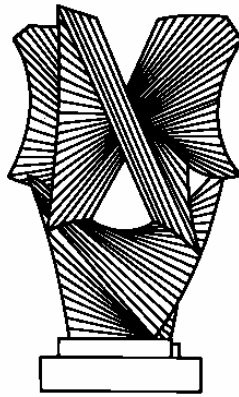


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Trade Remedy Laws

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Trade Remedy Laws

Alan O. Sykes*

Abstract

This paper is a preliminary draft of a chapter for eventual inclusion in the Handbook of International Economic Law, edited by Andrew T. Guzman and Alan O. Sykes, forthcoming from Edward Elgar Publishing. The chapter is a survey of the law and economics of trade remedy laws, including safeguard actions, antidumping law, and countervailing duty law. It lays out the central legal obligations of the WTO in each subject area, and carefully reviews the pertinent economic commentary, both positive and normative.

The term “trade remedy laws” refers to three types of national laws that impose import restrictions under specified circumstances. “Safeguard measures” are temporary trade restrictions, typically tariffs or quotas, which are imposed in response to import surges that injure or threaten “serious injury” to a competing industry in an importing nation. “Antidumping duties” are tariffs in addition to ordinary customs duties that are imposed to counteract certain “unfair” pricing practices by private firms that injure or threaten to cause “material injury” to a competing industry in an importing nation. “Countervailing duties” are tariffs in addition to ordinary customs duties that are imposed to counteract certain subsidies bestowed on exporters by their governments, again when they cause or threaten to cause material injury to a competing industry.

Such measures under national law are permitted, but not required, by WTO law, subject to the limitations found in WTO treaty text, including GATT 1994 (hereafter GATT), the WTO Agreement on Safeguards (hereafter SA), the WTO Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade (the Antidumping Agreement, hereafter ADA), and the WTO Agreement on Subsidies and Countervailing Measures (hereafter SCMA). These WTO Agreements impose extensive substantive and procedural restrictions on the use of each type of measure.

This chapter provides an introduction to the law on each trade remedy measure, and to pertinent economic research and commentary. My emphasis will be on WTO obligations, to which national laws must conform (in the case of WTO member states). I make occasional reference to the national law of the United States to illustrate how WTO

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obligations have been implemented (or not), but will make no attempt at a cross-sectional survey of variation in national statutes.

I. Safeguard Measures

The heart of the original GATT bargain in 1947 involved the reciprocal reduction of tariff rates, and negotiated ceilings or “bindings” on tariffs governed by GATT Article II. The drafters of GATT anticipated that tariff concessions might become unexpectedly burdensome, however, and provided two principal mechanisms for the adjustment of tariff commitments. GATT Article XXVIII provides for the renegotiation of tariff commitments once every three years, as well as for “out of season” renegotiation under special circumstances authorized by the membership. In addition, the drafters provided for “emergency action on imports of particular products” in GATT Article XIX, a provision that addressed unexpected import surges. These “emergency actions” came to be known as safeguard actions. Article XIX is also often termed the GATT “escape clause,” as it allows GATT members to “escape” from their tariff commitments (and other obligations) under specified circumstances.

Perceived deficiencies in Article XIX and in GATT practice pursuant to it led to the negotiation of the SA during the Uruguay Round. The SA was targeted at extra-legal or “gray area” substitutes for formal measures under Article XIX, but also introduced other procedural and substantive obligations.

The possibility of safeguard measures in services sectors has also been contemplated under WTO law. GATS Article X provides for multilateral negotiations on the subject. To date, however, the use of safeguards has not become an issue under GATS, and I will confine my attention here to the issues involving GATT and the SA, which govern trade in goods.

The key features of the treaty text in GATT and the SA are the subject of Sections A and B. Section C reviews the important disputes that have arisen over the use of safeguards to date in the WTO. Section D concludes with a review of the economic commentary on safeguard measures.

A. Safeguard Measures under GATT¹

Paragraph 1(a) of GATT Article XIX 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.”

The basic structure is a simple one. When an unanticipated import surge results from some obligation under GATT and the import surge is a cause of serious injury or threat thereof to import-competing firms in the importing nation, the importing nation may deviate from its obligation temporarily and to the degree necessary to address the injury due to the import surge.

Article XIX further provides that such deviation from GATT obligations will come at a price. Paragraph two requires that a party invoking its right to suspend or modify concessions must notify adversely affected parties and “consult” with them. Although it does not say so expressly, it was contemplated that such consultations might lead to an agreement to substitute alternative trade concessions for those withdrawn because of the import surge—trade “compensation.” Paragraph three provides, however, that if negotiations over compensation are unsuccessful, the importing nation may deviate from its obligations nevertheless. In that event, adversely affected trading partners have a right to suspend “substantially equivalent concessions.” Thus, absent a successful negotiation over compensation, affected trading partners could retaliate against safeguard measures, subject to the equivalence requirement. The equivalence requirement was subject to little policing, however, since collective action by the membership was necessary to disapprove the level of retaliation, and any such action under the original GATT required unanimity.

¹ Jackson (1969) remains the definitive reference on the treaty text of the original GATT and its interpretation.

Over the years, the system devised by Article XIX malfunctioned in two ways. The first problem arose because the textual requirements of paragraph 1(a) became increasingly difficult to apply with the passage of time. The text requires that safeguard measures respond to the consequences of an “unforeseen development.” Unforeseen by whom, at what point in time? These questions had a natural answer in 1947—an “unforeseen development” was something unforeseen by the original GATT negotiators, in 1947 when the original tariff bindings were negotiated. But ten, twenty, or forty years later, this anchor for the unforeseen developments requirement seemed inapt, as few things occurring that many years later could have been foreseen in 1947. And if the anticipations of the original negotiators were no longer the relevant benchmark, what should substitute for them?

Much the same issue arose with the requirement that the import surge be traceable to a GATT obligation. Again, the obvious interpretation in 1947 was that the surge had to result from the 1947 tariff binding. But what of a surge twenty years later? Could any import surge at that time be fairly said to “result” from a twenty-year old binding? What if additional bindings had been negotiated in the interim (or not)? Of course, it could always be argued that but for a tariff binding, the importing nation would have raised its tariff to prevent the surge. But on that reading, the requirement of linkage to a GATT obligation would be trivially satisfied for any product covered by a tariff binding.

The eventual response to these textual conundrums was to ignore the text that led to them. When domestic authority for safeguard measures was included in the U.S. Trade Act of 1974, for example, the statute made no mention of any requirement to link increased imports to any unforeseen development, or to any particular GATT obligation, and indeed U.S. law still omits any reference to these issues.² Prior to the entry into force of the treaty establishing the WTO, no nation complained about this state of affairs to my knowledge.

The demise of these textual prerequisites for safeguard measures created another problem, however, which I will address in detail below. For now, I simply note that the requisite inquiry into the “cause” of serious injury or threatened injury under Article XIX becomes conceptually problematic when there is no longer any “unforeseen

² See U.S. Trade Act of 1974 §§201 et. seq., codified as 19 U.S.C. §§2251-54.

development” to serve as an exogenous shock, and thereby to establish a baseline for the volume of imports and to define the counterfactual for ascertaining whether the import surge is causally responsible for injury.

The second problem with the system arose because GATT members resorted increasingly to extra-legal substitutes for safeguard measures, generally negotiated on a bilateral basis. These arrangements were often termed “orderly marketing” arrangements or “voluntary export restraints” (VERs). One of the most dramatic examples of the extra-legal nature of these measures arose after a safeguards case brought by the U.S. automotive industry, in which the domestic authority charged with administering the law (the U.S. International Trade Commission, (ITC)) concluded that the domestic industry had not met the statutory requirements for safeguard relief. President Carter nevertheless proceeded to negotiate an export restraint agreement with the Japanese government that remained in place for a number years.

The economic appeal of these negotiated “gray area” measures was readily apparent. As noted, nations wishing to use safeguard measures were subject to a requirement under Article XIX to provide trade compensation lest they suffer retaliation. VERs afforded compensation in the form of “quota rents”—covered exporters reduced the *quantity* of their exports, but because of the quantity restriction they were able to charge a higher *price* (the quota rent). Thus, VERs were the rough equivalent of cartel agreements, in which foreign and domestic industries agreed to restrict overall output in a national market in order to enjoy the benefits of higher prices.

Although these arrangements proliferated during the later years of GATT, they were subjected to extensive criticism by economic commentators. See, for example, Lawrence and Litan (1986). The commentators observed that gray area measures may be used when the Article XIX preconditions for safeguard measures had not been met, and that the magnitude and duration of gray area measures was entirely undisciplined. The political tide turned against these measures during the Uruguay Round, and a substantial effort was undertaken to put an end to them, culminating in the SA.³

³Bown (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.

B. The Agreement on Safeguards

The SA introduces a number of innovations. Most prominently, it seeks to end the use of gray area measures through two devices. The first is a simple prohibition on them—Article 11(1)(b) 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.” Second, to diminish the perceived incentives to resort to gray area substitutes, the SA alters the rules regarding compensation and retaliation. All members using safeguards “shall endeavor to maintain a substantially equivalent level of concessions,”⁴ i.e., to negotiate trade compensation. But if negotiations over compensation are unsuccessful, no right of retaliation exists during the first three years of a safeguard measure that conforms to the legal requirements of the Agreement and that follows an absolute increase in the level of imports. (Article 8(3)) 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.

Related, because various measures to protect injured industries dragged on for years under GATT, the SA introduces some bright-line time limits. Safeguards measures can last only four years, although they may be extended another four years if a formal determination is made to justify it. Further, after safeguard measures are once used in an industry, they cannot be re-applied in that industry for a length of time equal to the time that they had been in effect. Finally, any safeguard measure lasting over one year is to be liberalized at “regular intervals.”⁵

Several other elements of the SA warrant brief mention here. GATT Article XIX contained no procedural requirements for the imposition of safeguard measures under national law, and GATT members sometimes used procedures that were not transparent. Article 3 of the SA now requires an investigation by “competent authorities,” including notice to all interested parties and “public hearings or other appropriate means” to allow parties to present evidence and views. The findings of the competent authorities must be published setting forth “reasoned conclusions” on all matters of law and fact.

⁴Art. 8(1).

⁵Id. Art. 7.

Articles 2 and 5 pertain to the so-called issue of “selectivity,” or discrimination in the use of safeguard measures. Article 2 requires that a measure apply to any imported product “irrespective of its source.” Article 5 contains rules regarding the use of quotas, including rules for the allocation of quota shares among supplier countries. Such shares must be negotiated among all concerned, or else based on market shares during a “previous representative period,” subject to an exception for disproportionate import surges from particular sources.

Unlike Article XIX, the SA makes no reference to “unforeseen developments” as a predicate for safeguard measures, or to the requirement that import surges be linked to any particular GATT obligation. On the basic preconditions for safeguard measures, the Agreement simply states 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.”⁶

The only guidance as to the meaning of “serious injury” under this standard, and on the proper approach to the analysis of causation, is provided by Article 4 of the Agreement, which states 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 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.

⁶Id. Art. 2(1).

(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.

The next section will address some of the issues that this text leaves open.

C. Issues in Dispute Resolution—WTO Safeguards Cases to Date

The brief exposition of the law above masks a number of difficult issues that have now surfaced in WTO dispute proceedings. As has been argued elsewhere, WTO case law in the safeguards area has done little to resolve these issues, and has instead produced confusion and incoherence. See Horn and Mavroidis (2003), Grossman and Mavroidis (2004), Grossman and Sykes (2004), Pauwelyn (2004), Sykes (2003), Sykes (2004). This section briefly reviews the major issues, and notes their (often unsatisfactory) resolution to date.

