

Chapter 12

The “New” Protectionism

12.1 Introductory Remarks

The typical instruments of the “old” protectionism are tariffs and (non-discriminatory) import quotas. The last few decades have seen a progressive reduction of these traditional trade barriers: GATT and WTO have provided a negotiating framework for such a reduction and outlawed the use in general of import quotas, as well as established the extension to all members of the MFN (Most Favoured Nation) treatment (see Sect. 10.2). Up-to-date information is contained in the annual publication World Tariff Profiles, that can be downloaded from the WTO site (www.wto.org).

However, notwithstanding the dramatic decrease in average world tariffs, protectionism is still around under new forms.

12.2 Why the New Protectionism?

In parallel with the decline of the old protectionism (see above), the last decades have witnessed the emergence of a “new” protectionism or neoprotectionism, based on the type of non-tariff barriers (NTB) exemplified in items (a) through (i) listed in Sect. 10.6.4. (see, e.g., [Laird and Yeats, 1990](#); [Schucknecht, 1992](#); [Vousden, 1990](#))

The common feature of these barriers is that they are less overt and more subject to discretion than the instruments of the old protectionism. Several reasons have been set forth in the literature to explain this trend:

1. The countries members of GATT did agree not to use discriminatory tariffs and quantitative import restrictions, except in special circumstances contemplated by the GATT Articles (e.g. to relieve temporary balance-of-payments pressures, and for the emergency protection of domestic industry). By using the instruments of the new protectionism, GATT members avoided a clash with the letter of the

GATT rules (although, of course, these instruments clashed with the spirit of GATT).

2. The barriers under consideration are politically much easier to implement. In fact, the traditional measures (tariffs and quotas) must be implemented through either legislative acts or highly transparent administrative channels. The measures of the new protectionism, on the contrary, can often be negotiated in secret: a typical example is that of voluntary export restraints.
3. For the reason given under (2), pressure groups lobbying the government for protection find it more convenient to ask for measures belonging to the “new” rather than to the “old” protectionism.

This brings us to the question of how protectionist measures are *actually* introduced, a question that, largely neglected in the old theory, is given a lot of attention in the new theory. Now, in reality, protection is usually sought for by interested domestic industries through the lobbying of politicians or the use of administered protection procedures. The difference is that in the former case the possible introduction of a protective measure is a matter of political discretion, while in the latter it is the result of a codified administrative procedure aimed at remedying an alleged injury. These topics will also be dealt with in the present chapter.

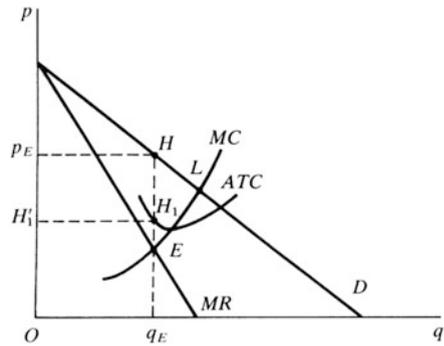
12.3 Voluntary Export Restraints and Import Expansion

A voluntary export restraint (VER) is an agreement negotiated between the exporting and the importing country, whereby the exporting country “voluntarily” curtails exports to the importing country. Another name under which such agreements are also presented in order to avoid conflict with the letter of the GATT articles is “orderly market agreements”. A VER is really an alternative, for the exporting country, to the imposition of a tariff or a quota by the importing country.

Since the outcome of a VER is a quantitative reduction in the amount of goods that the importing country receives from the exporting country, the effects on the former country can be analysed—in the small-country, partial-equilibrium context—by the same diagram developed for the analysis of quotas (see Fig. 10.7, that we reproduce here as Fig. 12.1 for the reader’s convenience). Suppose that as a consequence of a VER the imports of the home country fall from q_1q_4 to q_2q_3 . The effects on the home country’s price and output would then be the same as under a quota (Greenaway, 1983, chap. 7).

What is completely different is the destination of the sum represented by the area $F_1F'_1H'_1H_1$. Under a quota this is a gain accruing to importers (unless the government auctions off the licenses). But since a VER is by definition administered by the foreign country, the sum under consideration accrues to this country. Thus this part of the reduction in domestic consumers’ surplus is not offset by a redistribution to domestic importers or authorities, but is redistributed abroad. The fact that this “rent” from VER protection accrues to the exporting country is clearly an important

Fig. 12.2 VER and monopolistic cartel



For the analysis of all the differences between a quota and a VER under different market conditions and different degrees of participation in the VER, see [Takacs \(1978\)](#) and [Hillman and Ursprung \(1988\)](#). The political preferability of VERs is examined by [Jones \(1984\)](#) and [Dinopoulos and Kreinin \(1989\)](#). [Pomfret \(1989\)](#) gives a survey of the economic consequences of VERs. For a general equilibrium analysis of VERs (which substantially confirms the results of the partial equilibrium analysis used here) see [Herberg \(1990\)](#).

A trade policy tool that can be used as an alternative to a VER is a *voluntary import expansion* (VIE). Rather than voluntarily restricting exports from country 2 to country 1, trade agreements between the two countries can take the form of country 2 voluntarily increasing imports from country 1. A VIE sets a minimum market share for imports, hence symmetrically sets a maximum share for the domestic producer. To reduce its market share to the level required by the VIE, the domestic firm increases its price, which induces an increase in the foreign firm's equilibrium price.

