases, countries fear that their growth will be slow and will negotiate only small tariff reductions. When safeguards are added to the trade agreement, countries negotiate larger tariff reductions because they know that if they turn out to have slow growth, they can temporarily increase their tariffs.

Klimenko, Ramey, and Watson arrive at a similar result by examining the question of why the WTO's Dispute Settlement Body ("DSB") exists. In their paper, they show that when countries regularly renegotiate their tariffs, as in the GATT/WTO trade rounds, a DSB is necessary for the trade agreement to survive. A DSB makes it possible for countries to punish each other for violations. Because countries want to avoid punishment, they are less likely to violate a trade agreement that includes a DSB. As an extension to their paper, they also show that if the DSB allows countries to temporarily

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raise their tariffs (as is the case with safeguard measures) in response to some unexpected change in the economic environment, they will negotiate larger tariff reductions initially.

Although some of the theoretical arguments suggest that safeguards help to facilitate trade liberalization, other economists arrive at the opposite conclusion. Staiger and Tabellini show that allowing for safeguard measures could reduce the credibility of a trade agreement. If governments are not fully committed to liberal trade, the productive factors in their economies may not efficiently reallocate because changing sectors is costly, and they expect their government to step in and utilize the safeguard provisions at their disposal. From this perspective, the inclusion of a safeguard measure can weaken the overall agreement.

B. **Safeguards as Insurance against Negative Terms of Trade Shocks**

Another economic argument in favor of the inclusion of a safeguard clause is that it acts as a form of insurance against changing international prices, or, in economics jargon, fluctuations in the terms of trade. Consider a country that imports a good whose price fluctuates substantially. For example, the price of steel imported by the United States rises with the price of its main inputs - iron and energy - and falls as new factories with low-cost technologies come online. When prices change, the economic environment can become so different that countries want to pull out of a trade agreement that constrains them to set low tariffs.

Bagwell and Staiger explore how price fluctuations affect large players in a trade agreement - countries like the United States, the EU and Japan which have markets that

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are so large that their safeguard measures can significantly alter world prices. They argue that due to the self-enforcing nature of the trade agreement, in periods of large import volumes, a safeguard measure acts as a pressure valve to enable countries to sustain cooperation by temporarily raising tariffs. In the absence of a safeguard clause, countries would not be able to sustain cooperation, and the result would be a costly trade war of high levels of tariff retaliation. Fisher and Prusa show that even small countries, which cannot affect world prices by imposing a safeguard, can use safeguards to insure themselves against international price shocks.

To date, empirical research in economics has not been able to prove or disprove the ideas put forth in the papers mentioned above. In some ways this is an impossible task - how can we prove that countries negotiate lower tariffs when a safeguard is part of a trade agreement when all the trade agreements in existence include safeguards?

C. Safeguards Assist Import-Competing Industries

The starting point for another important area of research is the belief that the WTO allows the use of safeguards because of concerns for the interests of importing countries, and in particular importing countries with firms and industries that compete with foreign firms. This may arise because the agent that benefits from the potential

19 Kyle Bagwell and Robert W. Staiger, A Theory of Managed Trade, 80 AMERICAN ECONOMIC REVIEW 779 (1990)
21 A related paper is the recent empirical contribution by Robert Staiger and Guido Tabellini, Do GATT Rules Help Governments Make Domestic Commitments?, 11 ECONOMICS AND POLITICS 109 (1999), who compare two different policy environments (U.S. escape clause petitions and U.S. Tokyo Round sectoral exclusions) to investigate the question of whether GATT rules help governments make trade policy commitments to its private sector. The fact that they find evidence to support the claim that GATT rules do
safeguard is politically powerful, and the result is that these papers then investigate how the politically powerful agent gains from the safeguard. If one country pursues a policy that benefits itself but harms other countries, economists want to understand how and why the policy creates a benefit so that they can develop alternative policies that create a similar benefit but reduce or eliminate the harm to others. Here we pursue three potential arguments explaining why governments may seek to assist import-competing industries; to help them catch-up to their foreign competitors, to facilitate their exit from the industry, or to reap the gains from a politically-preferred sector.