Unforeseen Developments and the Effect of the Obligations Incurred. As noted, GATT practice came to ignore the requirement in Article XIX(1)(a) that any import surge be linked to unforeseen developments and to particular GATT obligations as a prerequisite for GATT members to employ safeguard measures. Likewise, the SA made no mention of these requirements, and it might have been assumed that they would remain dormant under WTO law. But in its first important ruling in a safeguards dispute—*Korea–Dairy*⁷—the WTO Appellate Body held Article XIX and the Safeguards Agreement are to be read cumulatively, and that all of the original requirements of Article XIX remain binding: “[I]t seems to us that the ordinary meaning of the phrase ‘as a result of unforeseen developments’ requires that the developments which led to a product being imported in such increased quantities and under such conditions as to 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

⁷Korea–Definitive Safeguard Measure on Imports of Certain Dairy Products, WT/DS98/AB/R (1999).

obligations under the GATT 1994, including tariff concessions.⁸” 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.”⁹ “*United States–Lamb*,¹⁰ further held that WTO members must demonstrate their compliance with these elements of Article XIX 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.¹¹ The same problem arose for the United States in the recent steel decision.¹²

Given the uniform practice of ignoring these issues in the latter years of GATT, it is questionable whether the drafters of the SA had any intention of reviving them. Having done so, however, the Appellate Body has done little to resolve the conundrums that led these parts of the treaty text to be ignored in the first instance. 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.

Another issue of considerable practical importance concerns the task of demonstrating the *effects* of an unforeseen development. How do the competent authorities determine the degree to which imports have surged as a consequence of it? In

⁸ Id. ¶84.

⁹ Id. ¶89.

¹⁰ United States–Safeguard Measures on Imports of Fresh, Chilled or Frozen Lamb Meat from New Zealand and Australia, WT/DS178/AB/R (2001).

¹¹ Id. ¶73.

¹² United States–Definitive Safeguard Measures on Imports of Certain Steel Products, WT/DS248-49, 251-54, 258-59/AB/R (November 2003).

the recent steel dispute, the United States asserted before the WTO dispute panel that the collapse of the former Soviet Union and the Asian financial crisis were both “unforeseen developments” that had resulted in an import surge. But there was little more than bare assertion that these events had caused significant import shocks in each of the many steel product lines or “industries” under investigation. Sykes (2004) reviews the efforts of the dispute panel in the steel case to come to grips with some of these issues, but the fundamental problems remain unresolved.

With regard to the “effect of the obligations incurred,” by contrast, the Appellate Body apparently offers a reading that enables the requirement to be trivially satisfied in every case—a member simply needs to show that it has incurred some obligations with respect to the product in question. It is hard to imagine how a dispute could arise without such an obligation, since a member with an unbound tariff could always raise it unilaterally without any need to rely on a safeguard measure.

Increased Quantities. Article XIX allows safeguard measures when a “product is being imported...in such increased quantities and under such conditions as to cause or threaten serious injury.” To ascertain whether imports have increased, of course, some baseline must be used. The original baseline for Article XIX was the volume of trade in 1947. But with the passage of time, that baseline became increasingly absurd, since global trade in most products had since increased dramatically. The other obvious baseline might have been the volume of trade on the date of the “unforeseen development” that produced the import surge, but since that prerequisite for safeguards measures had long been ignored under GATT, it did not supply a baseline in practice either.

In *Argentina–Footwear*,¹³ 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 Appellate Body concluded that the phrase “is being imported” requires “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.”¹⁴ “[N]ot just *any* increased

¹³Argentina–Safeguard Measures on Imports of Footwear, WT/DS121/AB/R (1999).

¹⁴*Id.*

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....[T]he 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’.”¹⁵

Thus, the Appellate Body insists that imports must have increased “recently.” But how recently, and in what amount? The phrase “recent enough, sudden enough, sharp enough, and significant enough, both quantitatively and qualitatively, to cause or threaten to cause ‘serious injury’” hardly provides useful guidance. The insistence on “not just any increase” but “such increased quantities” as to cause injury is equally unhelpful. Indeed, as I will detail in a moment, it is not even clear what it means to say that increased imports are a “cause” of injury.

Serious Injury. Like Article XIX and the SA, 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.¹⁶ 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.¹⁷

Otherwise, the Appellate Body has simply insisted that serious injury represents “significant overall impairment” as stated in Article 4.1 of the Safeguards Agreement. It

¹⁵ Id. ¶131.

¹⁶ See Argentina–Safeguard Measures on Imports of Footwear, WT/DS121/AB/R (1999), ¶121.

¹⁷ See United States–Definitive Safeguard Measures on Imports of Wheat Gluten from the European Communities, WT/DS166/AB/R (2001), ¶55.

characterizes this standard as “high” and “exacting.”¹⁸ 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.’”¹⁹ Beyond a requirement that all factors listed in the Safeguards Agreement be “evaluated” in each case, however, 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.

Causation. As originally drafted, Article XIX contemplated that the conjunction of an “unforeseen development” with new GATT constraints on national trade policy might lead to an import surge that caused or threatened serious injury. The causal variable in this chain, or the exogenous shock in economic parlance, was the “unforeseen development.” The economic logic of this test is clear, although to be sure it begs the question of what counts as an unforeseen development, and how its impact is to be demonstrated.

Because GATT practice came to ignore the unforeseen developments requirement, however, member states wishing to use safeguard measures had to employ a different conceptual framework to assess the causal impact of imports. United States law took the lead, and under the Trade Act of 1974 it simply asks whether increased quantities of imports cause or threaten serious injury.²⁰ The difficulty with this inquiry from the standpoint of economic logic is that import quantities are not a causal or exogenous variable—they are endogenous and *result* from other forces.

For example, if imports and domestic products are perfect substitutes, then the quantity of imports will simply equal the difference between domestic demand and domestic supply at the equilibrium price. Within this framework, the exogenous factors are the determinants of domestic supply, domestic demand, and the import supply curve. 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

¹⁸United States–Safeguard Measures on Imports of Fresh, Chilled or Frozen Lamb Meat from New Zealand and Australia WT/DS178/AB/R (2001), ¶124.

¹⁹Argentina–Safeguard Measures on Imports of Footwear, WT/DS121/AB/R (1999), ¶139.

²⁰ See 19 U.S.C. §2251(a). U.S. law actually asks whether increased quantities are a “substantial cause,” defined as a cause no less important than any other. For more detail on this test and its operation under U.S. law, see Sykes (2003), (2004).

technology; and import supply by factors affecting supply and demand in other countries. The quantity of imports is then a *result* of the interaction of these forces; it is not a causal variable at all. Likewise, changes in the quantity of imports will be the *result* of changes in the determinants of domestic supply, demand and the world price. Increased quantities of imports may result, for example, from a fall in the world price due to falling input costs abroad, to improved production technology abroad, or to weakening demand abroad. Increased quantities of imports can also result from an increase in domestic demand attributable, for example, to rising consumer incomes. Finally, increased quantities of imports can result from increasing costs of domestic production reflected in a leftward shift of the domestic supply schedule.

Against this backdrop, the question “did increased quantities of imports cause serious injury to a domestic industry?” is largely 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 changed are the costs of domestic firms, and that change *resulted* in reduced domestic production and increased imports.

The decision by the Appellate Body to resurrect the unforeseen developments requirement can offer at least conceptual solution to this problem, by reframing the question as one of whether the imports that *resulted* from the exogenous “unforeseen development” are the cause of actual or threatened injury. The practical challenges of making such a showing might be considerable, and it would remain to determine what should “count” as an unforeseen development, but at least the issue would be framed coherently. Puzzlingly, however, this is not the approach that the Appellate Body has taken to date.

Argentina–Footwear briefly addresses the proper method for determining whether imports are the “cause” of injury. The dispute panel in the case concluded that “if causation is present, an increase in imports normally should coincide with a decline in the relevant injury factors.”²¹“ The Appellate Body agreed with the panel that “in an analysis

²¹Argentina–Safeguard Measures on Imports of Footwear, WT/DS121/AB/R (1999), ¶141.

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.”²²

Hence, in its first important statement on the subject, the Appellate Body holds that the principal way to determine whether increased imports are the cause of injury is simply to look for a correlation between rising import volumes and indicators of decline in the domestic import-competing industry. It tips its hat to the familiar statistical distinction between correlation and causation, but sweeps it under the rug. One has no sense that the Appellate Body is aware of (or at least troubled by) the profound conceptual difficulty in confounding the two in a setting where the ostensible “causal” variable is in fact endogenous.

The other Appellate Body opinions on causal analysis focus principally on the so-called “nonattribution requirement” of Article 4.2 of the Safeguards Agreement, which 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 SA 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.”²³

²²Id. ¶144.

²³United 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’ “nonattribution analysis” on multiple occasions, generally because the reasoning was deemed inadequately clear.²⁴

Among the difficult issues posed by the nonattribution requirement of the SA is the identification of what constitutes a “factor other than increased imports.” In line with the earlier illustration, suppose that an increase in the costs of domestic firms leads to an increase in imports. Is the cost increase a “factor other than increased imports?” Is that view coherent when the “other factor” was actually the cause of the increased imports, as posited? At this writing, the Appellate Body has given no indication that it even understands the complex issues of economic causality raised by the SA. Sykes (2003) and (2004) provide further discussion of the conceptual difficulties with causation analysis under the SA and the unsatisfactory state of Appellate Body opinions on the matter to date.

Several economic commentators have proposed ways to make the causation analysis in safeguards proceedings more coherent. The predominant suggestion is that national authorities should inquire whether shifts in the import supply curve have caused serious injury or threat, as opposed to shifts in domestic demand and supply conditions. See Grossman (1986); Kelly (1988); and Irwin (2003). Pindyck and Rotemberg (1987) offer another suggestion based on counterfactual quotas that freeze import quantities at some baseline level, and analogous counterfactual assumptions to assess the quantitative impact of “other factors.” To date, however, national authorities have shown little inclination to embrace either approach, and the receptiveness of the Appellate Body to either approach remains untested.

²⁴See United States–Definitive Safeguard Measures on Imports of Wheat Gluten from the European Communities WT/DS166/AB/R (2001); United States–Safeguard Measures on Imports of Fresh, Chilled or Frozen Lamb Meat from New Zealand and Australia WT/DS178/AB/R (2001); United States–Definitive Safeguard Measures on Imports of Circular Welded Carbon Quality Line Pipe from Korea, WT/DS202/AB/R (2001).

A final important issue that as yet has received little attention from the Appellate Body concerns the task of determining which domestic firms are relevant for purposes of injury analysis. SA Art. 2 follows GATT Art. XIX in stating that the serious injury or threat thereof must be suffered by the domestic industry that produces “like or directly competitive products.” The question of how to “define the industry” under this standard often receives much attention from the competent authorities during their investigation—in the recent steel safeguard investigation in the United States, for example, the U.S. ITC ultimately determined that 27 separate steel product “industries” were involved, and conducted a separate analysis of each. Although some of the WTO safeguard disputes have included challenges to the definition of “industry” by competent authorities, most have been resolved largely on other grounds.

D. An Economic Perspective on Safeguard Measures

Sykes (1991) reviews the possible justifications for safeguard measures, and rejects most of them. Plainly, safeguard measures afford protection to industries that have difficulty meeting foreign competition. They delay the contraction of those industries, and impede the transfer of resources from declining industries to others where comparative advantage may lie. At first blush, therefore, safeguard measures seem quite problematic from the standpoint of economic efficiency.

Industrial proponents of safeguards most often argue that they are need for troubled industries to restore their competitiveness—a temporary period of protection will afford firms with profits to finance new investments, the argument runs, so that they can again compete in global markets. A difficulty with this argument is that it is often impossible for declining industries to restore their competitiveness through new investment, which would simply entail throwing good money after bad. In addition, there is little reason to think that national governments have the ability to identify industries that can become competitive “again” very reliably. And if governments can do it, why do the capital markets not do it as well and lend firms the money to finance worthwhile investments without the need for temporary protection?

From the standpoint of economic efficiency, therefore, safeguard measures appear highly questionable, at least at first blush. If this observation is correct, however, a puzzle

arises from a positive economic standpoint—why does the WTO system provide for safeguard measures nevertheless? Commentators have suggested several answers to this puzzle.