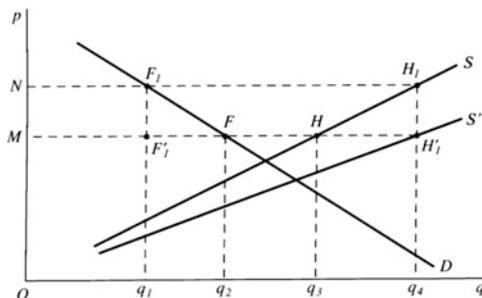
According to some authors, VIEs are to be preferred to VERs because, while the latter are intended to restrict trade, the former are, on the contrary, designed to increase trade by increasing foreign sales in countries where structural impediments and policies restrict access to foreign suppliers. Actually, the US-Japan trade negotiations seem to have shifted from trying to limit the access of Japanese firms to the US market to trying to increase the access of American firms to the Japanese market, namely from agreements based on VERs to agreements based on VIEs.

For a theoretical analysis of VIEs see [Bhagwati \(1987\)](#) and [Greaney \(1996\)](#).

12.4 Subsidies

Subsidies can be present in both the export and the import sector. As regards the export sector, the subsidy can be either an export subsidy (i.e., given to domestic producers only on the exported part of their output) or a production subsidy (i.e., given to domestic producers on their whole output). Let us begin by

Fig. 12.3 Effects of production and export subsidies

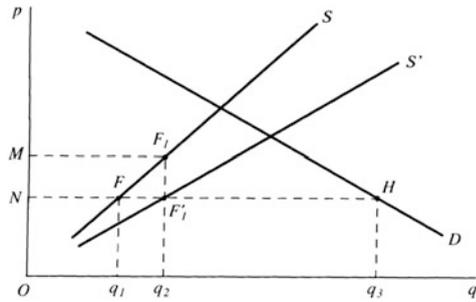


considering an *export subsidy*. In Fig. 12.3, D and S represent as usual the domestic partial equilibrium demand and supply curves. With free trade, given the ruling international price OM , domestic price is the same, and exports are $FH = q_2q_3$. Suppose now that an export subsidy, say MN per unit of output exported, is given to domestic firms. The situation is perfectly symmetrical to that of an export duty (Sect. 10.6.2). The *domestic* price increases from OM to ON : domestic producers, in fact, receive ON per unit of the commodity exported, and will not be willing to serve the domestic market unless they receive the same price. If we exclude the possibility of re-importing the commodity to the domestic market at the world price OM , the domestic price will be driven to ON . Thus domestic producers will sell NF_1 in the domestic market at the price ON and export F_1H_1 at the prevailing world price OM , but actually getting ON given the subsidy MN . The total amount of the subsidy that they receive is thus the area $F_1F'_1H'_1H_1$.

Benefits and costs can be calculated using the concepts explained in Sect. 10.3 as regards an import duty. Producers' surplus increases by the area MNH_1H . Consumers' surplus decreases by the area MNF_1F . The government has to pay an amount $F_1F'_1H'_1H_1$ (note that the area $F_1F'_1F$ appears twice among the costs). Hence the net welfare cost of the export subsidy is the sum of the two triangles $F_1F'_1F$ (the consumption cost) and $H_1H'_1H$ (the production cost). These have the same interpretation as in the case of a tariff (Sect. 10.4).

The case of a *production subsidy* can also be examined using Fig. 12.3. Since this subsidy is given to domestic producers on their whole output, the result is an equiproportional shift downwards of the supply curve (from S to S') by a percentage equal to the (ad valorem) subsidy. In Fig. 12.3 we have assumed a production subsidy of the same percentage as the export subsidy. This is shown by the fact that at output level Oq_4 the vertical distance between S and S' is $H_1H'_1 = MN$, denoting that the subsidy to producers is the same per unit as in the case of the export subsidy. The cost to the government is now higher: since the subsidy is given on all domestic output, the total amount is $MNH_1H'_1$. But now there is no decrease in consumers' surplus, since the price remains at OM . Producers' surplus increases by MNH_1H , as before; hence the net cost is now only the triangle $H_1H'_1H$ (the production cost). Thus it appears that a production subsidy (which creates no wedge between the domestic and the international price) is preferable to a direct trade intervention like an export subsidy (which creates such a wedge).

Fig. 12.4 Effects of subsidies to the import-competing sector



Let us finally consider a subsidy to the domestic sector producing import-competing goods (Fig. 12.4). This is actually a production subsidy, hence the supply curve of domestic producers (S) shifts downwards equiproportionally by a percentage equal to the (ad valorem) subsidy (S').

The effect of the subsidy is that, for any output, the price received by producers is greater than the price paid by consumers by the amount of the subsidy. Let us assume a world price ON and a subsidy such that the amount received by domestic producers on every unit of output is MN . Hence domestic producers will be able to supply $NF' = Oq_2$ instead of $NF = Oq_1$. Consumers continue to pay ON per unit, but producers receive OM . The outcome of this protective measure is that imports fall from q_1q_3 to q_2q_3 .