1. Technological Catch-Up

Several theoretical papers\textsuperscript{22} explore how safeguards benefit import-competing firms that are technologically behind their foreign competitors. These papers examine the consequences of using a temporary safeguard to induce domestic firms to adopt newer, more efficient production technologies. Economists have long understood that a government subsidy is better than a tariff for helping a firm adopt a new technology.\textsuperscript{23} A direct subsidy can achieve the same result as a safeguard, but because it does not also give governments commitment power also provides support for the theory that the inclusion of an escape clause can have damaging effects that erode a government’s ability to commit to liberalization.


\textsuperscript{23} Avinash K. Dixit and Victor Norman, \textit{THEORY OF INTERNATIONAL TRADE} (1980); Richard E. Caves, Jeffrey A. Frankel and Ronald W. Jones, \textit{WORLD TRADE AND PAYMENTS: AN INTRODUCTION} (2002); Paul R. Krugman and Maurice Obstfeld, \textit{INTERNATIONAL ECONOMICS: THEORY AND POLICY} (2000) are a few standard textbooks that make this point.
increase the price facing consumers, it is less costly to society as a whole. Thus, using a safeguard to facilitate technological improvement is a “second-best” policy at best. However, if a government wants to use a trade policy to induce technological improvement, what specific features should this safeguard measure have? How long should it last? Should it be applied against imports from all countries or just a few?

Matsuyama and Miyagiwa and Ohno provide theoretical support for the requirement of a strict termination date for safeguard protection and allowing exporting countries to retaliate against safeguard measures that extend beyond the three year “grace period” where an absolute increase in imports is involved. Miyagiwa and Ohno find that safeguards provide an incentive for protected firms to innovate quickly only if the cost of the new technology is falling over time and the termination date for safeguard protection is credibly enforced by foreign retaliation. One implication of their paper is that the exact length of time that a safeguard must be in place in order to induce a domestic firm to acquire a new technology will depend critically on how quickly the cost of the new technology is falling. Thus, the WTO's three-year time limit will provide too much protection in some cases and not enough in others. The cases in which it provides too little protection are particularly troubling. The safeguard will force consumers to pay higher prices but will not yield any benefit to the economy. Crowley finds that a nondiscriminatory safeguard tariff can accelerate technology adoption by a domestic import-competing firm, but will slow down technology adoption by foreign exporting

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24 More generally, economists have shown that an import tariff has an equivalent economic impact as the simultaneous imposition of a production subsidy and consumption tax. The direct subsidy would thus be more efficient than a safeguard tariff as it would not have the second welfare distortion of the tax effect that raises the price facing consumers.

25 Matsuyama, supra note 22; Miyagiwa and Ohno, supra note 22
firms. Because an MFN safeguard tariff can delay a foreign firm's adoption of new technology, its worldwide welfare costs may exceed its benefits.

Unfortunately, the little empirical evidence on the effect of safeguards on technology adoption is not very encouraging. A 1982 study by the US government's administrative body that reviews safeguard petitions, the US International Trade Commission (“USITC”), found that most safeguards failed to promote positive adjustment to import competition. Rather than assisting companies in upgrading their facilities, in most cases safeguards merely slowed an industry's inevitable decline. A review of U.S. safeguard cases since 1974 shows that some industries seek and receive protection repeatedly - for example, stainless alloy tool steel was granted safeguard protection in 1976 and again in 1983.