Safeguards as “Compensation.” The distributional consequences of trade liberalization are uneven. Some groups will benefit, and others will lose, even if the aggregate effect on economic welfare is positive. It is sometimes suggested that safeguard measures may serve a mechanism for compensating some of the groups disadvantaged by trade.²⁵

One difficulty with this claim is that trade protection is an extremely costly and clumsy device for compensating the “losers” from trade liberalization. To a great extent, it may simply benefit diversified shareholders in protected industries, doing little for individuals whose jobs have been sacrificed for the broader public good. Targeted unemployment and retraining programs seem a much more tailored response. 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 as noted. 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, it is perhaps a puzzle as to why measures to achieve it would have been limited to the situations in which dislocation was unforeseen.

Adjustment Costs and Orderly Contraction. Proponents of safeguard measures sometimes argue that temporary protection is needed to facilitate “orderly contraction.” Implicitly, the claim is that without protection the industry will collapse precipitously, leading to unnecessary unemployment and dislocation. This argument has received some credence from economic commentators. See Horn and Mavroidis (2003), Sykes (1990).

²⁵For a related argument predicated on Max Corden’s notion of the conservative social welfare function, see Deardorff (1987).

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 justification for safeguards under WTO law? The difficulty with this account is that nothing in the structure of WTO law (or in the national laws) 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.

The Political Economy Rationale for Safeguard Measures. In my judgment, the most convincing explanation for the presence of safeguards in the WTO system lies in the realm of political economy. Treaties are contracts of a sort, and the direct parties in interest are political officials. The officials who negotiate and ratify treaties may be expected to design provisions that serve their joint political interests, which may or may not coincide with economic welfare, conventionally defined. Because treaties are negotiated under conditions of uncertainty, it is in the interest of political officials to include provisions that allow them to adjust the bargain when its obligations become politically onerous, much as private contracting parties permit deviation from contractual commitments under circumstances where their performance has become economically onerous (as through clauses excusing nonperformance due to acts of war or force majeure). Several commentators have advanced theories of safeguard measures that locate them squarely within this framework.

Bagwell and Staiger (1990, 2002) suggest that safeguard measures are allowed because the temptation to cheat on tariff commitments can become acute in response to short-term import surges. In their model, the temptation arises because following an import surge, a tariff increase affords a larger terms of trade gain to the importing nation. If a tariff increase under these circumstances were defined as a breach of agreement, other nations would retaliate, cooperation might unravel and the long-term benefits of the trade agreement might be lost. The parties to trade agreements recognize this problem

and allow each other to “cheat” in these short-term situations to preserve long-term cooperation.

Sykes (1991) offers a slightly different argument, which rests on the observation that the political pressure to protect industries in severe decline is often acute. One explanation is that in declining industries, both firms and workers have made sunk investments on which the rates of return have fallen below competitive levels. If they are able to obtain protection that raises prices, they will retain the benefits for themselves—no competitive entry will occur unless returns exceed the competitive level. Accordingly, they will lobby harder for protection than other industries in which the benefits of protection would be competed away. Likewise, if protection for a declining industry harms foreign exporters who are highly profitable and growing, they will tend to raise less political objection to it because their prosperity would often be competed away in any event. It may then be in the mutual political interest of parties to trade agreements to allow each other to reimpose protection to help an industry that is in severe decline due to some shock that also leaves its foreign competitors prosperous and expanding—arguably, the circumstances contemplated by Article XIX. 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. Such industries will tend to become a less potent lobby for protection over time as existing physical and human capital depreciates, and the returns to sunk investments that are lost due to foreign competition diminish.

Bagwell and Staiger (2005) extend their prior work to consider a related situation in which governments face uncertainty about future political pressures for protection, and where the degree of domestic pressure that they face cannot be observed by other governments (private information). Here again, it may be in the mutual interest of the parties to trade agreements to allow each other to deviate from commitments when the domestic pressure to do so is high in an importing nation, but they must also worry that trading partners may deviate opportunistically because domestic political pressure is unobservable by others. A partial solution to this problem is to limit the number of times that nations may deviate from commitments in a given industry—governments will be less tempted to cheat by deviating when political pressure to do so is low, for fear of losing their right to deviate in the future when pressure is high. This observation suggests

an explanation for one feature of the SA noted earlier—safeguard measures cannot be used in an industry that has used them in the past, for a length of time equal to the time that they were in place.

These analyses also have interesting normative implications. The Bagwell and Staiger framework suggests that without a safeguards mechanism, cheating on trade agreements might become acute and cooperation might unravel, denying trading nations the long-term benefits of trade liberalization. Sykes further emphasizes how the opportunity to deviate from commitments when the pressure to do so is high may make trade negotiators more comfortable about making trade concessions in the first instance, a point also noted in Dam (1970). The economic welfare effects of the safeguards mechanism then depend on the balance between the economic welfare gains associated with more trade concessions *ex ante*, and the economic costs associated with renewed protection under the safeguards mechanism *ex post*. The *ex post* welfare consequences of the safeguards mechanism also depend importantly on the extent to which nations negotiate trade compensation when they employ safeguards measures, or instead trigger trade retaliation.

II. Antidumping Duties

Antidumping duties are by far the most frequently used measure in the trade remedy arsenal. The WTO website reports the initiation of over 2500 investigations between 1995 and June, 1994. Exporters in the People’s Republic of China have been the most frequent targets of antidumping complaints. Other frequent targets include exporters in Korea, Taiwan, and the United States.

“Dumping” entails a decision by an exporter, usually a private firm, to sell abroad at an “unfairly” *low* price. The benchmark for what constitutes a “fair” price, generally termed the “normal value,” and the task of ascertaining the magnitude of dumping, is a principal subject of this section. Before antidumping duties may be employed as a countermeasure against dumping, however, WTO law also requires that dumped imports be a cause of actual or threatened injury to competing firms in the importing nation. This “injury test” will also be a focus of attention. Section A provides a brief pre-GATT history of antidumping law. Section B concerns the existence and magnitude of dumping

under modern WTO law and practice, while Section C addresses the injury test. Section D concludes with a review of economic commentary regarding the logic and wisdom of antidumping law. In contrast to the safeguards area, WTO Appellate Body decisions to date in antidumping disputes largely concern narrow technical or procedural points, and I will not devote a section to them although I will mention a few rulings in passing.

A. The Genesis of Antidumping Law

The first antidumping law was enacted by Canada in 1904. As amended in 1907, it provided that any imported article, of a class or kind also manufactured in Canada, would be assessed an additional duty (subject to a cap) whenever the price charged for the article in Canada, less the costs of shipment to Canada, was less than the price of the article in the exporter's home market.²⁶

The Canadian legislation was proposed in a budget speech by the Minister of Finance, who offered the following justification for it:

“We find today that the high tariff countries have adopted that method of trade which has now come to be known as...dumping; that is to say, that the trust or combine, having obtained command and control of its own market and finding that it will have a surplus of goods, sets out to obtain command of a neighboring market, and for the purpose of obtaining control of a neighboring market will put aside all reasonable considerations with regard to the cost or fair price of the goods; the only principle recognized is that the goods must be sold and the market obtained...They send the goods here with the hope and expectation that they will crush out the native Canadian industries. And with the Canadian industries crushed out, what would happen? The end of cheapness would come, and the beginning of dearness would be at hand.”²⁷

The passage reflects a concern for what we might today term predatory pricing, or monopolization, under national antitrust laws.

After Canada enacted its antidumping law, antidumping policy quickly spread. Australia included antidumping measures as part of its unfair business practices law in 1906 (although with a more antitrust-like procedure for setting cases in motion and

²⁶ See U.S. Tariff Commission, *Information Concerning Dumping and Unfair Competition in the United States and Canada's Antidumping Law* (Washington: Govt. Printing Office, 1919).

²⁷ Quoted in *Id.*, p. 22.

deciding them), and the Union of South Africa followed with an antidumping law substantially the same as Canada's in 1914.

The Antidumping Act of 1916 Act in the United States, still on the books at this writing,²⁸ makes it “unlawful for any person...to import, sell or cause to be imported...articles within the United States at a price substantially less than the actual market value or wholesale price of such articles, at the time of exportation to the United States, in the principal markets of their country of production, or of other countries to which they are commonly exported...[if] such act or acts be done with the intent of destroying or injuring an industry in the United States.”²⁹ Criminal penalties attach to violations, and injured parties may sue for treble damages. This Act has been construed to require much the same showing as a predatory pricing case under the U.S. antitrust laws, and has been little used throughout its history.

The U.S. Antidumping Act of 1921, now subsumed in the Tariff Act of 1930, embraced antidumping duties as a countermeasure against dumping, thus moving American law in the direction of Canada's statute. And unlike the 1916 Act, it requires no showing of predatory design, simply a showing that dumped imports cause or threaten “material injury.” Much of the substance and procedure of the antidumping provisions of the Tariff Act of 1930 have been imported wholesale into WTO antidumping law.

B. GATT and the ADA—Identifying and Quantifying Dumping

In the course of negotiations over the creation of an International Trade Organization during the 1940's, the United States proposed to include a provision in the ITO charter to regulate antidumping measures. A modified version of the U.S. proposal was incorporated into the General Agreement on Tariffs and Trade (GATT) as Article VI. As far as one can tell from historical accounts, the drafters of the GATT did not discuss the policy behind antidumping measures at length. Rather, it was accepted at the time that national antidumping legislation was permissible, and the goal was to constrain its use to

²⁸ The 1916 Act has been ruled a violation of the ADA, and proposals to repeal it are now pending in Congress. The violation was found by the Appellate Body on the basis of its conclusion that GATT Article VI(2) limits the remedy for dumping to antidumping duties imposed in conformity with the ADA – the criminal penalties and treble damages under the 1916 Act are additional measures against dumping that are impermissible. See *United States–Antidumping Act of 1916*, WT/DS136, 162/AB/R (2000).

²⁹ 15 U.S.C. § 72.

avoid a proliferation of antidumping measures that would frustrate the market access expectations created by the reciprocal tariff concessions of GATT.³⁰ Additional discipline over antidumping measures was introduced in the 1960's with the conclusion of the first GATT Antidumping Code. The Code was revised during the Tokyo Round, and after further changes became the ADA during the Uruguay Round.³¹

Note that GATT members are under no obligation to prevent their exporters from engaging in dumping, and of course WTO/GATT law does not bind private exporters. GATT Article VI(1) simply provides that “dumping, by which products of one country are introduced into another country at less than the normal value of the products, is to be condemned if it causes or threatens material injury to an established industry...or materially retards the establishment of a domestic industry.” The remedy for dumping, however, lies entirely with the importing country, in the form of antidumping duties, “not greater in amount than the margin of dumping.” GATT Art. VI(2). In this section, I address the task of determining whether dumping exists, and of measuring its magnitude (the “margin of dumping”). Injury will be considered in the next section.

Antidumping investigations proceed in several stages. The first stage, “initiation,” generally involves a petition from a domestic industry alleging that dumping and injury (or threat) are present and setting forth evidence in support of that claim.³² If the investigating authorities find the evidence presented to be both accurate and adequate, a formal investigation will begin. They will then gather further information from both exporters and domestic petitioners regarding the existence of dumping and injury, and will commonly make preliminary determinations on these issues. If the preliminary determinations are “affirmative” on both issues, provisional duties may be imposed.³³ After affirmative preliminary determinations, there may also be an opportunity for a settlement of sorts in the form of a price undertaking from exporters. Absent a settlement, the investigating authorities will next proceed to audit the information provided to them by exporters for accuracy, and to entertain further arguments from all interested parties regarding the magnitude of dumping and the injury issue. Ultimately, they must make

³⁰ See generally Jackson (1969).

³¹ See generally Jackson (1997).

³² See ADA Art. 5. In exceptional circumstances, investigating authorities can self-initiate investigations. ADA Art. 5.6.