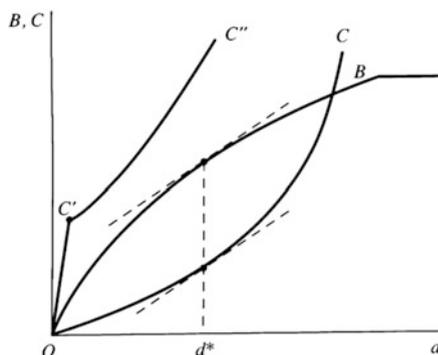
If we now make the usual cost-benefit analysis, we see that there is no decrease in consumers' surplus, since they continue to pay the same price as before. The only cost is the government's outlay for the subsidy, namely area $MNF'F_1$. On the side of benefits we have the increase in producers' surplus, which is $MNFF_1$. The balance is a net cost of the subsidy equal to the triangle $FF'F_1$ (the production cost). It follows that, if we compare a subsidy to the import-competing sector with a tariff (which entails both a production and a consumption loss), we conclude that the subsidy is preferable to the tariff. *Ceteris paribus*, a tariff creates two distortions (on both the production and the consumption side) while a subsidy only creates one distortion (on the production side).

Let us now put this result together with the previous result, that a production subsidy on the side of exports is preferable to an export subsidy (which can be taken as a negative tariff). The conclusion is that production subsidies are to be ranked above tariffs. This conclusion lies behind the suggestions given in Sects. 11.3 and 11.4, that a subsidy to domestic production is a better policy than a tariff.

12.5 The Political Economy of Protectionism

The previous treatment explains why countries may prefer the instruments of the new protectionism rather than the traditional ones. But it does not explain why protectionism in general is still around. We know quite well from the theory of

Fig. 12.5 The optimal amount of lobbying



second best (Sect. 11.6) that, when we are in the presence of many violations to the Pareto-optimum conditions, it is not possible to say in general whether the introduction or elimination of a violation (such as a protectionist measure) decreases or increases social welfare. Hence the continuing presence of protectionism would seem to imply that the above uncertainty has been solved in the sense that social welfare increases in the presence of protectionism. This is certainly not the case: no theoretical study exists in this sense.

Thus we must look elsewhere, and the political economy of protectionism offers an interesting answer. This school of thought starts from the observation that protectionist measures are not introduced (or eliminated) by a benign, omniscient government aiming at the maximization of social welfare. Rather, they are the result of pressure groups lobbying the government for particular policy changes (see, e.g., Jones and Krueger, 1990; Lopez and Pagoulatos, 1994; Markusen et al., 1995). Hence, protectionism can be interpreted as a *rational* policy for decision makers in a democracy.

12.5.1 The Demand for and Supply of Protection

The observation of actual decision making in a democracy suggests that there exists a *political market* for protection, where there is a *demand* for, and a *supply* of protection (Baldwin, 1982; Brock & Magee, 1978; Frey, 1984). The demand for protection comes from particular groups of voters, firms, and associated interest groups. The supply comes from politicians and government officials.

Let us begin with the demand side. The economic agents who will gain from protectionist measures invest resources in order to influence political decisions in their favour. Hence the situation can be examined in the context of cost-benefit analysis, as shown in Fig. 12.5 (Baldwin, 1982; Frey, 1984). The amount of protection is measured by the variable d , that for simplicity we take as the tariff rate but can be any other protectionist measure. Benefits (B) and costs (C) of lobbying are measured in money terms. The cost-of-lobbying curve OC is

drawn on the assumption of increasing marginal costs, since it is reasonable to expect that it becomes more and more difficult to obtain higher and higher tariff rates from the government. The benefits-from-lobbying curve OB increases up to a maximum, which corresponds to the prohibitive tariff. It is not inconceivable that increasing tariff rates might yield increasing marginal benefits over a certain range, but for simplicity's sake OB has been drawn assuming decreasing marginal benefits everywhere. As in any case of cost-benefit analysis with well-behaved curves, the net benefit is maximised where the marginal benefit equals the marginal cost. This gives the associated tariff rate d^* (endogenously determined), where the slopes of the OB and OC curves are equal, and the vertical distance between these two curves (i.e., the net benefit) is highest.

The figure also shows that a lobbying activity is not always worthwhile. The $OC'C''$ cost curve shows that the initial costs of lobbying may be so high that the curve lies above the benefits curve everywhere. This cost situation may occur when the interest groups benefiting from protection are difficult to organise, and no organisation for other purposes (e.g., for social gatherings) already exists that could be used for setting up the lobby, thus avoiding the initial cost OC' . This explains why protection is not “demanded” by everybody and why the interest groups that are already organised tend to get additional advantages, while newcomers are in a difficult position in the political market for protection.

Before turning to the supply side, it should be observed that, in addition to the interest groups gaining from protection, there are groups losing from protection. Pro-tariff groups mainly consist of firms (including the workers) producing import-competing goods. These have strong lobbies, because such groups are usually well organised. On the contrary, anti-tariff groups (typically the consumers and the exporters) have weak lobbies as they find it difficult to organise (see [Olson, 1964](#)).