2. Senescent Industries

Another group of theoretical papers shows how firms in declining industries can utilize political support to maintain protection. Hillman, Brainard and Verdier, and Magee all examine the use of tariff protection to allow a dying industry to collapse slowly, rather than quickly. Because these papers all assume that there are high costs to quickly scaling back production, they find that a temporary tariff that can slow an industry's decline can improve an importing country's welfare. However, this type of policy also slows the reallocation of capital and labor into other industrial sectors in

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26 Crowley, supra note 22
which they would be more productive. This loss of productivity is an indirect welfare
cost on the country imposing the safeguard measure.

3. Political-Economy Motives

Both the economist Robert Baldwin and the political scientist Wendy Hansen
have found that political factors are important in determining whether or not an American
petition for safeguard protection is successful. Evidence that safeguards are politically
tainted in a country like the United States that has transparent and well-defined
administrative procedures underscores the necessity for the WTO to thoroughly review
how safeguard policy is being carried out by its many members.

D. Frequency and Use of Safeguards Relative to Other Trade Policy Instruments

There is some empirical research that addresses the question: why have
safeguards been used so rarely? Hansen and Prusa argue that the existence of another
policy tool, the antidumping duty, explains the rare use of safeguard measures. Indeed,
during the 1987-1994 period, while there were only eighteen safeguard measures
implemented worldwide, Miranda et al. report that over seven hundred antidumping

JOURNAL OF INTERNATIONAL ECONOMICS 221 (1997); Christopher Magee, Declining Industries
and Persistent Protection, 10(4) REVIEW OF INTERNATIONAL ECONOMICS 749 (2002)
28 Baldwin, supra note 8; Wendy L. Hansen, The International Trade Commission and the Politics of
29 Wendy L. Hansen and Thomas J. Prusa, The Road Most Taken: the Rise of Title VII Protection, 18 THE
WORLD ECONOMY 295 (1995)
measures were used, after 1586 antidumping investigations. In the case of the United States, Baldwin argues that the strict injury criteria of the U.S. law, especially prior to 1974, has led the US ITC to reject many safeguard petitions.

While there is undoubtedly some truth to these ideas, there are other potentially important explanations. For example, economists believe that provisions for compensation and the threat of retaliation may have dissuaded countries from imposing safeguards in numerous instances. However, it is impossible to document all of the potential occasions in which a country chose not to pursue a safeguard, although it may have considered doing so.

Nevertheless, Bown has proposed a theory to explain why countries that have committed to implementing protection will choose to use safeguard measures, as opposed to using GATT/WTO-illegal alternatives that may result in a trade dispute. The explanation is that countries will use safeguards when the trading partners that are affected by the increase in import protection have a substantial capacity to retaliate. By considering the GATT rules of retaliation that take place under safeguards and dispute settlement negotiations, the safeguard provisions can be interpreted as providing cover to countries that must implement protection but who wish to mitigate the retaliatory response and limit the compensation due to affected trading partners. Given that the

31 A simple comparison of the number of safeguard and antidumping measures that are implemented does not tell the entire story, however, given that AD measures are country-specific and each safeguard measure can affect multiple exporting countries. Suppose we were to compare the number of countries affected instead of measures imposed. If we assumed that that an average of twenty countries were affected by each safeguard measure (e.g., the average number of countries affected in the twenty-one safeguard measures investigated by Chad P. Bown and Rachel McCulloch in Nondiscrimination and the WTO Agreement on Safeguards, BRANDEIS UNIVERSITY MANUSCRIPT, January 2003), the relevant comparison would be 360 versus 700 affected countries. This would still indicate a significant bias toward the use of antidumping measures.

32 Baldwin, supra note 8

33 Chad P. Bown, The Economics of Trade Disputes, the GATT’s Article XXIII and the WTO’s Dispute Settlement Understanding, 14(3) ECONOMICS AND POLITICS 283 (2002)
affected trading partners are large, policymakers find the safeguard measures attractive if retaliation threats under dispute settlement provisions are either unpoliced or excessive, which may have been the case under the GATT regime.