³³ See ADA Art. 7.

final determinations on the dumping and injury questions, and if both determinations are affirmative, the investigating authorities will impose definitive antidumping duties. Note that the ADA contains a *de minimis* rule, and forbids duties when the margin of dumping is less than two percent of the export price.³⁴

On the existence and magnitude of dumping, Article VI(1) states that an exported product is sold below “normal value” when its price (a) “is less than the comparable price, in the ordinary course of trade, for the like product when destined for consumption in the exporting country, or, (b) in the absence of such domestic price, is less than either (i) the highest comparable price for the like product for export to any third country in the ordinary course of trade, or (ii) the cost of production of the product in the country of origin plus a reasonable allowance for selling cost and profit.” Thus, an export price may be judged a dumping price with reference to three benchmarks: the “comparable” price of the like product sold by the exporter in its home market in the “ordinary course of trade;” the “comparable” price of the like product sold by the exporter to a third country in the “ordinary course of trade;” and what is generally termed the “constructed value” of the good, which is equal to its “cost of production” plus a reasonable allowance for general, selling and administrative expenses and profit. In turn, the “margin of dumping” will equal the difference between the price of the exported good, adjusted as necessary to make it “comparable,” and one of these three benchmarks. This same basic approach, now considerably elaborated, is now contained in Article 2 of the ADA.

Several remarks are in order about the use of these benchmarks in practice and under the ADA. First, importing nations are not free to pick and choose among the benchmarks. The *preferred* benchmark is the “comparable” price of the “like product” sold by the exporter in its home market. Importing nations may use another benchmark only when home market sales do not establish a reliable benchmark. Why might this problem arise? The obvious possibility is that the exporter in question does not sell the “like product” in its home market. ADA 2.6 defines “like product” as “a product which is identical, i.e. alike in all respects to the product under consideration, or in the absence of such a product, another product which, although not alike in all respects, has

³⁴ ADA Art. 5.8.

characteristics closely resembling those of the product under consideration.” If the exporter does not sell an identical product in the home market, therefore, it is permissible to use the price of a similar product to establish the benchmark. Adjustments to the price must then be made to account for differences between the products—if the product sold at home is more expensive to produce, for example, one might expect it to sell for a higher price, and it would be inappropriate to conclude that dumping is present simply because the product sold in the home market has a higher cost of production. These adjustments can become complex, and may rest on shaky assumptions about cost differences. At some point, the dissimilarities between products may become so great that confident adjustments are impossible. And in some cases, an exporter simply does not sell any plausibly “similar” products at home. The importing nation must then turn to one of the other benchmarks.

A related problem may arise when the exporter has some home market sales of a “like product,” but they are very small in number.³⁵ A possible concern in such cases is that the exporter may be manipulating home market sale prices downward simply to avoid a finding of dumping, so that the home-market benchmark becomes unreliable. That concern also arises when home market sales are made to a related company and may not reflect arm’s-length pricing.³⁶ Prices charged between related parties may be manipulated with an eye on the antidumping laws, and need not be used as the basis for comparisons.³⁷ Sometimes this problem can be solved by looking further down the chain of distribution to subsequent arm’s-length sales, but such transactions may not always be available.

Lastly, it is permissible to disregard home market sales as being outside the “ordinary course of trade” if they are made “below per unit (fixed and variable) costs of production plus administrative, selling and general costs,” if they are also made over an “extended period of time” and in “substantial quantities.”³⁸ After such sales are disregarded, there may be no sales left in the home market, or too few of them to establish a reliable benchmark.

³⁵ See ADA 2.2.

³⁶ *Id.*

³⁷ ADA 2.3.

³⁸ ADA 2.2.1.

If the home market benchmark cannot be used, the ADA makes clear that the next preferred alternative is the “comparable price” on the “like product” sold to a third country.³⁹ The importing nation is free to select the third country to use for this benchmark when more than one are plausible candidates, and will often choose the one that yields the highest benchmark (and thus the highest margin of dumping). The third-country benchmark may prove unusable, however, for essentially the same reasons as the home-market benchmark—there may be no sales of like products to third countries, they may be very few in number or made to related parties, or they may be below cost. In that event, the importing nation must turn to the third benchmark, constructed value.

Second, in the price-to-price cases (home-market or third-country benchmark), it is essential to compare prices at the same “level of trade”—a comparison of “apples to apples.” The ADA deems it inappropriate to compare the retail price in one country, for example, with the wholesale price in another. ADA 2.4 requires a price comparison “normally at the ex-factory level, and in respect of sales made at as nearly as possible the same time.” This requirement necessitates an additional set of price adjustments beyond those for any physical differences between the “like product” and the imported product noted earlier. Typically, for example, an importing nation may have information on the delivered prices of imported goods. It must then deduct built-in costs like freight and insurance to work back to the ex-factory prices, and may be required to make the same adjustments to home-market or third country prices. These adjustments become even more extensive when sales to related parties are present, and the investigating authorities must look farther down the chain of distribution to find an arm’s-length price with which to begin the analysis.

The desire to compare apples to apples in the price-to-price cases can necessitate a range of other adjustments as well. For example, suppose that sales in one market are to large customers who negotiate quantity discounts in the ordinary course, while sales in another market are to small customers who do not receive discounts. Or suppose that goods are marketed in different ways in different markets, with considerable differences in selling expenses. Many other factors might be imagined that affect the prices of the

³⁹ ADA 2.2.

goods in question,⁴⁰ and that must be made the subject of an adjustment lest dumping be found (or not) even though, from the seller's perspective, the same net price is being charged to comparable buyers.

Third, certain additional adjustments are required by GATT law to avoid impermissible findings of dumping. Article VI(5) provides that if a product benefits from an export subsidy, so that the export price is below the home-market price by the amount of the subsidy, and if that product is subject to a countervailing duty as a result, it cannot also be subjected to an antidumping duty to counteract the price differential as dumping (and vice-versa). In an antidumping case, therefore, the amount of a countervailing duty imposed on the same good to counteract an export subsidy will be added into the price of the exported good to reduce the margin of dumping and prevent a "doubling up" of the duties. Likewise, Article VI(4) prohibits antidumping duties where the price differential results from a rebate on exportation, or an exemption for exports, for certain qualifying taxes. Visitors to Europe, for example, may recall the opportunity to obtain a refund of the VAT on goods that they purchase in Europe and take home with them. The same rebate is available to firms who export from Europe. The VAT is built in to the price of goods in Europe, and so if the price for exports were calculated net of the VAT refund, it would be lower than the home market price by that amount and dumping would appear to be present. To avoid such a result, VAT refunds and certain other qualifying rebates or exemptions will be added to the price of the exported good to reduce the margin of dumping. It bears emphasis that not all taxes qualify for rebate or exemption, which has sparked a longstanding debate over whether particular tax systems (such as a VAT) create an advantage for exporters in international trade.⁴¹

Fourth, the computation of dumping margins requires some method for comparing and averaging data. Dumping investigations may involve vast number of transactions, both in the importing nation and the home country or third country market, and the ADA provides three possible ways for the information from the pertinent transactions to be aggregated to produce a dumping margin. The first is to compute a weighted average of the export prices, to be compared with a weighted average of the

⁴⁰ See ADA 2.4.

⁴¹ For further information, see the chapter by Julie Roin in this volume.

home-market or third-country transactions. The second is to compare export prices and home market prices on a transaction-to-transaction basis, and then to create an average of these individual comparisons to establish the dumping margin. Under limited circumstances, dumping margins may also be based on a comparison of individual export transaction prices with a weighted average of home-market or third-country prices.⁴² As of yet, the Appellate Body has said little about when these different comparison methods can or should be used, and the ADA itself provides only modest guidance.⁴³

An issue relating to the comparison that has surfaced repeatedly in dispute proceedings concerns the practice of “zeroing.” As a simple illustration, imagine that an importing nation is using the transaction-to-transaction method, and imagine a total of four sales of identical products, two in home market and two in the importing nation. In month one, a home-market sale occurs at \$4 and an export sale at \$5. In month two, a home-market sale occurs at \$5 and an export sale at \$4. The average of the two sales in each market is \$4.50. With “zeroing,” however, the investigating authorities conclude that there is no dumping in month one, and the margin of dumping for that month is set at zero. They conclude that a dumping margin of \$1 is present in month two. The margin of dumping is then computed to be $(\$0 + \$1) / 2 = \$0.50$, even though a comparison of the average home-market price with the average export price would yield a zero margin of dumping. The same issue can easily arise when the importing nation compares weighted-average normal value prices to individual export transaction prices. Less transparently, it can also arise in weighted-average to weighted-average comparisons because in many cases, investigating authorities will break down the products under investigation into sub-categories for purposes of comparability, and the practice of zeroing across the sub-categories will have a similar effect when the data from the subcategories are re-aggregated to produce a “weighted average of the weighted averages.” In the cases decided thus far, the Appellate Body has ruled against the practice of zeroing, although it has not yet confronted all conceivable scenarios in which it might be used.⁴⁴

⁴² ADA 2.4.2.

⁴³ For the current approach of the U.S. Commerce Department, see 19 C.F.R. §351.412.

⁴⁴ See European Communities–Anti-Dumping Duties on Imports of Cotton-Type Bed Linen from India, WT/DS141/AB/R (2001); United States–Final Dumping Determination on Softwood Lumber from Canada, WT/DS264/AB/R (2004). The Bed Linen case is discussed in Janow and Staiger (2003).

Fifth, although dumping is a practice in which individual firms engage, firms involved in dumping cases may or may not be aggregated for the purpose of computing a dumping margin. Antidumping cases generally encompass all of the exports of covered products from a given country, not just those of selected exporters. The ADA states that, “as a rule,” investigating authorities should determine individual dumping margins for each exporter.⁴⁵ But where that becomes impracticable because large numbers of exporters are involved, the investigating authorities may instead employ statistically valid samples, or may investigate the exporters supplying the largest percentage of the volume of exports that it is reasonably practicable to investigate. Exporters who desire to be investigated individually but who are excluded from the sample chosen by the investigating authorities may submit individual information to the authorities nonetheless, who must then determine an individual margin if the information is sufficient and the task is not unduly burdensome or time consuming. Exporters who are not individually investigated will be subject to antidumping duties based on averages for the exporters who are investigated.⁴⁶

Sixth, any examination of dumping is necessarily based on information about past transactions or costs, but antidumping duties are applied going forward after dumping is found (if injury is also found as discussed below), and WTO law requires that such duties “not exceed the margin of dumping.” What ensures that duties applied to future transactions will not exceed the margin of dumping, when that margin is calculated on the basis of historical information? The ADA provides for two approaches to the assessment of duties, “retrospective” and “prospective.”⁴⁷ Both approaches must be designed to ensure that exporters have an opportunity to receive refunds for any duty paid in excess of the actual margin of dumping. In the U.S. system, for example, the Commerce Department will conduct an administrative review periodically to examine the transactions to which an antidumping duty has been applied. Excess duties are refunded, and if the margin of dumping has increased the importer of record will be responsible for the difference.

⁴⁵ ADA 6.10. A dispute over this obligation arose in *Argentina—Definitive Anti-Dumping Duties on Imports of Ceramic Floor Tiles from Italy*, WT/DS189/R (2001).

⁴⁶ See ADA 6.10, 9.4.

⁴⁷ ADA 9.3.

It may occur to the reader to ask why an exporter would ever continue dumping once subject to an antidumping duty—why not cease dumping, and then collect a full refund of antidumping duties paid down the road (or allow one’s customers to collect the refund)? One answer is that to obtain a full refund, the exporter must raise its price to offset the margin of dumping, while its customers pay in addition the full antidumping duty for a period of time until the issue of a refund is adjudicated. Customers may simply turn elsewhere. In addition, as noted below, a full refund may be far from a certainty, because many factors make it difficult for exporters to know by how much they will be found to be dumping.