We now consider the *supply of protection*. The protectionist measures of a country are determined by politicians (typically the government) and by government officials (even if they are not entitled to decide the introduction of a protectionist measure, bureaucrats prepare, formulate and implement trade bills). A government has certain ideological goals (amongst which there may be a specific position with regard to free trade or protection), but also has a number of other goals, amongst which the need or desire of being re-elected. Since the interest groups demanding protection are much better organised than the anti-protection ones and have greater lobbying power (which includes financial help for the election campaign), a government will pay more attention to them. Furthermore, a government also has constraints, such as the budget and the balance of payments. A high balance-of-payments deficit may induce protectionist measures, and a budget deficit may be an additional element for a tariff (which gives a revenue to the government).

As regards the bureaucrats, it has been argued ([Messerlin, 1981](#)) that they favour greater protection than politicians. Amongst the various reasons there is the fact that they must reach their goals (which are not the common interest or collective welfare, but the maximization of their utility function) by using the instruments available to them (which are more limited than those available to politicians) more intensely.

Actual tariff rates are the outcome of the interaction between the demand and the supply in the political market for protection. Various models exist for the analysis of this interaction (Brock & Magee, 1978; Brock, Magee, & Young, 1989; Findlay & Wellisz, 1983; Mayer, 1993).

Brock and Magee, for example, consider the case of two lobbies, one pro-tariff and the other anti-tariff, and two political parties. The pro-tariff lobby is better organised and has more money but less votes than the anti-tariff lobby. Hence there is a trade-off between the number of votes that the lobby can offer to politicians and the amount of money that the lobby can give the politicians to finance the electoral campaign. The parties want to maximise the probability of re-election by choosing an appropriate position on the free trade-protectionism issue. Each party knows that it can obtain less votes but more financial resources (which in turn can be used to obtain more votes through the electoral campaign) by taking a position in favour of protectionism, and vice versa. The evaluation of the effects of this trade-off on the probability of re-election is specific to each party.

It is intuitive that each party reaches the optimal position when the marginal benefit (on the probability of re-election) of more financial resources equals the negative marginal benefit of the votes lost. It can be shown (Brock & Magee, 1978) that the equilibrium solution of the model (a game-theoretic Cournot-Nash equilibrium) endogenously determines the tariff level, the amount and distribution of the financial resources employed in the financing of the parties, and the distribution of votes between the two parties. In this context, tariffs can be seen as a “price” that clears the political market for protection (Frey, 1984).

12.6 Administered and Contingent Protection, and Fair Trade

In Sect. 12.5 we have seen how domestic industries can seek protection by lobbying politicians. Another avenue for seeking protection is to petition for import relief through ‘administered protection’ (AP) procedures. These procedures are rules-oriented and are codified in both national legislation and international agreements. Their characteristic is that they are based on objective criteria rather than on political discretion, and offer protection when an alleged injury occurs. Antidumping, countervailing duty, and safeguard actions are the foremost examples of such procedures.

However, AP is a somewhat broader concept than protection granted to offset the domestic injury deriving from allegedly ‘unfair’ foreign trade practices (antidumping, countervailing duty: see below) or from an occasional import surge (safeguard actions: see below). It also includes all kinds of protection deriving from domestic regulations whose primary aim is *not* that of (directly or indirectly) influencing international trade as such: for example, regulations aimed at environmental protection. A country worried that a domestic industry is generating an excessive amount of

pollution might subsidize imports of the commodity produced by that industry, so as to reduce its domestic production and hence pollution. Or export restrictions might be imposed to curb exports of a commodity (say, timber) so as to prevent excessive exploitation of natural resources (deforestation).

Box 12.1 Free Trade or Fair Trade?

The pursuit of *free trade* involves activities as the harmonization of trading rules and the reduction of barriers to trade. In its simplest sense the issue of free trade should be conducted on a *level-playing field*: more free trade would result from the application of the same policies, rules, mechanisms and institutions to each participant in the trade regime, regardless of origin and capacity. This last point brings us to the conceptual notion of *fair trade*. The term *fair trade* is used to indicate a position that calls for protectionist measures by developed countries against products that have been produced in developing countries at prices developed countries cannot compete with because of their different economic circumstances. As an example we can consider demands by the rich countries for imposing higher environmental and labour standards on the poor countries as preconditions for trade liberalization to prevent social dumping and a so called “race to the bottom” in wages and benefits. Trade sanctions or eco-dumping duties (sometimes referred to as a “social clause”) are often imposed in response to violations of labour and environmental standards. Developing countries consider such sanctions as disguised protectionism. Let us shortly analyse the issue of labour standards.

The core labour standards—freedom of association and the right to organize and bargain collectively, freedom from forced labour, the abolition of child labour and freedom from discrimination—are recognized as fundamental rights to which all workers are entitled regardless of the level of development of the country or sector they work. Such list of labour standards is the OECD set of the core standards which corresponds with the International Labour Organization’s (ILO) core standards.

The literature on international labour standards can be broadly divided in two categories. The first focuses on the evaluation of the appropriateness of linking labour standards with trade. For surveys see Brown, Deardoff and Stern (1996) and Stern (2003). The second includes recent writings by development economists such as Basu (2001), that link the issue of international labour standards to broader perspectives on development.

The central question is whether implementation and enforcement of global labour standards should be explicitly linked to trade agreement.

The reason why the issue of trade and labour standards is so much debated in trade negotiations is that labour interests in high-standards countries argue that low labour standards are an unfair source of comparative advantage and that increasing imports from low-standards countries will have an adverse impact on wages and working conditions: low wages and labour standards in developing countries threaten the living standards of workers in developed countries. For low-standards countries there is the fear that the imposition of high labour standards upon them is just a form of protectionism and is equally unfair as regards their competitiveness.