Bown\textsuperscript{34} pursues the empirical question of whether the concern for retaliation affects a government’s policy decision of how to implement protection: under the GATT’s safeguard provisions or through some ‘GATT-illegal’ provision that results in a viable trade dispute. Using data on 1973-1994 Article XIX safeguard measures\textsuperscript{35} and trade disputes that were filed under Article XXIII, the results suggest that countries use the safeguard measures as opposed to GATT-illegal policies when there is a substantial concern for retaliation.

While the threat of retaliation may be important to a government’s determination of how to implement protection, this does not address the question of whether the threat of retaliation affects the decision of whether a government will offer safeguard protection, relative to no protection at all. Recent empirical research by Blonigen and Bown\textsuperscript{36}, however, does find that the threat of retaliation is an important deterrent for firms and governments that are considering trade protection in the form of antidumping duties, a related policy instrument. Using data on U.S. antidumping measures between 1980-1998, they find that the threat of foreign firms retaliating through antidumping duties on U.S. exports affects the decision of which foreign firms are named in a petition, while the threat of a GATT/WTO trade dispute and potential retaliation through that

\textsuperscript{34} Chad P. Bown, \textit{Trade Disputes and the Implementation of Protection under the GATT: An Empirical Assessment}, JOURNAL OF INTERNATIONAL ECONOMICS (forthcoming)

\textsuperscript{35} The paper also uses data on countries invoking protection through the GATT’s Article XXVIII, which is similar to Article XIX (in terms of how compensation is handled), although it provides for permanent protection.

\textsuperscript{36} Bruce A. Blonigen and Chad P. Bown, \textit{Antidumping and Retaliation Threats}, JOURNAL OF INTERNATIONAL ECONOMICS (forthcoming)
channel affects the U.S. government in its antidumping duty determination decision. Thus, while the Bown result suggests that retaliation threats affect how countries implement protection, the Blonigen and Bown result suggests that retaliation threats also affect the decision of whether a government should implement protection at all. Given that safeguard measures and antidumping duties are potentially substitutable policy instruments, these related empirical results on retaliation threats may also have implications for both how firms (in addition to countries) choose between policy instruments when they seek import protection, or also whether to seek protection through safeguard measures at all.
E. Further Empirical Research on Safeguards

Hansen and Prusa have produced an important paper that explored the available data on U.S. safeguard measures. They examine the trade restricting effects of five U.S. safeguard measures imposed between 1980 to 1988. They find that trade volumes fell by an average of 34 percent after the government imposed the safeguard measure. On the other hand, over the same time period, they find that trade volumes fall by an average of only eleven percent when the government imposes an antidumping duty. Even though safeguard measures are more effective at restricting imports, U.S. industries file more antidumping than safeguard petitions and the success rate for antidumping (63 percent) is higher than for safeguard (26 percent) petitions. Hansen and Prusa thus conclude that while it may have a less effective impact on overall trade, antidumping protection is most likely more popular because it is easier to obtain. As one of the few empirical papers on safeguards, this is a useful starting point for future research.

The empirical research on safeguards applies almost entirely to the pre-UR regime. One exception is recent work by Bown and McCulloch who use data on WTO safeguard measures implemented under the 1995-2000 period to investigate the differential impact that the form of the safeguard (tariff, tariff rate quota, quota) has on exporting country market shares. They find that exporters’ market shares after the application of the safeguard are more closely tied to historical market shares for quantitative measures than tariffs, supporting the idea that quotas have the potential to discriminate in favor of historical suppliers and be biased against new entrants.

37 Hansen and Prusa, supra note 29
38 Chad P. Bown and Rachel McCulloch, Nondiscrimination and the WTO Agreement on Safeguards, BRANDEIS UNIVERSITY MANUSCRIPT, January (2003)
Other questions that economic researchers might consider include the following: what has changed since the creation of the WTO? Furthermore, we previously identified five concerns that existed before the UR and discussed the UR reforms intended to address them. Thus, regarding the use of compensation and retaliation, how has the prohibition on retaliation during the first three years of a safeguard measure directed against an absolute increase in imports affected its use?