Seventh, an exporter can only dump in an importing nation if it is aware that its goods are being sold to that nation. For example, suppose that an exporter sells its goods to a trading company without knowledge as to where the trading company will resell them, and the goods are later resold by the trading company at different prices in different national markets. In this chain of distribution, only the trading company can engage in dumping, not the original exporter. Likewise, when goods are sold by a company in country A to another company in country B without knowledge as to their ultimate destination, and the second company then re-exports them to country C, only the company in country B can engage in dumping, and its resale price in country B would provide the relevant home-market benchmark.⁴⁸

Eighth, even though dumping in principle involves a deliberate decision by a firm to sell to the importing nation at a price below the pertinent benchmark, firms often “dump” by accident. As should now be clear, the computation of a dumping margin is a complicated undertaking. Complex price adjustments are required, which may be based on controversial assumptions about costs and cost allocation. Averaging methods may be used that can inflate apparent dumping, and the time period for price comparisons can be chosen strategically to maximize the evidence of dumping as well. If the constructed value benchmark is used, investigating authorities may assess the cost of production and the additional expenses that may be added to constructed value using data that a firm may not ordinarily gather itself, and using assumptions about cost allocation that are unpredictable or with which the firm may disagree. Investigating authorities are not

⁴⁸ See ADA 2.5.

required to accept everything submitted to them at face value, and will generally insist on verifying its accuracy, rejecting information that is unverifiable. In that event, investigating authorities may turn to other sources of information to complete their analysis, information termed “facts available,” which in practice may involve reliance on allegations submitted by the domestic industry seeking antidumping duties.⁴⁹ Exporters are also to some extent at the mercy of currency fluctuations, which may convert their prices into dumping prices unexpectedly.⁵⁰ As a result, it is exceedingly easy for exporters to find themselves “dumping” notwithstanding their best efforts to avoid it.

Ninth, once an exporter is once found to be dumping and becomes subject to antidumping duties, it may be exceedingly difficult for that exporter to get out from under them later. To be sure, the ADA does require investigating authorities to entertain requests by exporters for reinvestigation if they allege that circumstances justifying the antidumping duty have changed, and further requires a “sunset review” of antidumping duties every five years to ascertain whether the removal of the duty would likely lead to continuation or recurrence of dumping and injury.⁵¹ On what basis may such a determination be made? In U.S. practice, for example, the fact that dumping continues after an antidumping duty is in place is treated by the investigating authorities as evidence strongly supporting the continued need for the duty. Likewise, even if dumping ceases after a duty is in place, the fact that import volumes decline or fall to zero after the cessation of dumping is taken to be evidence of the continued need for the duty. Thus, whether the exporter ceases exports to the United States, raises price to avoid dumping and then suffers a large but not complete loss of business, or continues dumping to avoid losing market share, the investigating authorities will likely conclude during the sunset review that the duty should be maintained. The only case where the authorities will likely conclude that the duties are unnecessary is where dumping has ceased, and imports of the goods covered by the duty were steady or rising after the duty was imposed—a scenario unlikely to materialize very often. The Appellate Body has suggested that this policy is not on its face inconsistent with the ADA as long as the investigating authorities are

⁴⁹ See ADA 6.8, Annex II.

⁵⁰ See ADA 2.4.1.

⁵¹ See ADA 11.3.

willing to give proper weight to other considerations that may rebut the inference that dumping and injury are likely to recur.⁵²

Tenth, antidumping cases may be “settled.” After preliminary findings of dumping and injury by investigating authorities, exporters may enter “price undertakings” to revise their prices upward to a level that either eliminates the dumping fully or avoids its injurious effects.⁵³ From the exporter’s perspective, such agreements will often be preferable to the imposition of antidumping duties for the obvious reason that the exporter will retain the price increase, rather than see an antidumping duty paid by its customers to the importing nation. A fair number of cases are settled in this fashion, but many are not. Several reasons may be offered. In many instances, exporters accused of dumping face stiff competition from firms in the importing or a third nation, which do not face any prospect of antidumping duties. A price undertaking may force such an exporter out of the market, and its only hope of remaining competitive may be to proceed to the conclusion of the investigation in the hope of prevailing on the dumping or injury issues. Related, although the ADA prohibits price undertakings before the investigating authorities determine preliminarily that dumping and injury are present, in practice the authorities are unlikely to be interested in pursuing a price undertaking after final determinations on those issues have been made—the threat of the final determination exists as a sort of leverage to extract the price undertaking. When the outcome of the final determination appears uncertain, exporters may not be willing to offer a price undertaking with which the investigating authorities are satisfied, and may then prefer to take their chances by pursuing the case to conclusion.⁵⁴ In addition, investigating authorities need not accept price undertakings if their negotiation and administration is deemed impractical, as when a case involves a very large number of exporters—it is easily possible to imagine that exporters might “cheat” on their price undertakings, and investigating authorities will tend to reject them unless they are satisfied with their ability to verify compliance. Further, the investigating authorities will

⁵² See United States–Sunset Review of Anti-Dumping Duties on Corrosion-Resistant Carbon Steel Flat Products from Japan, WT/DS244/AB/R (2003).

⁵³ See ADA Art. 8.

⁵⁴ This problem is an example of the “optimism” model in the economics of litigation—if plaintiffs are more optimistic about their chances of winning or the size of their victory than defendants, then there may be no bargaining range within which settlement can occur.

not accept price undertakings unless a group of exporters accounting for substantially all of the imports from the country under investigation agree to them, and some of the exporters may balk (such as those that expect ultimately to demonstrate the absence of dumping on their part through an individual investigation). Lastly, investigating authorities might be expected to exhibit some bias against price undertakings, for the same reason that exporters might prefer them—a price undertaking represents a loss of revenue from the national treasury to the exporter, relative to an antidumping duty.

* * *

The remarks above are by no means a complete guide to the ADA. I have emphasized the substantive aspects of the investigation into the existence and magnitude of dumping, for example, over the procedural aspects. The ADA contains numerous other provisions regarding access to proceedings by interested parties, notice and publication of proceedings and findings, the presentation of evidence and the protection of confidential information, the requirements for the initiation of investigations, the standing of parties to seek antidumping duties, and other details regarding the conduct of proceedings and reviews. The major category of substantive obligations not yet discussed pertains to the analysis of injury in antidumping cases, the subject of the next section.

Before proceeding, however, note one unique feature of the ADA that must be borne in mind whenever any controversies arise as to its interpretation. Article 17.6 of the ADA provides a special standard of review to be applied in WTO antidumping disputes. In particular, “[w]here the panel finds that a relevant provision of the Agreement admits of more than one permissible interpretation, the panel shall find the authorities’ measure to be in conformity with the Agreement if it rests upon one of those permissible interpretations.”

C. The Injury Test under the ADA (and the SCMA)

The so-called “injury test” under WTO law operates more or less identically in antidumping and countervailing duty proceedings. Accordingly, I will address it only

once in this chapter with particular reference to the ADA—the reader should recognize that nearly identical provisions exist in the SCMA.⁵⁵

GATT Art. VI(6)(a) provides that no party shall employ antidumping or countervailing duties “unless it determines that the effect of the dumping or subsidization, as the case may be, is such as to cause or threaten material injury to an established domestic industry, or is such as to retard materially the establishment of a domestic industry.” The last clause, sometimes termed the “material retardation” test, is of little importance in practice and I shall dwell on it.⁵⁶ Virtually all dumping investigations in practice are focused instead on the question whether dumped imports are a cause of current or threatened material injury.

To answer this question, investigating authorities must begin by determining the set of domestic producers who compete with the imports under investigation. This yields the “definition of domestic industry” in the parlance of ADA Art. 4, and is an exercise somewhat akin to (though imperfectly) the task of defining the relevant market in antitrust cases. In general, the domestic industry is to be defined as the “domestic producers as a whole of the like products.” The concept of the “like product” thus appears in the injury context too (recall that the price-to-price comparisons for computing a dumping margin are to the properly adjusted prices of home-market or third-country “like products”), and the definition of the term noted earlier applies equally here. It is permissible to exclude from the domestic industry any companies that are “related” to the exporters under investigation.⁵⁷ In exceptional cases where competition is highly regionalized within the territory of the importing nation, such that producers in one region sell little or none of their production in other regions, it is also permissible to define two or more regional industries and to impose limited antidumping duties if only one of them satisfy the injury test.⁵⁸ Finally, the members of a customs union or free trade area may define a single industry encompassing all of their territories.⁵⁹

⁵⁵ Compare ADA Arts. 3 & 4 with SCMA Arts. 15 & 16.

⁵⁶ It is easy to see why the material retardation test is unimportant. Dumping cases are generally initiated at the behest of a competing domestic industry—if no such industry yet exists, there is rarely any constituency for antidumping action.

⁵⁷ Note 11 to Art. 4.1 defines the concept of relatedness.

⁵⁸ See ADA Art. 4.1(ii), 4.2.

⁵⁹ ADA 4.3.

Art. 4.1 makes some allowance for the possibility that the number of domestic producers may be vast, making it difficult to survey them all in assessing injury—thus, it is enough to include “those of them whose collective output of the products constitutes a major proportion of the total domestic production.” Art. 3.6 makes a related allowance for data issues that may arise in the assessment of injury. If it is not possible to obtain reliable data limited to the domestic production of the like product, the injury analysis may be based on an “examination of the production of the narrowest group or range of products, which includes the like product, for which the necessary information can be provided.”

Once the industry is defined, investigating authorities must then determine whether “the effect of the dumping...is such as to cause or threaten material injury” to that industry. GATT Art. VI(6). ADA Art. 3.1 elaborates by stating that a determination of injury must rest on an “an objective examination of both (a) the volume of the dumped imports and the effect of the dumped imports on prices in the domestic market for like products, and (b) the consequent impact of these imports on domestic producers of such products.” The differences in language relate partly to a longstanding debate under U.S. law as to whether a causal link must be drawn between material injury and *dumping*, or only between material injury and *dumped imports*. The difference between the two may not be obvious, but consider the following illustration: Suppose that exporters under investigation have a 20% market share in the importing nation, and that all of their imports are dumped at a margin of only 2%, just above the *de minimis* threshold. If one focuses on the large market share, it may be easy to conclude that the effect of the *dumped imports* on domestic producers is material. If one focuses instead on the small dumping margin, however, one might in some cases conclude that the effect of *dumping* is not material, in the sense that a 2% change in the price of the imports might have little impact. ADA Art. 3 seems deliberately designed to perpetuate the debate over the proper standard. Art. 3.2–3.5 refers repeatedly to effects caused by “dumped imports.” And with regard to the size of the dumping margin, Art 3.4 simply lists it as one of “relevant economic factors and indices” that must be part of the “evaluation” by the investigating authorities. But Art. 3.5 then provides: “It must be demonstrated that the dumped imports are, through the effects of dumping, as set forth in paragraphs 2 and 4, causing injury

within the meaning of this Agreement.” The second clause seems to require a causal link to dumping, while the third undercuts that interpretation by referring back to paragraphs 2 and 4, which refer only to the effects of “dumped imports.” At this writing, the Appellate Body has yet to weigh in on the issue.

Otherwise, the central approach of ADA Art. 3 is to require that certain factors be taken into account by investigating authorities in their analysis of injury, without saying how much weight they should be given, or how as a methodological matter their “consideration” is to proceed. Paragraphs 2, 4 and 5 are the key provisions:

“3.2 With regard to the volume of the dumped imports, the investigating authorities shall consider whether there has been a significant increase in dumped imports, either in absolute terms or relative to production or consumption in the importing Member. With regard to the effect of the dumped imports on prices, the investigating authorities shall consider whether there has been a significant price undercutting by the dumped imports as compared with the price of a like product of the importing Member, or whether the effect of such imports is otherwise to depress prices to a significant degree or prevent price increases, which otherwise would have occurred, to a significant degree. No one or several of these factors can necessarily give decisive guidance.

3.4 The examination of the impact of the dumped imports on the domestic industry concerned shall include an evaluation of all relevant economic factors and indices having a bearing on the state of the industry, including actual and potential decline in sales, profits, output, market share, productivity, return on investments, or utilization of capacity; factors affecting domestic prices; the magnitude of the margin of dumping; actual and potential negative effects on cash flow, inventories, employment, wages, growth, ability to raise capital or investments. This list is not exhaustive, nor can one or several of these factors necessarily give decisive guidance.

3.5 It must be demonstrated that the dumped imports are, through the effects of dumping, as set forth in paragraphs 2 and 4, causing injury within the meaning of this Agreement. The demonstration of a causal relationship between the dumped imports and the injury to the domestic industry shall be based on an examination of all relevant evidence before the authorities. The authorities shall also examine any known factors other than the dumped imports which at the same time are injuring the domestic industry, and the injuries caused by these other factors must not be attributed to the dumped imports. Factors which may be relevant in this respect include, *inter alia*, the volume and prices of imports not sold at dumping prices, contraction in demand or changes in the patterns of consumption, trade restrictive practices of and competition between the foreign and domestic

producers, developments in technology and the export performance and productivity of the domestic industry.”