The broader concept of administered protection brings us to the problem of ‘fair’ trade and harmonization. Trade between countries with different environmental and labour standards, as well as with different competition rules, raises a number of new issues. Demands for harmonization to reduce the diversities of domestic policies and institutions, so as to foster free (or at least “fair”) trade are now at the centre of the new debate on protectionism versus free trade.

This problem involves not only economic, but also legal aspects, both of which are fully addressed in the two-volume set of essays edited by [Bhagwati and Hudec \(1996\)](#), see also [Krugman, 1997](#)). While referring the reader to these works, we shall however briefly show how these two aspects (the economic and the legal ones) are intimately intertwined even in the subset consisting of *contingent protection*.

Under the broader concept of administered protection, in fact, the subset consisting of protection against unfair foreign practices or to offset an import surge is called contingent protection, to which we shall limit our analysis.

Before going on, however, it is interesting to point out that lobbying and contingent protection can be viewed as alternative means for seeking protection in the presence of an alleged injury, so that the interested industry can choose between them through an optimization process that maximizes the expected net benefit ([Moore & Suranovic, 1992](#)). In addition, also antidumping law (see below) can be considered as a strategic business tool (alternative to lobbying), since it can be used by domestic firms as an *offensive* tool, even though the law is meant to be a defensive tool ([Hartquist, 1987](#)).

12.6.1 Dumping and Antidumping

Dumping is an international *price discrimination* which takes place when a producer sells a commodity abroad at a price lower than that charged in the domestic market (for a case in which dumping occurs in the intermediate goods market see [Bernhofen, 1995](#)). The export price considered is f.o.b. (free on board), and so transport cost and insurance are excluded. Also excluded are export duties (if any) and the (possible) markup of the foreign wholesale importer. Dumping is not necessarily a synonym of a bargain-sale below cost, as is often thought, for, on the contrary, it may be a way of maximizing profits. In general three types of dumping can be distinguished: *sporadic*, *predatory*, and *persistent*.

Sporadic dumping, as the name suggests, occasionally occurs when a producer, who happens to have unsold stocks (e.g., because of bad production planning or unforeseen changes in demand) and wants to get rid of them without spoiling the domestic market, sells them abroad at reduced prices. This is the type nearest to the concept of a sale below cost.

Predatory dumping takes place when a producer undersells competitors on international markets in an effort to eliminate them. Of course this producer also suffers losses but can subsequently (in case of success) raise the price to the monopoly level, once competitors leave the market. This type of dumping is, therefore, only temporary.

Persistent dumping is that started off by a producer who enjoys a certain amount of monopolistic power and exploits the possibility of price discrimination between domestic and foreign markets in order to maximize profits. This case can therefore be analysed by using the theory of the discriminating monopolist. It should be recalled that this theory is based on the assumption that the markets are completely

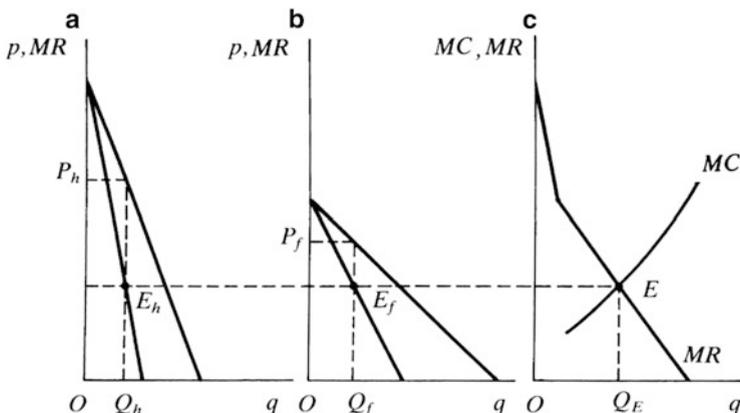


Fig. 12.6 Persistent dumping

separated, so that it is not possible for consumers to purchase the commodity in the market where the price is lower (and even less to carry out arbitrage operations, that is, to buy the commodity in the low-price market and resell it in the high-price one). This separation usually occurs in international trade: transport costs, customs duties and other barriers, imperfect (and costly) information, administrative regulations etc., effectively separate the domestic and the foreign market.

Now, the theory of the discriminating monopolist tells us that, to maximize profits, the monopolist must equalize the marginal revenues in the various markets with one another and with the marginal cost of output as a whole (for simplicity, we assume that the monopolist produces the commodity at one plant, situated at home). If, in fact, the marginal revenue in market i were greater than that in market j , the monopolist could—with the same output and so with the same total cost— increase total revenue (and so profits) by selling one unit less in market j (total revenue decreases by MR_j) and one unit more in market i (total revenue increases by $MR_i > MR_j$). The process would continue up to the point where $MR_i = MR_j$. Once the marginal revenues are equalized (this equalization gives the maximum total revenue corresponding to any given output), profits will be maximized by equating the (common level of the) marginal revenue to marginal cost.

This procedure is represented in Fig. 12.6a–c, where we have drawn, from left to right, the demand and MR curves in the home market, the demand and MR curves in the foreign market and the overall MR and the MC curves.