There is evidence that some countries are increasing their usage of safeguards. From 1980 to 1994, the United States imposed only seven safeguard measures, or fewer than one every two years. In contrast, between 1994 and 1999, the United States imposed five safeguard measures or one per year. On a worldwide basis, it seems that safeguard use has increased. Table 2 documents the number of safeguards reported to the GATT/WTO per year divided by both the number of GATT/WTO members and by the total trade volume of the members. Safeguard use fell fairly steadily from about 1960 to 1994. Interestingly, after the UR reforms were implemented around the world, their use began to grow. It is too early to determine if this is the beginning of a long-term trend or just a temporary increase, but it seems that safeguards have become a little more popular.39

Anecdotally, two interesting phenomena can be observed. First, many countries imposing safeguards have chosen to apply them for three years rather than four - presumably to avoid compensation or retaliation. Second, threats of retaliation have become concrete. In the wake of the U.S. safeguard measure on steel, several countries have published lists of U.S. products that would be hit with tariffs if the safeguard

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39 There was a substantial increase in the use of safeguards in 2002 after the March U.S. steel safeguard decision resulted in higher U.S. tariffs. Many trading partners responded by also implementing safeguard protection against likely re-routing of exports from the United States.
remains in place for more than three years or if the measure is otherwise found by the DSU to violate the United States’s WTO obligations and the United States refuses to bring it into conformity.\textsuperscript{40} For example, the EU claimed that for many of the products there had only been a relative increase in imports so that they did not have to wait three years for compensation.

Regarding the type of policy measure, since 1994 countries have imposed both tariffs and quotas. Thus, despite rule changes introduced in the UR, safeguards are still not subject to the basic GATT/WTO principle of equal treatment for all countries. This is compounded by evidence that even when countries are imposing safeguard tariffs, they are regularly applying safeguards in a discriminatory way.\textsuperscript{41}

As for the injury criteria, it is difficult to assess their stringency without detailed data on safeguard investigations around the world. However, it is encouraging to observe that countries are turning down some safeguard petitions. Of the 35 safeguard investigations conducted around the world between 1995 and 1999, only 21 resulted in import-restricting measures.\textsuperscript{42}

It is also too early to tell at this stage if countries will try to make temporary safeguard protection permanent by extending protection beyond the eight year maximum

\textsuperscript{40} As of February 2003, nine WTO members (EU, Japan, Korea, China, Switzerland, Norway, New Zealand, Brazil, and Taiwan) had initiated formal cases against the United States under the DSU regarding the March 2002 safeguard measure on steel imports. For the list of the goods the EU had threatened to retaliate over, see Immediate Notification Under Article 12.5 Of The Agreement On Safeguards To The Council For Trade In Goods Of Proposed Suspension Of Concessions And Other Obligations Referred To In Paragraph 2 Of Article 8 Of The Agreement On Safeguards European Communities. G/SG/43, May 15, 2002.

\textsuperscript{41} Bown and McCulloch, supra note 38

\textsuperscript{42} Furthermore, the application of many of these safeguards have been determined under the DSU to be inconsistent with WTO obligations. Douglas A. Irwin, Causing Problems? The WTO Review of Causation and Injury Attribution in U.S. Section 201 Cases, DARTMOUTH COLLEGE MANUSCRIPT, November 2002, investigates the problems of recent U.S. safeguard actions that have been brought before the DSU and that resulted in rulings that USITC decisions had failed to ensure that injury to the domestic industry was caused by non-import factors (e.g., domestic shocks) and was not mis-attributed to imports.
limit that the AS allows, perhaps through either Article XXVIII or through other WTO provisions, such as the Agreement on Antidumping. The fact that exporting countries have threatened retaliation if measures are not removed after three years suggests that most countries will choose to comply with the AS time limits.