Art. 3.2 lists factors that will be quite familiar to U.S. antidumping lawyers, as they have been central to decisions by the U.S. ITC for many years. An increasing volume or market share for the dumped imports weighs in favor of a finding of injury, particularly if the increases are correlated with declining prosperity for the domestic industry. Such analysis is subject, of course, to the objection that such correlation does not prove causation, doubly so if a causal link is required to *dumping*. The search for price undercutting by dumped imports is also a commonplace, even though such price differentials may simply reflect the fact that the dumped imports are lower quality products that must sell for less in equilibrium. The question whether dumped imports have suppressed domestic prices is a more logical question to ask from an economic standpoint, although nothing is said about how that question should be answered. In practice, investigating authorities may rely heavily once again on a simple correlation between import quantities or prices on the one hand, and domestic prices on the other.

Art. 3.4 merely lists a number of factors that must be evaluated by the investigating authorities in deciding whether injury is present, again without saying how or indicating how much weight each should receive. WTO antidumping disputes to date make clear, however, that investigating authorities would be wise to ensure that they expressly “consider” every factor, along with any others brought to their attention by parties to the investigation.⁶⁰

In addition to the confusing phrasing regarding the requisite causal link discussed above, Art. 3.5 contains the “nonattribution” requirement of the ADA. Again without saying how the investigating authorities are to perform the task, the investigating authorities must “examine” all of the “known factors” that are causing injury to the domestic industry, and ensure that such injury is not attributed to dumped imports.⁶¹ Investigating authorities may indeed run afoul of this provision if a known factor is

⁶⁰ See Thailand–Anti-dumping Duties on Angles, Shapes and Sections of Iron or Non-Alloy Steel and H-Beams from Poland, WT/DS122/AB/R (2001); Egypt–Definitive Anti-Dumping Measures on Steel Rebar from Turkey, WT/DS211/R (2002).

⁶¹ In European Communities–Anti-Dumping Duties on Malleable Cast Iron Tube or Pipe Fittings from Brazil, WT/DS219/AB/R (2003), the Appellate Body held that the other known factors may be considered individually and need not be assessed collectively.

before them and they do not provide adequate evidence that it has been “considered,” or that its effects have somehow been separated from the effects of dumped imports.⁶²

I note in passing that nothing in Article 3 clearly speaks to an issue that has divided ITC Commissioners under U.S. law—the choice between “bifurcated” and “unitary” injury analysis. “Bifurcated” analysis first asks whether the domestic industry is suffering “material injury,” i.e., some degree of distress, in an absolute sense. Only if the answer to that question is yes does the analysis proceed to the second stage and inquire into the cause of the material injury. “Unitary” analysis does not search for indicia of distress relative to normal times, but instead simply asks whether the domestic industry would be materially better off without the dumping (or dumped imports). Hence, unitary analysis might find injury to an industry that is “healthy” in an absolute sense. My reading of the ADA suggests that both approaches are permissible, although the issue has not been raised in WTO dispute proceedings at this writing.

Two other provisions in ADA Art. 3 warrant a mention. Art. 3.3 allows for what is generally termed “cumulation.” When a dumping investigation involves imports from only one country, it is understood that all exporters from the country may be aggregated for purposes of examining, for example, the volume of dumped imports, even if the exporters will later receive individual margins and duties. Art. 3.3 authorizes a similar practice for purposes of injury analysis when the investigation covers exporters from more than one country. Their exports may be “cumulated” if the exporters from each nation have a non-*de minimis* dumping margin, the quantity of imports from each nation is not “negligible,” and a “cumulative assessment of the effects of the imports is appropriate in light of the conditions of competition.” The effect of cumulation, of course, is that exporters from countries with small volumes of exports may be swept into an investigation, and ultimately subjected to duties, even though the investigating authorities might not consider them to have a material impact on the domestic industry if viewed in isolation. Likewise, cumulation may result in the imposition of duties on exporters whose exports have been declining, and might not be viewed as sufficiently correlated with decline in the domestic industry if analyzed in isolation.

⁶² See United States–Anti-Dumping Measures on Certain Hot-Rolled Steel Products from Japan, WT/DS184/AB/R (2001).

Finally, Art. 3.7–3.8 add some special provisions regarding affirmative determinations of injury based on threatened injury alone. Such cases are to be decided with “special care,” the threatened injury must be “clearly foreseen and imminent,” and the investigating authorities must address four additional factors as part of their analysis. WTO decisions to date do indicate that dispute panels may take a particularly hard look at the investigating authorities’ reasoning when an affirmative injury finding rests solely on threat.⁶³

The reader may well have noted that the ADA leaves much open, including the basic methodological approach to injury analysis in dumping cases. National authorities often proceed quite loosely, relying as noted on simple correlations and other economically questionable methods for drawing a causal link between dumping and injury. A number of economic commentators have suggested ways to give the analysis of injury more structure and coherence. See Boltuck (1991); Kaplan (1991); Knoll (1989); Murray and Rousslang (1989). Although these proposals differ in some particulars, the thrust of each is to suggest that investigating authorities use some form of econometric or simulation modeling to estimate the impact of dumping quantitatively. Given econometric estimates or otherwise plausible assumptions about the magnitude of dumping, the quantity of dumped imports in the market, the elasticity of domestic supply and demand, the elasticity of the supply of nondumped imports, and the degree of substitutability between imports and domestic products, computer models can generate estimates about the impact of dumping on domestic production and prices, and can be expanded to yield results about other relevant variables in the domestic industry as well (e.g., employment). The Office of Economics at the U.S. ITC has produced simulation results based on such modeling exercises quite regularly, although few Commissioners have relied heavily on them in their analysis.

Widespread adoption and reliance on such methods would, if done carefully, bring much more economic coherence to the assessment of injury by national

⁶³ See United States–Investigation of the International Trade Commission in Softwood Lumber from Canada, WT/DS277/R (2004) (affirmative threat determination based on “finding of a likely imminent substantial increase in imports is not one which could have been reached by an objective and unbiased investigating authority in light of the totality of the factors considered”).

authorities.⁶⁴ It is not obvious, however, that economic coherence in injury analysis is of any particular utility—for reasons that the next section will elaborate, antidumping policy itself is of dubious economic value, and one may doubt whether a more coherent implementation of only one aspect of that policy will improve it. In particular, recall that the injury test requires nothing more than “material injury,” which is understood to impose a fairly low threshold for an affirmative finding (contrast “serious injury” in the safeguards area). It will be an extremely rare instance in which a simulation exercise does not show *some* adverse impact of dumping on domestic prices and production. Might investigating authorities that are otherwise inclined to decide in favor of the domestic industry not simply label the effect as “material” and declare victory? Would the Appellate Body second guess a determination that injury is “material” if investigating authorities otherwise jump through all the hoops? For those who believe that antidumping policy ought be curtailed, it is not clear whether economically rigorous injury analysis would help or hinder. Sykes (1996) develops this theme at length.

This last observation raises another general issue. Because the injury test is so loosely framed under WTO law, and the findings by investigating authorities rest on analysis that is quite malleable, one might wonder whether the whole exercise in the end turns on political considerations rather than on any economic “merits.” Finger, Hall and Nelson (1982) hint at an affirmative answer to this question. Anderson (1993) responds in the negative.

D. Economic Commentary on Antidumping Policy

Antidumping law found an early friend in the respected economist Jacob Viner. Viner (1923) introduced a distinction that survived for some time in the literature between “sporadic” dumping, “short-run” dumping, and “permanent” dumping. “Sporadic” dumping was extremely short-lived, as for the purpose of disposing of a

⁶⁴ The models used in practice do not explicitly identify the effects of other “known factors,” and it is not entirely clear whether they might be perceived as running afoul of the “nonattribution” requirement as described in the cases. See United States–Anti-Dumping Measures on Certain Hot-Rolled Steel Products from Japan, WT/DS184/AB/R (2001). Logically, they simulate the partial equilibrium effect of a change in dumping alone, and so would not attribute to dumping injury caused by other factors. Whether the Appellate Body would accept this point as satisfactory “nonattribution” reasoning is unclear. If the investigating authorities must also quantify in systematic fashion the effects of all other “known factors,” the costs of proceeding in an economically careful fashion rise dramatically.

temporary overstock, and Viner viewed it as benign even if an irritant to competitors. “Permanent” dumping is continuous over a period of many years, as perhaps when the home market is protected from competition but export markets are competitive, and Viner believed here that the gains to consumers from such dumping would outweigh the losses for domestic firms. But where dumping is “short-run”—of significant but not indefinite duration—Viner believed that the injury to the domestic industry might be severe, and might outweigh the gains to consumers. That prospect was acute when the domestic industry would be driven out of business and exporters would later enjoy a monopoly, but Viner did not believe that outcome necessary for short-run dumping to be harmful. He argued that even if prices do not rise above their previous levels after dumping ceases, a net loss is likely to arise because short-run dumping leads domestic workers and firms to sit around idle while waiting for it to stop.

Viner further believed that much dumping was of the short-run variety. He noted correctly that prices below long run average costs of production are by definition unsustainable (although the short-run can last many years). He evidently believed that price discrimination dumping (prices below home-market or third-country prices) is also likely to be temporary, although a clear explanation for that belief is lacking. Modern economics suggests that price discrimination dumping (when it is deliberate rather than accidental) will tend to occur mainly because exporters face different demand elasticities in different markets—firms with market power will sell at higher prices in markets where demand is less elastic. The home market price can be higher, for example, for no other reason than the fact that it has a higher protective tariff, allowing firms to charge more in their home markets. There is no reason to think that this situation is necessarily short-run. Nevertheless, on the basis of his twin premises—that short-run dumping was injurious to the importing nation, and that most dumping was short-run—Viner argued that dumping in general should be condemned.

Viner wrote in the early days of modern microeconomics, and made no attempt to formalize his argument or to identify carefully the assumptions necessary for it be true. Modern economists find the analysis questionable. If factor markets clear at competitive prices and if expectations regarding the duration of dumping are rational, one would expect resources to remain idle in response to short run dumping only if that is their best

expected use under the circumstances. The loss to the owners of those resources should be smaller than the gain to consumers for much the same reasons that yield efficiency in any competitive equilibrium. Viner's argument requires some market imperfection or error in expectations that prevents efficient adjustment to temporarily cheap imports, and he gives us no reason to expect that such problems will arise routinely. Likewise, and even more importantly, if the government is to have the capacity to take corrective measures sensibly, it must be able to identify industries suffering from these market failures. Certainly, nothing in the antidumping law itself requires a search for indicia of these market imperfections. The modern economic literature on choice of policy instruments also casts doubt on the soundness of Viner's position. If the difficulty lies with some imperfection in the labor market that leads to inefficiently long periods of unemployment, for example, the modern literature would suggest that the proper policy instrument is direct intervention in the labor market, as perhaps with a wage subsidy.

Since the work of Viner, the positive and normative economics of dumping and antidumping measures have received a great deal of further study. On the positive side, new reasons for the existence of dumping have been identified, such as various kinds of uncertainty across markets. See, e.g., Ethier (1982). Dumping within industries that fit the "strategic trade" models has also been exhaustively analyzed. See, e.g., Gruenspecht (1988), Dick (1991).

On the normative side, the weight of modern commentary has been highly critical of antidumping policy. It is generally argued that the only plausibly useful function of the antidumping laws from an efficiency standpoint is the avoidance of predatory pricing and monopolization by foreign firms. Many commentators note that this objective can be accomplished through the antitrust laws without the need for a separate antidumping law.