The MR curve in panel (c) is obtained by horizontal summation of the MR curves in (a) and (b): in such a way, for any given output, for example OQ_E , the common level of the MR in the two markets is immediately found ($OQ_E E = Q_f E_f = Q_h E_h$), which is then carried into panels (b) and (a) ($OQ_E E = Q_f E_f = Q_h E_h$), showing the optimal allocation between the two markets, OQ_f and OQ_h (note that $OQ_f + OQ_h = OQ_E$ by construction). The intersection between MC and MR in panel (c) determines the equilibrium point E ; from panels (b) and (a) one finds the price to be charged in

the foreign (OP_f) and domestic (OP_h) market respectively, and the corresponding quantities sold.

We see from the figure that $OP_f < OP_h$, but this is *not* due to a sale below cost: on the contrary, it is the condition required by profit maximization (this explains why persistent dumping is also called *equilibrium dumping*). The fact that it is profitable to sell on the foreign market at a lower price than on the home market depends on the fact that *the elasticity of demand is higher on the foreign market*, so that the monopolist's optimum markup—which equals the reciprocal of the elasticity of demand—is smaller in the foreign than in the domestic market. And since the markup is applied to marginal cost, which is one and the same, it follows that the price charged to foreign buyers is higher than that charged domestically.

Whilst sporadic and predatory dumping are undoubtedly harmful to the foreign importing country, it might seem that persistent dumping is beneficial, as the consumers of the importing country will pay a *systematically* lower price for the commodity. But this opinion ignores the loss of the foreign producers of the commodity (or of close substitutes), who will ask for antidumping protection. This (subject to a legal procedure) is granted through an *antidumping tariff*, namely a duty on imports equal to the *dumping margin*.

The dumping margin may be calculated as the difference between OP_f and OP_h (so as to equalize the price to that in the domestic market of the exporting country); alternatively it may be calculated as the difference between OP_f and the so called "*fair value*" of the commodity, which is usually taken to be average cost of production by the exporting firm.

Subject to country-specific institutional differences, the process leading to antidumping action may be broadly described as follows:

- (a) A domestic firm (or group of firms representing an industry) files a petition against a foreign firm or industry. This petition is filed with the domestic institution legally entitled to examine it. In the United States, this petition has to be filed with both the International Trade Commission and the Department of Commerce; in the European Union (where trade policy vis-à-vis the rest of the world is centralized) with the European Commission. This action is costly, for it entails data collection costs and legal expenses. Let us call C_0 this initial (sunk) cost.
- (b) Within a time t_0 the institution issues a preliminary determination, which may be interlocutory or negative. In the latter case, the procedure ends, in the former case it continues with the next stage.
- (c) On the basis of the preliminary findings of the institution, the domestic industry may decide to withdraw the petition or to pursue it. In the latter case further ongoing legal expenses are incurred, say C_1 , and the institution continues its investigation, issuing the final decision within a time t_1 .
- (d) The decision may be positive or negative. In the former case, an antidumping duty is levied (in the United States, the basis is usually the fair value, see above).

Box 12.2 Antidumping Measures in the World

Antidumping, contrary to other neoprotectionist measures, has a long history. The first antidumping laws in the United States go back to 1916 and 1921, while the first multilateral regulation is contained in article VI of GATT 1947. However, up to the 1980s AD actions concentrated within a restricted number of countries: US, European Community, Australia, Canada. It was only in the late 1980s that AD actions began to come from developing countries, mainly Argentina, Brazil, India, and Mexico. In the period 1995–2008 more than 60 % of the world AD actions (3,305 initiated and 2,106 enforced) concerned developing countries. About two thirds of these are directed at other developing countries.

China is the main target of AD actions: in the period 1995–2008 there were 446 petitions against China (about 15 % of the total), of which 441 gave rise to an antidumping measure. The next target is the Republic of Korea with 247 petitions (of which 147 accepted) and the United States with 183 petitions (of which 112 accepted).

All the data are drawn from the WTO web site, <http://wto.org>

Let us now examine the domestic welfare effects of a successful antidumping petition. The traditional view is that the antidumping duty, as any duty, increases producers' surplus at the expense of consumers' surplus. This view has however been challenged on the basis of possible collusive behaviour of the domestic and foreign industry. Prusa (1992) started from the observation that in the United States each of the three possible outcomes of antidumping cases initiated in the period 1980–1985 (petition accepted, rejected, withdrawn) accounted for approximately a third of the total. Now, since most of the costs of a petition are sunk (C_0 is much greater than C_1), one would expect few cases to be withdrawn. However, as Prusa (1992, p. 2) remarks, frequently a petition is withdrawn only after the domestic industry has achieved some type of out-of-court settlement with its foreign rival. The settlement may involve either a price undertaking (i.e., a voluntary price increase by the foreign firm) or a quantity restriction. Furthermore, settlements can be made with or without government approval. Subsequent periods have confirmed this view: in the United States in the period 1980–2005, 1,132 AD procedures were initiated, and about 20 % of these ended with the withdrawal of the petition (Morkre and Kelly, 1994; WTO, 1995 and following years).

Similar results hold for the European Union, where in the same period of the 631 petitions more than 35 % have been withdrawn (Bown, 2010).