Finally, as the data compiled by Miranda et al. indicate, the use of antidumping duties has exploded over this time period, and it is certainly the case that they are being used when a safeguard would be the more appropriate trade policy. In the next section we discuss the interplay between antidumping policy and safeguard policy and the need for joint reform of both safeguards and antidumping.

In summary, economics research on safeguards points to their many potential benefits - most importantly, the role they play in sustaining trade agreements. Sadly, in practice it appears that safeguards may not be used when they can create benefits for society and may be used when they cannot.

**IV. UNFINISHED BUSINESS**

In this part we provide a discussion of where to go from here. The caveat we note from the outset is that it is difficult to make any policy reform that will target a deficiency in the current system without introducing another problem somewhere else. Thus our goal is to discuss potential reforms and to illustrate as clearly as possible their benefits and costs. Ultimately it is then the role of researchers and policy-reformers to try to estimate the magnitude of the costs and benefits of policy changes, in order to determine which should be pursued. While we propose what are ultimately a set of empirical
questions, these questions may admittedly be difficult to answer conclusively because of
the rather infrequent resort to safeguard measures and thus limited data availability.
Nevertheless, we start from the perspective that safeguards in their current form under the
WTO are not being utilized as researchers and policymakers envision, especially given
their unpopularity relative to the explosion of implementation and use of national
antidumping statutes.

The first issue that must be addressed is the question of the frequency of
protectionist measures being implemented under the WTO system. Given the
substitutability between policy instruments, it may be useful to take a step back and
recognize the inevitability and indeed, potential welfare-enhancing feature of
GATT/WTO provisions that give domestic governments the ability to temporarily protect
domestic industries. From this perspective, perhaps the most important questions to
consider when discussing reforms to the WTO that would affect safeguards are: should
the measures be applied on an MFN basis? Should the measures be accompanied with
compensation? Should the use of safeguards be made more attractive or at least more
transparent?

A. MFN Versus Discrimination

An empirical question that reformers need to take into consideration is whether
the economic “benefits” from requiring the MFN application of safeguards outweigh the
“costs” of an MFN policy. The benefit of a temporary MFN measure is that there is no
trade diverted into the protection-implementing country’s market from less efficient

43 Miranda et al., supra note 30.
sources, as could have been the case had the country had been permitted to implement a discriminatory policy. Furthermore, if countries are given the ability to discriminate, governments may take advantage of that by allowing their trade policy to be tailored so as to avoid potential retaliation by “large” countries, thus implicitly targeting smaller trading partners that do not have the capacity to retaliate.

On the other hand, there are other practical benefits to not forcing countries to implement safeguard measures on an MFN basis. First, a discriminatory policy may be preferred if the safeguard scheme requires compensation based on the fact that with fewer trading partners affected by the measure, less compensation is required. In a system with a de facto inflexible compensation mechanism such as that faced by the WTO currently, this has its benefits as there is the potential for fewer secondary inefficiencies to be generated through retaliation-as-compensation. If safeguards were applicable on a non-MFN basis, this would arguably also improve their attractiveness relative to antidumping measures which are discriminatory by their very nature.

Another open question is what are the full, international trade-diversionary effects of a non-MFN as opposed to an MFN safeguard policy? While a non-MFN policy can generate trade diversion into the protected market, because fewer countries are targeted, there is perhaps less trade that is “bounced” or “re-routed,” from export to the protecting market to export to other international destinations. With a safeguard measure that is applied on an MFN basis, an unanswered empirical question is what is happening to overall world trade? Is it simply being dampened or suppressed, or is more trade being re-routed to other international destinations? In the second case, this could lead to surges of

44 See the evidence for the case of antidumping duties in the United States, a discriminatory policy, presented by Bruce A. Blonigen and Chad P. Bown, Antidumping and Retaliation Threats, JOURNAL OF INTERNATIONAL ECONOMICS (forthcoming).
imports to other importing countries and hence calls to resort to protection there as well. The implications of this are currently not well understood but should be considered.