More importantly, antidumping law is not simply redundant of antitrust policy. Price discrimination dumping (when deliberate) likely occurs in most instances because of differences in demand elasticities, as noted, and not because of predation. Sales below "constructed value" are commonplace in many markets as well, particularly when demand is weak or new competitors have entered. Hence, investigating authorities will find dumping in circumstances where firms are in no way embarked on a campaign of monopolization. Likewise, if the underlying concern were for monopolization,

antidumping measures would be restricted to concentrated markets exhibiting entry and reentry barriers so that a monopolistic outcome is plausible. Nothing in the modern definition of dumping or the injury test imposes such a restriction. See, e.g., Barcelo (1972); Deardorff (1993); Hindley and Messerlin (1996); Ordoover, Sykes and Willig (1983).

If modern antidumping law is badly tailored for addressing any *bona fide* problem, it is nevertheless worth noting that antidumping duties may, in some instances, yield economic benefits by coincidence. At least three scenarios may be identified in which such benefits may arise.

First, taking a global welfare perspective, antidumping duties will to some degree discourage international price discrimination. Much as the domestic welfare effects of imperfect price discrimination are indeterminate, so are its effects across global markets, and it is possible that global welfare will increase because antidumping policy reduces the degree of output constriction by firms with market power. Of course, the opposite outcome is also possible. Second, from a national welfare perspective, antidumping duties may benefit large nations that are not already charging their “optimal tariff.” The logic here is that large nations have a degree of monopsony power, and can exploit it through tariffs that extract rents from foreign exporters by inducing them to lower their prices. Antidumping duties might by chance yield a welfare gain to a large importing nation (but not the world as a whole) for this reason, although again the opposite outcome is certainly possible. Third, in industries fitting the strategic trade paradigm—an industry that exhibits increasing returns to scale that can eventually earn monopoly rents at the expense of foreign consumers, or that generates positive externalities that do not cross national borders—it is well known that protection can enhance national economic welfare. See Gruenspecht (1988), Dick (1991). There is no reason to think that a duty equal to the margin of dumping calculated under existing law is the best duty for this purpose, of course, and the law applies antidumping measures to all industries, most of which do not plausibly fit the strategic trade paradigm. But one cannot exclude the possibility that in some cases, antidumping duties generate these types of benefits by chance. Sykes (1998) and Willig (1998) offer a more detailed treatment of these issues.

Some commentators have offered what might be termed “political” defenses of antidumping policy. One possibility is that whenever trade is perceived to be “unfair,” governments will be induced to restrict it, and that it is better to do so through measures that eliminate only the perceived unfairness than through measures that go even farther. This is the essence of Jagdish Bhagwati’s argument for countermeasures against subsidized imports, as I understand him, an argument that might be extended to dumped imports if they too are genuinely perceived as “unfair.” Bhagwati (1988). A difficulty with such an argument is that it is not clear why dumping should be perceived as unfair, given that it is really quite a normal business practice for many foreign and domestic firms.

A related, though seemingly distinct, argument for antidumping measures is the suggestion that they redirect pressures for protection away from the legislature and into a more benign administrative process. Boltuck and Litan (1991) observe: “[T]he imperfect success with which domestic interests have pursued unfair trade remedies suggests perhaps the only principled reasons for the statutes: as a legal ‘safety valve’ for channeling the strongest claimants for protection away from overtly supporting more transparent forms of protection.” The administrative process that doles out antidumping remedies, the argument runs, will ultimately give less protection than would arise if the interest groups seeking protection were to turn to the legislature for more conventional protectionist intervention. A difficulty with this argument is that it is hard to see why the interest groups who, by hypothesis, could secure a greater degree of protection from the legislature in the absence of the administrative remedy, will be forced to settle for the lesser degree of protection that the administrative remedy provides. An alternative hypothesis is that groups with the power to secure high levels of protection from the legislature will do so notwithstanding the administrative alternative, and that groups without such power will avail themselves of the administrative route, thereby increasing the total amount of protection in the end. Put differently, it seems problematic to argue that if an additional avenue for interest groups to secure protection is opened while previous avenues also remain open, the net result will be a reduction in protection. Of course, if antidumping measures were somehow restricted or abolished, it is surely right

to say that the resources devoted to the pursuit of antidumping duties would be redirected elsewhere and that unintended consequences might result.

If the bulk of the modern normative commentary is correct in suggesting that antidumping policy is economically unsound, however, a positive puzzle arises: Why do trading nations not agree to eliminate the use of antidumping duties, much as they have negotiated to reduce their tariffs generally? Occasional proposals within the WTO system to eliminate antidumping policy and subsume it within a sensible competition policy have had little traction. What explains the persistent popularity and survivability of antidumping policy? Sykes (1998) offers the suggestion that the political constituency for antidumping policy is not (and never has been) an anti-monopoly constituency, but is instead much the same as the political constituency for safeguard measures—declining industries. Because of the injury test, the principal beneficiaries of antidumping duties are industries that have difficulty competing in open markets. These industries present an effective lobby for protection for reasons noted earlier, and as yet the exporters targeted by antidumping measures have proven ineffective in political opposition.

Part of the reason why may lie in the fact that at least some exporters may not be harmed by antidumping actions against them. If they are able to settle the case through a price undertaking, they will have raised price and restricted output much like a cartel. Prusa (1992) and Staiger and Wolak (1989) argue that antidumping policy can indeed provide a government-sponsored route to cartelization that would otherwise violate the antitrust laws. This outcome is not observed in all cases by any means, since many cases are not settled. But the fact that it occurs some of the time no doubt has bearing on the ongoing political equilibrium.

Finally, it is interesting to note that antidumping policy may disappear as trading economies become more integrated. The U.S. federal system has some restrictions on domestic price discrimination in the Robinson-Patman Act, but they have always been much more closely linked to antitrust concerns and are not nearly as intrusive on pricing policies as international antidumping rules. Indeed, the Robinson-Patman Act is hardly ever enforced. Similarly, the formation of the European Union eventually led to the abolition of antidumping law internally. By contrast, NAFTA assiduously preserves the right of members to take antidumping measures against other members, as did the

predecessor U.S.-Canada Free Trade Agreement. An understanding of the political reasons for this heterogeneity in regional arrangements may also illuminate the reasons for the current state of the law in the WTO.

III. Countervailing Duties

The WTO system takes a two-track approach to the discipline of subsidies. First, subsidies may directly violate WTO law, which now contains elaborate rules limiting the ability of governments to engage in certain subsidy practices. For nonagricultural products, these rules are contained in the SCMA; for agricultural products, they are contained in the Agreement on Agriculture. These direct limitations on subsidy practices are discussed in the chapter by Trebilcock and Fishbein elsewhere in this volume. Readers seeking a more elaborate discussion may wish to consult Sykes (2005).

Second, WTO/GATT law has always permitted members to take countermeasures against imported goods⁶⁵ that benefit from “subsidies,” and that cause or threaten material injury to import-competing firms. These “countervailing duties” are part of the trade remedy arsenal, and will be the final subject of this chapter.

Note that the injury requirement for the use of countervailing duties is virtually identical to that for the use of antidumping duties, both substantively and procedurally. I thus refer the reader to the discussion of injury analysis in the last section and will not address it further here. Likewise, the procedural requirements for national countervailing duty investigations, and for the collection and periodic review of countervailing duties, are nearly identical to those for antidumping investigations, and I will not dwell on them. The focus of this section is on what constitutes a countervailable subsidy, how the subsidy is measured, and whether countervailing duties make economic sense.

A. Countervailable Subsidies under WTO Law

Countervailing duty law dates back to the first U.S legislation in 1897. The U.S. Tariff Act of 1930 strengthened the law, authorizing the Department of the Treasury to impose duties to offset any “bounty or grant” bestowed on imported merchandise. Article

⁶⁵ The GATS commits members to negotiate regarding subsidies in Article XV, but as of yet little has been accomplished, and I will focus here entirely on the rules governing goods markets.

VI of the original GATT was drafted in 1947 to permit the continuing use of countervailing duties, providing in paragraph two that “[n]o countervailing duty shall be levied on any product...in excess of an amount equal to the estimated bounty or subsidy determined to have been granted, directly or indirectly, on the manufacture, production or export of such product,” and adding an injury requirement in paragraph six.

U.S. law did not attempt to define the term “bounty or grant,” and GATT likewise left open the definition of “bounty or subsidy.” Early U.S. cases generally involved what are now termed “export subsidies,” which entail government payments or other incentives contingent on exportation (for example, a government program providing that producers will receive one shilling for each widget that they export). Later cases imposed duties to offset what are now termed “domestic subsidies,” which entail government payments or other benefits to domestic producers that are not contingent on exportation (for example, a government program providing that producers will receive one shilling for each widget that they produce). WTO law now recognizes that both types of programs may produce countervailable subsidies.

1. The Concept of “Subsidy” in the SCMA

The Uruguay Round SCMA undertook for the first time to provide a definition of “subsidy” under WTO law, drawing heavily on the evolution of the concept under U.S. law. Article 1 defines “subsidy” as a “financial contribution” by a government or any other public body within the territory of a member. The contribution can arise from a direct transfer of funds, from revenue otherwise due that is foregone, from government provision of goods or services “other than general infrastructure,” from government purchases, from government support for a funding mechanism that makes any such contributions, or from certain income or price support schemes. The government contribution must also confer a “benefit”—government purchases of goods or services at fair market value, for example, would not result in any benefit.

Not all “subsidies” within this definition may be the subject of countervailing duties. In addition to the injury requirement, the subsidy must also be “specific.” The “specificity test” has its origins in U.S. law, and has long been a source of controversy. Very roughly, the function of the specificity test is to distinguish familiar activities of

governments that are considered acceptable and in no way “unfair,” from other activities that somehow confer an unfair advantage on the beneficiary. The essential premise of the test is that narrowly-targeted programs (and export-contingent or import-substitution programs) are more troublesome than those that are more broadly available in the economy. Accordingly, pursuant to Article 2.3, all subsidies contingent in law or in fact on export performance are automatically “specific,” as are subsidies that are contingent on the use of domestic over imported goods. For other programs that fit the definition of “subsidy” in Article 1, “specificity” is present when the beneficiaries of the subsidy are limited to “an enterprise or industry or group of enterprises or industries.” This situation can arise when the granting authority or the legislation that it administers expressly limits the beneficiaries to “certain enterprises,” or can occur when the subsidy is *de facto* specific. A finding of *de facto* specificity may result from the “use of a subsidy programme by a limited number of certain enterprises, predominant use by certain enterprises, [or] the granting of disproportionately large amounts of subsidy to certain enterprises.” In addition, a subsidy that is “limited to certain enterprises located within a designated geographical region within the jurisdiction of the granting authority shall be specific.”

The definition of specificity under WTO law leaves open a most fundamental issue—how narrowly targeted must a subsidy be to be deemed limited to a “group of enterprises or industries?” This text on its face is quite useless at delimiting the scope of the relevant “group,” and to date WTO dispute cases provide little guidance on the subject.

2. Measurement Issues

Once a subsidy is found to be specific, its value must be computed in relation to the value of the subsidized merchandise in order to compute an appropriate countervailing duty. Sometimes this exercise is fairly straightforward. For example, if widget producers in an exporting nation receive a one shilling grant for each exported widget and the value of an exported widget is ten shillings, then a 10% duty is appropriate to “countervail” the export subsidy. Likewise, if widget producers receive a two shilling grant for every widget produced, and each widget is worth ten shillings, then

the proper duty is 20% to countervail the domestic subsidy. Producers receiving both subsidies would properly be subject to a countervailing duty of 30%.

Often, however, valuation of the subsidy is more complicated. Suppose the subsidy takes the form of a loan or loan guarantee, an equity infusion, a special tax provision, or the sale of goods by the government—how is the subsidy to be measured in such cases? The SCMA begins with the premise that the relevant “benefit” is the benefit to the recipient (see Article 14), as distinguished from the cost to the government. Thus, a loan to a firm at a below market rate would confer a “benefit,” even if the government could borrow funds itself at an even lower rate, and thus argue that it earns a “profit” on the loan.