Hence most if not all of the withdrawals are really out-of-court settlements. This is interpreted by Prusa in terms of a game-theoretic bargaining model which gives rise to a unique Nash solution. The result is that within this bargaining process the domestic and foreign firms cooperate on pricing decisions so as to achieve a collusive level of profits.

Thus antidumping cases may actually be used as a stratagem that paves the way for collusion among (domestic and foreign) oligopolistic firms. In these cases, as Prusa observes, the welfare conclusion is exactly the opposite of conventional wisdom: the imposition of an antidumping duty, instead of decreasing consumers' surplus, might actually increase it, because the alternative is not free trade, but a collusive oligopolistic situation.

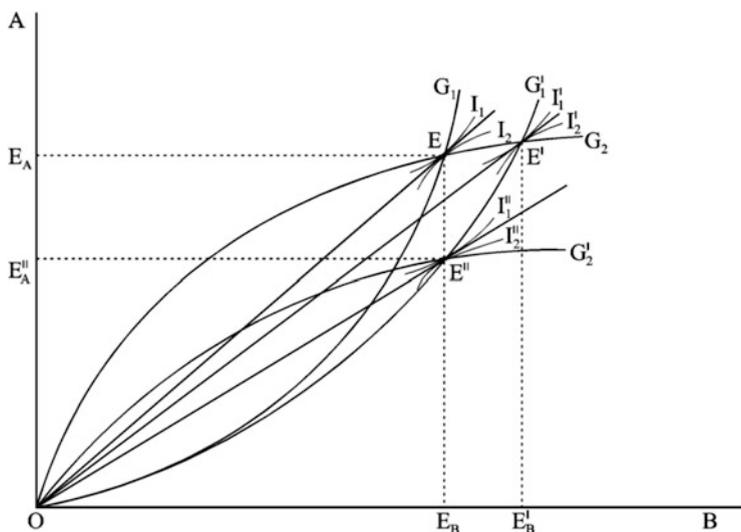


Fig. 12.7 Export subsidies and countervailing duties

For further analysis of the effects of antidumping duties see [Anderson et al. \(1995\)](#).

12.6.2 Countervailing Duty

A countervailing duty (CVD) is a duty levied in retaliation to an export or production subsidy by a foreign country. It is interesting to observe that export subsidies constitute a sort of official dumping, since they are paid out by the government to domestic producers-exporters, enabling them to sell abroad at a lower price than at home. This explains why export subsidies are prohibited, except when they are rebates of indirect taxes (see above, point (i) in Sect. 10.6.4).

Since an export subsidy increases consumers' welfare in the importing country, why should there be a retaliation? The answer is the same as in the case of dumping: the producers of the importing country are harmed, hence they will ask for protection by filing a petition (the procedure is similar to that described above in the case of an antidumping petition).

Subsidies have been treated above (Sect. 12.4) in a partial equilibrium context, but in order better to examine the effects of a CVD levied against a foreign subsidy we need a general equilibrium setting. Let us start from the free-trade situation depicted in Fig. 12.7, and assume that country 1 introduces an export subsidy.

The export subsidy causes country 1's offer curve to shift downwards and to the right, from OG_1 to OG'_1 . To show this, take for example point E on country 1's

offer curve. At the price ratio given by the slope of OE , consumers and producers are willing to exchange OE_B of exportables for OE_A of importables. However, due to the presence of an export subsidy (measured in terms of commodity A taken as *numéraire*)¹ equal to EE'' , the foreigners actually give $OE''_A = E''E_B$ of importables. Hence we have a domestic price ratio

$$p_d = \text{slope of } OE = EE_B/OE_B$$

and an international price ratio (terms of trade)

$$p = \text{slope of } OE'' = E''E_B/OE_B.$$

The subsidy rate (s) is then measured by

$$s = EE''/EE_B.$$

Another way of showing this is to note that $(1-s)p_d = p$, hence $s = (p_d - p)/p_d = EE''/EE_B$.

Let us now consider what happens to international equilibrium. Given country 2's offer curve OG_2 , the equilibrium point shifts from E to E' , and country 2's imports increase from OE_B to OE'_B .

Note that the terms of trade move in favour of country 2, whose welfare improves while that of country 1 decreases: this can be seen by checking that the social indifference curve I'_2 is better than I_2 , while I'_1 is worse than I_1 (these curves are drawn according to the same technique described in Fig. 11.1).

Suppose now that country 2 retaliates by a CVD, whose amount is calculated so as to bring imports back to the pre-subsidy situation, namely to OE_B . Country 2's offer curve shifts downwards (see Sect. 10.5.2) to position OG'_2 , and the new equilibrium point is E'' . The terms of trade further move in favour of country 2, whose welfare again increases at the expense of country 1's welfare (I''_2 is better than I'_2 , and I''_1 is worse than I'_1).

Note that such a CVD also restores country 2's domestic price ratio to its initial (free trade) value. In fact, at the beginning, the domestic price ratio coincided with the terms of trade (slope of OE). In the final situation, the terms of trade are given by the slope of ray OE'' , but country 2's domestic price ratio is given by the slope of ray OE , since EE'' is the amount of the tariff (see Sect. 10.5.2).