**B. Compensation Versus No-Compensation**

A second empirical question to consider is whether the economic “benefits” from requiring compensation with the application of a safeguard measure outweigh the “costs” of requiring compensation. The costs to requiring compensation in the current system are larger than the monetary costs might indicate – due to the inflexible nature of the *de facto* current system which more and more frequently requires countries to rely on the threat of retaliation and the difficulties inherent in compensation negotiations. Furthermore, requiring compensation makes more attractive the inappropriate use of alternative policy instruments, such as antidumping duties, that are just as easy (or arguably easier) to obtain but which require no compensation.

Given that retaliation imposes costs (through the inefficiencies generated) that are larger than the benefits to the retaliating country (which receives the compensation), one legitimate question is why require compensation at all? Are there explicit benefits to a compensation requirement? Recall that the imposition of a tariff measure by any large country generates a “negative externality” – it imposes a cost on the foreign exporting country. Specifically, the protection drives down the price received by the trading partner’s exporters, generating potential welfare gains for itself at the expense of these foreign agents. Because the country does not face all of the costs of its protection, it engages in an excessive level of protection, relative to that which it would invoke if it
were to face all the costs of its actions. A compensation requirement, on the other hand, forces the protection-implementing country to internalize more of the externality, imposing fewer costs of the protection onto its trading partners. Because of the internalization, it faces costs closer to the “true” costs of implementing the protection, thus it will tend to implement such protection less frequently, only when the (political, economic) gains are larger than those “true” costs.

What reforms to the compensation requirements might be considered? Recall that while the UR reforms did much to change the size of the compensation required (e.g., there is no compensation required for AS cases with an absolute surge in imports) the effect on increasing the relative attractiveness of the safeguard provisions appears to have been minimal. Governments still prefer to use antidumping measures, even though in many instances if they were to implement the protection as a safeguard measure, they would also not have to offer compensation. Nevertheless, an important negative effect on the compensation mechanism induced by the UR reforms was actually a restriction to the means by which countries were able to compensate each other through resort to safeguards, with the general prohibition of VERs. One reform is thus to try to introduce an additional explicit means of compensation that has the efficiency properties of a VER, so that the costs of compensation are not increased simply because of the means through which the compensation is exchanged (retaliation).

Bown, for example, has suggested that compensation might take the form of the protection-implementing country refunding the tariff revenue collected to the foreign government, whose firms have been adversely affected by the domestic government’s
The benefit to such a mechanism is that the effect on economic welfare across countries in this case can work in a manner similar to a VER, as the exchange of tariff revenue could be equivalent to the exchange of the “quota rents” under a VER. In addition, this would not necessarily have the same discriminatory or anti-competitive (collusive) side-effects or “costs” of the VERs of the past, as the safeguard tariff could still be applied on an MFN basis and there would be no need for negotiation between foreign and domestic firms or the domestic and foreign governments, and thus no scope for arm-twisting or discriminating on the basis of “power” relationships. Furthermore, the compensation of tariff revenue could be handed directly to the foreign firms which would help overcome the problem of how to effectively compensate the “losers” of a safeguard measure, which is hard to do when the limited means available are retaliation.

C. Additional Transparency

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45 Chad P. Bown, Why are Safeguards under the WTO so Unpopular?, 1 (1) WORLD TRADE REVIEW 47 (2002). To clarify, this should not be confused with the recent controversial Byrd Amendment which changed U.S. trade law to automatically allocate tariff revenue collected in U.S. antidumping and countervailing duty cases to the U.S. industries that supported the petition. The Byrd Amendment has been found by the WTO Appellate Body to violate the WTO Agreements on Antidumping and Subsidies and Countervailing Measures, see Report of the Appellate Body, United States - Continued Dumping and Subsidy Offset Act of 2000, WT/DS217/AB/R, January 16, 2003.