When feasible, the benefit to the recipient will be measured by a market benchmark. Thus, for a loan by the government, the benefit must ordinarily be assessed with reference to the interest rate that the recipient would pay on a comparable commercial loan in the private market. For a loan guarantee, the question is whether the guarantee results in interest savings to the recipient in excess of the price paid to the government for the loan guarantee. When the government sells goods and services, the question is whether the government has sold them for less than the private market would charge in the same country. When the government infuses equity into domestic firms, the question becomes whether it has behaved in a manner inconsistent with what private investors would do under similar circumstances.⁶⁶

Market benchmarks, however, are not always available. The tax issue presents an obvious example—when a firm benefits from a special provision in a tax law, it makes no sense to ask how much tax the firm would instead pay in a “private market.” Rather, the standard benchmark looks to the taxes that the firm would otherwise pay. Although such an approach sounds sensible, it leads to some arguably peculiar results. Imagine a widget industry in a country that has no corporate income tax at all. Such an industry receives no tax “benefit.” By contrast, consider a widget industry that is exempted from corporate income tax in a country that applies a corporate income tax to other industries. That industry would receive a “benefit” in the amount of the foregone taxes on its income,

⁶⁶ See generally SCMA Article 14.

even though it pays exactly the same tax (zero) as the other hypothetical widget industry that receives no tax “benefit.”

Market benchmarks may also prove unavailable in countries that do not have private markets. The United States, for example, has long taken the position that the countervailing duty laws cannot be coherently applied to nonmarket economies. [It has more than made up for its “generosity” on this front, however, through aggressive application of antidumping law to nonmarket economies.]

Finally, market benchmarks may prove problematic if the government subsidy program is so extensive that it can be said to have “distorted” the private market. In the long-running dispute between the United States and Canada over alleged subsidization of lumber exports by Canada, the United States has claimed that subsidized prices for standing timber on crown lands have depressed prices for all timber in Canada.⁶⁷ Thus, argues the United States, the price of private timber is not the proper benchmark for measuring the amount of the government timber subsidy. In a subsequent WTO proceeding, the Appellate Body accepted the notion that, in principle, private market prices in the subsidizing may be distorted by subsidy programs and an alternative benchmark may become necessary.⁶⁸

Several other recurrent issues warrant a mention. First, the valuation of subsidies can involve complicated allocation issues, across products and over time. Suppose that a one-time below-market loan is used to build a multi-product factory. If only one of the products of the factory is subject to a countervailing duty investigation, say, it will be necessary to determine what portion of the subsidy “benefits” the production of that particular product. Likewise, if the factory has a useful life of a number of years, it will be necessary to decide how much of the subsidy “benefits” the production of the product in any window of time. Such questions are typically answered with complex allocation rules that may rest on somewhat arbitrary assumptions.⁶⁹

⁶⁷ Canada has forcefully disputed this proposition, to be sure, arguing that a below market price for standing timber on government lands will not affect the size of the harvest, and thus the price of competing timber on private land.

⁶⁸ See United States–Final Countervailing Duty Determination with Respect to Certain Softwood Lumber from Canada, WT/DS257/AB/R (2004).

⁶⁹ For further discussion of such issues and the way that they are handled under U.S. law, see 19 C.F.R. §§351.504 et. seq.

Second, difficult issues may arise when a subsidy is bestowed at one stage of processing, while the exported good is produced by a later stage of processing. One must then ask whether the “upstream” subsidy “passes through” to the later stage of processing. When both stages of processing are integrated into a single company, the tendency is to assume that the subsidy passes through in full. But what if the recipient of the subsidy sells its goods at arm’s-length to another company that processes them further and then exports the finished product? Again drawing on the softwood lumber dispute for illustration, the Appellate Body has faulted the United States for failing to conduct a proper analysis of whether timber subsidies given to loggers pass through to unaffiliated sawmills that purchase the logs and manufactured them into lumber.⁷⁰

Third, privatization transactions can raise difficult questions regarding alleged subsidies to the owners of privatized assets. Suppose that a government builds an uneconomical steel mill, for example, seeking to prop up local employment. Subsequently, the government auctions the mill for as much as the market will bear. Can the new owner be deemed “subsidized,” or is he immune from such a finding on the grounds that he paid fair market value for the assets and thereby received no “benefit?” In two recent decisions, the Appellate Body leans strongly toward the latter view.⁷¹ Grossman and Mavroidis (2003) question the logic of that approach, which implies that a government can build uneconomic productive capacity in an industry and then “cleanse” the assets of any subsidy by selling them at arm’s length, even though the uneconomic plants will thereafter continue to operate and cause the same harm to foreign competitors.

Finally, because countervailing duties offset subsidies that are commonly granted to an entire industry, it has been commonplace for national authorities to compute a single rate of duty for all exporters in a given exporting nation. Article 19.3 of the SCMA affords an opportunity for individual exporters to seek an individual rate, however, noting the possibility that some exporters may renounce subsidies, while others may enter price undertakings to avoid the application of countervailing duties, akin to the undertakings available in antidumping cases. Differential rates of duty may also arise when the

⁷⁰ See United States – Final Countervailing Duty Determination with Respect to Certain Softwood Lumber from Canada, WT/DS257/AB/R (2004).

⁷¹ See United States–Imposition of Countervailing Duties on Certain Hot-Rolled Lead and Bismuth Carbon Steel Products Originating in the United Kingdom, WT/DS138/AB/R (2000); United States–Countervailing Measures Concerning Certain Products from the European Communities, WT/DS212/AB/R (2002).

granting authority is a subsidiary government—in the softwood lumber case, for example, the United States has computed different duties for each Canadian province because most of the alleged subsidy programs are administered at the provincial level.

B. Economic Commentary on Countervailing Duties

In contrast to the generally hostile view of antidumping measures taken by most modern economists, commentary on countervailing duties is more mixed. Critics such as Sykes (1989) begin with the observation that subsidized (and thus cheaper) imports are generally beneficial to an importing nation—regardless of the reason why imports are cheap, an improvement in the terms of trade will yield an aggregate gain in national economic welfare, other things being equal. Likewise, the welfare effect of countervailing duties will often be adverse, much like the welfare effect of any other tariff. This view counsels openness to subsidized imports, and indeed suggests that perhaps the proper policy response is to “send a thank-you note to the embassy” as Paul Krugman once quipped.

To be sure, special circumstances may arise in which countervailing duties yield a benefit to the importing nation. Two possibilities, noted earlier in the discussion of antidumping duties, are that countervailing duties allow the extraction of monopsony rents by a large nation with market power over the price of its imports, or that they afford useful protection to an industry that fits the “strategic trade” paradigm. But nothing in WTO law (or national law) limits countervailing duties to the cases where such benefits plausibly arise. Further, the gains to an importing nation from exploiting its monopsony power or from protecting its strategic industries come at the expense of its trading partners, and global welfare can decline if all nations pursue such policies.

Defenders of countervailing duty law, by contrast, such as Jackson (1997), urge that countervailing duties may serve as a useful deterrent to wasteful subsidy practices. It is well known that government subsidies can distort market outcomes and divert resources away from higher-valued uses. The problem can become all the more acute when political pressure exists for governments to match the subsidies granted by others—many governments may find themselves subsidizing the same sectors, collectively wasting resources while accomplishing little to provide net benefits to the subsidy

recipients. See Hufbauer and Erb (1984). A threat of countervailing duties, the argument runs, will discourage such wasteful practices. The benefits of countervailing duty law thus arise not in the cases where duties are actually employed, but in the cases where subsidies are never bestowed in the first instance. Likewise, even if the actual use of a countervailing duty by an importing nation lowers its welfare when viewed narrowly, the broader systemic benefits from the discouragement of wasteful subsidies by a prospect of countervailing duties may make all nations better off on balance.

This more optimistic view may be correct, but there are several reasons to question it. First, and rather trivially, a tradeoff exists between the welfare costs that can arise in cases where duties are actually used, and any welfare gains that arise in other cases from the discouragement of wasteful subsidy practices. It is not obvious *a priori* how the balance is struck in practice.

Second, and related, there are reasons to doubt the efficacy of countervailing duties as a deterrent to wasteful subsidy practices. Countervailing duties are unilateral policies undertaken by importing nations without coordination. When the United States imposes a countervailing duty on a product from another country, for example, it will often be the only country in the trading system to impose a countervailing duty on that product. The subsidized goods may simply be diverted to another market, and in any case the damage to the beneficiary of the subsidy may be quite modest in relation to the value of the subsidy. The use of countervailing duties is also limited by the injury test. One can question whether the prospect of uncoordinated countermeasures, limited to situations of demonstrable injury, will do much to discourage subsidization.

Third, the ability of countervailing duties to discourage wasteful subsidies turns importantly on the ability of the law to distinguish the subsidies that are “wasteful.” The specificity test may be a questionable basis for sorting cases in this respect. Broad subsidies to agricultural producers, for example, may be “nonspecific” because they benefit more than a “group” of industries, even though the agricultural sector is widely considered to be distorted by subsidies in many countries. More generally, nations may be able to exploit the specificity test by designing subsidy programs to be broad enough to avoid running afoul of it. It is also possible that a “specific” subsidy may not be wasteful. For example, a subsidy to research and development in an industry where

intellectual property rights are difficult to enforce may have sound economic justification, yet appear quite “specific.”⁷² Schwartz and Harper (1972) take this type of criticism a step further. If a democratic society chooses to divert resources into a particular industry—such as family farming—who is to say that the program is waste? Perhaps the program results from a failure of the political process, or perhaps it reflects genuine preferences of the society for preserving certain activities despite the cost. The general point is that a simple and administrable criterion to distinguish “waste” from the legitimate activities of governments may be quite difficult to fashion, and one can certainly wonder whether the specificity criterion is satisfactory.

Fourth, as Bagwell and Staiger (2002) note, any notion that a subsidy is “wasteful” must be mindful of the theory of the second best. In a global economy still pervaded by various trade barriers—tariffs, quotas, and the like—the existing volume of trade in many products is inefficiently small. Subsidies can increase the volume of trade toward its “free-trade” ideal, and enhance global welfare, other things being equal.

Fifth, and again related, countervailing duty laws invariably examine subsidy programs in isolation. Firms are subject to a wide array of tax, regulatory and possibly subsidy policies. All of these have the potential to distort the behavior of the firm relative to some ideal, “free-market” benchmark, and many of the distortions may be offsetting. Ideally, a subsidy program should be deemed “wasteful” only if it induces a *net* diversion of resources into the subsidized activity relative to a proper benchmark. But the task of determining the net impact of government on the position of a firm or industry relative to a proper benchmark would be Herculean, and so countervailing duty law generally ignores most government burdens that might offset the benefits of a subsidy. For this reason as well, the notion that countervailing duties as computed in practice will appropriately target “wasteful” subsidies and leave constructive government activities alone seems quite dubious.

One last strand of literature warrants a quick note. WTO law does not clearly require an importing nation to demonstrate that a subsidy program has caused injury to its producers before imposing a countervailing duty. It is arguably enough that the subsidy has conferred a “benefit,” is specific, and that the “subsidized imports” have caused

⁷² Note that the limited “safe harbor” for R&D subsidies under Part IV of the SCMA has now expired.

injury.⁷³ Some commentators have suggested that this situation leads to an inappropriate use of countervailing duties in cases where the subsidy has no cross-border impact. For example, a government might give an unconditional grant to a firm, and the firm might simply distribute it to shareholders without changing output or prices. Or perhaps the government might pay a firm to reduce its output (as in certain agricultural schemes), which raises prices and actually benefits its foreign competitors. To avoid duties in such cases, Goetz, Granet and Schwartz (1986) and Diamond (1990) advocate legal reforms that would limit countervailing duties to amounts that offset the adverse cross-border impact of subsidy programs, roughly, by undertaking to measure the extent to which subsidy programs lower marginal costs. Critics question the administrative feasibility of such reforms, among other things, although it is noteworthy that the WTO Agreement on Agriculture does take some steps toward distinguishing trade-distorting subsidies from those that arguably do not distort trade. See Sykes (2005).

⁷³ The requisite linkage between injury and subsidization is confounded as in the antidumping area by the argument that a link to the “subsidized imports” is enough. See the discussion of this issue earlier in this chapter in the antidumping section.

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