Hence both the quantity of imports and the domestic price ratio are back to the initial situation: the impact of the export subsidy has been completely offset by the CVD. One might then ask “why can't countervailing duties deter export subsidization?”. This is the title of a paper by Qiu (1995), who shows that there are three factors that explain the coexistence of export subsidies and CVDs. He

¹This neglects the problem of how the government raises the funds required to pay the subsidy. For an in-depth treatment of this problem see Meade (1952, chap. VI).

works in the context of a duopolistic model, but his considerations can be applied to the standard competitive model as well.

The first reason is a delay in retaliation. A petition against an alleged foreign export subsidy requires time to be examined by the domestic institution, and hence, even assuming a 100% probability of success, during this time the export subsidy exerts all its effects. International agreements, in fact, allow retaliation but not vengeance, which means that no CVD can be levied if the foreign country withdraws the export subsidy at the end of the procedure.

The second reason is the upper limit to a CVD. According to international agreements, in fact, the CVD rate cannot exceed the subsidy rate. Now, we see from Fig. 12.7 that *the fully offsetting CVD rate is greater than the export subsidy rate*. In fact, the CVD rate is measured by the proportional downward shift of the OG_2 curve, for example by $EE''/E''E_B$ (see Sect. 10.5.2), which is clearly greater than EE''/EE_B . The application of a CVD with the same rate as the subsidy would entail a smaller downward shift of the OG_2 curve, that would bring this curve to an intermediate position (not shown in the diagram) between OG_2 and OG'_2 . It is then easy to check that the CVD would not completely offset the subsidy, since the final quantity of country 2's imports would be somewhere between E_B and E'_B .

The third reason is the phenomenon of out-of-court settlements that give rise to VERs. This is the same phenomenon already examined above in the case of AD petitions. The data are also similar: between 1980 and 2005, about 30% of CVD petitions were withdrawn in the US, most of them resulting in VERs. Of the remaining ones, 64% have been rejected and only 36% accepted.

Box 12.3 THE US-EU Dispute on Steel

Among the 12 active WTO disputes between the European Union, as a complaining party, and the United States—mostly associated to misuse of trade defence instruments, four of them relate to the steel sector. Under case number WT/DS248, in particular, the EU is complaining on the US definitive safeguard measures on imports of certain steel products adopted on 5 March 2002, with the belief that such measures are in breach of both the US obligations under the provisions of GATT 1994 and of the Agreement on Safeguards (SA).

Following the recommendations of the International Trade Commission (ITC), which, on 22 June 2001, initiated a safeguard investigation on imports of four broad groups of steel products, the US President announced, on 5 March 2002, definitive safeguard measures in the form of an increase in duties ranging from 8 to 30% on imports of certain steel products, effective as of 20 March 2002.

Although three rounds of consultations took place over March–April 2002, the last jointly with Korea, Japan, China, Switzerland and Norway, they did not succeed in solving the dispute, and a panel was established, under request by the EC, at the special meeting of the Dispute Settlement Body (DSB) of 3 June 2002. More precisely, a single Panel was established against the US steel safeguards under Article 9.1 of the Dispute Settlement Understanding (DSU), following requests presented by Japan, Korea, China, Switzerland, Norway, New Zealand and Brazil.

The claims put forward relate to violations of both the Article XIX of the GATT agreement on “unforeseen developments” and a number of SA provisions, including, among others, the lack of increased imports, the incorrect definition of the domestic

industries that produce like products, the lack of serious injury or threat thereof serious injury and the absence of causal link between imports and serious injury.

The Panel report, which was circulated to all WTO Members on 11 July 2003, found that all safeguard measures lacked a legal basis. However, on 11 August 2003 the United States decided to appeal the panel report. The Appellate Body rejected the appeal on 10 November 2003, and authorized an appropriate retaliation by the EU against the United States in case the United States maintained the tariffs on steel imports. On 4 December 2003 the United States withdrew these tariffs.

12.6.3 *Safeguard Actions*

International agreements also allow a country to protect domestic producers against fair imports (that is, imports that are not dumped or subsidized by the foreign country) under certain circumstances. The characteristic of this form of administered protection (called a *safeguard* action) is that it must be temporary and nondiscriminatory. For example, a country experiencing a sudden surge of imports that threatens severe injury to domestic producers, may impose a temporary nondiscriminatory tariff.

Although SA, AD, and CVD are called *emergency measures* by WTO, there are three important differences among them.

The first is that, while for the application of AD and CVD measures it is necessary that unfair competition has taken place, for the application of SA it is enough that the industry of the country has been damaged by the increase in imports, in the absence of export subsidies or dumping by the exporting country.

The second concerns the application. AD and CVD measures are only applied against the country guilty of unfair competition. On the contrary, SA measures are applied against all countries (with some exceptions concerning developing countries) whose exports have harmed the country which presents the petition.

The third concerns the compensation. AD and CVD measures are a penalty imposed on countries guilty of an unlawful behaviour, hence obviously they do not imply compensation to these countries. On the contrary, a country that obtains an SA is required to compensate the exporting countries for possible losses that they undergo because of the SA measure.

Safeguard actions are a small minority with respect to AD and CVD actions: for example, at the world level, in the period 1995–2008, 3,305 AD petitions were undertaken (of which 2,106 were accepted), while there were only 209 requests for CVD (of which 121 were enforced) and 164 requests for SA (of which 83 were applied).

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