46 Bown supra note 45 has also suggested that this is an additional reason why antidumping measures are attractive to protection-implementing countries relative to safeguard measures. As noted above, under the Agreement on Antidumping, managed trade arrangements are encouraged through the resort to “price undertakings,” which economists like Michael O. Moore, VERS and Price Undertakings under the WTO, GEORGE WASHINGTON UNIVERSITY mimeo (2001) have argued can be equivalent (or even worse) than a VER on welfare grounds.

47 This would require, however, an additional mechanism to ensure that foreign exporters did not anticipate the refund and further reduce prices in the domestic market, thus eliminating the effectiveness of the safeguard protection from the perspective of the domestic industry, which was benefiting from the higher prices.
Additional useful reforms to the safeguard provisions would include further refinements of the Agreement in order to differentiate between alternative categories of safeguard measures, perhaps along the lines of the different economic reasons that policymakers use to justify their use. If countries also provided a reason why they are resorting to that form of protection, this would add transparency to the system.

Furthermore, a more refined safeguards agreement could potentially have different rules on the applicability of MFN and compensation, based on the (legitimate) justifications behind why countries are resorting to the measures. Much as the AS already does not require compensation during the first three years for an “absolute increase” in imports, compensation might also be eliminated in the instances in which a government implements safeguards in order to facilitate an orderly exit of the declining, domestic industry. On the other hand, more compensation might be required if safeguards were being used for reasons of technological catch-up or because of pure political considerations.

Nevertheless, any increased transparency requirements in the safeguard provisions that were not also included in antidumping provisions, would also be costly as they would act to make the alternatives relatively more attractive.

D. Reforms to other WTO Agreements

As experience after the UR has shown, any reforms that might be designed to make safeguards more attractive will have limited effectiveness if they are not combined with reforms to the Antidumping Agreement and perhaps penalties and compensation under the DSU that makes the use of antidumping measures less attractive.
V. CONCLUSION

Safeguards play an important, multi-faceted role in trade regimes such as the GATT and now the WTO. How and when they are used – both relative to the alternative of free trade and also the alternative of policy instruments such as antidumping measures – are affected from a variety of influences in the underlying rules of the system.

In this chapter we have documented the historical and continuing role of safeguard provisions in the GATT and WTO agreements. We have provided a review of the primary economic explanations for the benefits of including safeguard provisions into trade agreements such as the GATT/WTO as well as the costs of doing so. We have also identified some of the important pitfalls that arise and which can lead to misuse of the provisions, once they have been included. We have discussed the relationship of safeguards with other, substitute policy instruments in the system, in particular antidumping duties. Throughout our discussion, we have attempted to highlight the most relevant rules and procedures of the WTO system that affect safeguards in order to illustrate how these rules generate incentives that affect the ways that countries use safeguards. Finally, we have documented some ideas for potential reforms to the safeguards and related agreements and provided a discussion of their costs and benefits, in the attempt that future researchers and reformers play special attention to the full interaction of the safeguards provisions with the overall WTO agreement.
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WTO. 2002b. *Immediate Notification Under Article 12.5 Of The Agreement On Safeguards To The Council For Trade In Goods Of Proposed Suspension Of Concessions And Other Obligations Referred To In Paragraph 2 Of Article 8 Of The Agreement On Safeguards European Communities*. G/SG/43/Suppl.1, June 20.
Table 1. Country use of Article XIX and the Agreement on Safeguards, 1950-2001

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<td><strong>Total</strong></td>
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Source: WTO (1995a, 2000, 2001a)
Table 2. The Relative Frequency of Safeguards Use, 1950-2000

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* Value of WTO trade in billions of 1996 U.S. dollars. ** 15 measures including provisional safeguards of up to 200 days. 10 measures not including provisional measures.