GATT Exceptions

There are several situations in which countries are allowed to violate GATT nondiscrimination principles and previous commitments such as tariff bindings. These represent allowable exceptions that, when implemented according to the guidelines, are GATT sanctioned or GATT legal. The most important exceptions are trade remedies and free trade area allowances.

Trade Remedies

An important class of exceptions is known as trade remedies. These are laws that enable domestic industries to request increases in import tariffs that are above the bound rates and are applied in a discriminatory fashion. They are called remedies because they are intended to correct for unfair trade practices and unexpected changes in trade patterns that are damaging to those industries that compete with imports.

These remedies are in the GATT largely because these procedures were already a part of the laws of the United States and other allied countries when the GATT was first conceived. Since application of these laws would clearly violate the basic GATT principles of nondiscrimination, exceptions were written into the original agreement, and these remain today. As other countries have joined the GATT/WTO over the years, these countries have also adopted these same laws, since the agreement allows for them. As a result, this legal framework, established in the United States and other developed countries almost a century ago, has been exported to most other countries around the world and has become the basic method of altering trade policies from the commitments made in previous GATT rounds.

Today, the trade remedy laws represent the primary legal method WTO countries can use to raise their levels of protection for domestic industries. By binding countries to maximum levels of protection, the GATT and WTO agreements eliminate their national sovereignty with respect to higher trade barriers. Note that countries are always free to lower trade barriers unilaterally if they wish without violating the agreements. The trade remedy laws offer a kind of safety valve, because in certain prescribed circumstances, countries can essentially renege on their promises.

Antidumping

Antidumping laws provide protection to domestic import-competing firms that can show that foreign imported products are being “dumped” in the domestic market. Since dumping is often considered an unfair trade practice, antidumping is known as an unfair trade law. Dumping is defined in several different ways. In general, dumping means selling a product at an unfair, or less than reasonable, price. More specifically, dumping is defined as (1) sales in a foreign market at a price less than in the home market, (2) sales in a foreign market at a price that is less than average production costs, or (3) if sales in the home market do not exist, sales in one foreign market at a price that is less than the price charged in another foreign market. The percentage by which the actual price must be raised to reach the fair or reasonable price is called the dumping margin. For example, if a firm sells its product in its home market for $12 but sells it in a foreign market for $10, then the dumping margin is 20 percent since a 20 percent increase in the $10 price will raise it to $12.

Any import-competing industry is allowed to petition its own government for protection under its antidumping law. Protection in the form of an antidumping (AD) duty (i.e., a tariff on imports) can be provided if two conditions are satisfied. First, the government must show that dumping, as defined

above, is actually occurring. Second, the government must show that the import-competing firms are suffering from, or are threatened with, material injury as a result of the dumped imports. Injury might involve a reduction in revenues, a loss of profit, declining employment, or other indicators of diminished well-being. If both conditions are satisfied, then an AD duty set equal to the dumping margin can be implemented. After the Uruguay Round, countries agreed that AD duties should remain in place for no more than five years before a review (called a *sunset review*) must be conducted to determine if the dumping is likely to recur. If a recurrence of dumping is likely, the AD duties may be extended.

Normally, AD investigations determine different dumping margins, even for different firms from the same country. When AD duties are applied, these different firms will have separate tariffs applied to their products. Thus the action is highly discriminatory and would normally violate MFN treatment. The increase in the tariff would also raise it above the bound tariff rate the country reached in the latest negotiating round. However, Article 6 of the original GATT allows this exception.

Antisubsidy

Antisubsidy laws provide protection to domestic import-competing firms that can show that foreign imported products are being directly subsidized by the foreign government. Since foreign subsidies are considered an unfair trade practice, antisubsidy is considered an unfair trade law. The subsidies must be ones that are targeted at the export of a particular product. These are known as *specific subsidies*. In contrast, *generally available subsidies*, those that apply to both export firms and domestic firms equally, are not actionable under this provision. The percentage of the subsidy provided by the government is known as the subsidy margin.

Import-competing firms have two recourses in the face of a foreign government subsidy. First, they can appeal directly to the WTO using the dispute settlement procedure (described in Chapter 1 "Introductory Trade Issues: History, Institutions, and Legal Framework", Section 1.7 "The World Trade Organization"). Second, they can petition their own government under their domestic antisubsidy laws. In either case, they must demonstrate two things: (1) that a subsidy is being provided by the foreign government and (2) that the resulting imports have caused injury to the import-competing firms. If both conditions are satisfied, then a country may implement a *countervailing duty* (CVD)—that is, a tariff on imports set equal to the subsidy margin. As with AD duties, CVDs should remain in place for no more than five years before a sunset review must be conducted to determine if the subsidies continue. If they are still in place, the CVD may be extended.

Since CVDs are generally applied against one country's firms but not another's, the action is discriminatory and would normally violate MFN treatment. The higher tariff would also raise it above the bound tariff rate the country reached in the latest negotiating round. Nonetheless, Article 6 of the original GATT allows this exception.

Safeguards

Safeguard laws (aka escape clauses) provide protection to domestic import-competing firms that can demonstrate two things: (1) that a surge of imported products has caused disruption in the market for a particular product and (2) that the surge has substantially caused, or threatens to cause, serious injury to the domestic import-competing firms. The use of the term *serious injury* means that the injury must be more severe than the injury cause in AD and antisubsidy cases. Since import surges are not generally

considered to be under the control of the exporting firms or government, safeguard laws are not considered unfair trade laws.

In the event both conditions are satisfied, a country may respond by implementing either tariffs or quotas to protect its domestic industry. If tariffs are used, they are to be implemented in a nondiscriminatory fashion, meaning they are executed equally against all countries. However, if quotas are used, they may be allocated in a way that favors some trading partners more than others. Safeguard actions are also intended to be temporary, lasting no more than four years.

As with antidumping and antisubsidy cases, because a safeguard response involves higher levels of protection, it will likely conflict with the previously agreed bound tariff rates and thus violate the GATT principles. However, Article 19 of the GATT, the so-called *escape clause*, provides for an exception to the general rules in this case.

Because safeguard actions in effect take away some of the concessions a country has made to others, countries are supposed to give something back in return. An example of acceptable compensation would be the reduction of tariffs on some other items. This extra requirement, together with the need to establish serious rather than material injury, have contributed to making the use of safeguard actions less common relative to antidumping and antisubsidy actions.

China's Special Safeguards. When China was accepted as a WTO member country in 2001, it agreed to many demands made by other WTO members. One such provision requested by the United States was allowance for a "special safeguard provision." The agreement reached allowed the United States and all other WTO countries to implement additional safeguard provisions on specific products from China that might suddenly flood their markets.

One important concern at the time was the surge of textile and apparel products that might come after the expiration of the quota system in 2005 under the Uruguay Round's Agreement on Textiles and Clothing. As a stopgap, countries were allowed to reintroduce quotas or other barriers in the event that imports from China surged in once the official quotas were gone. Both the United States and the EU implemented increased protections in 2005, and China did not enjoy the full benefit of the quota elimination until this safeguard provision expired in 2008.

Additional special safeguards are in place to protect against import surges of other products from China, and these do not expire until 2014. (In the United States, these are called section 421 cases.) Although these provisions are similar to the standard safeguards, they are more lenient in defining an actionable event.

Free Trade Areas

One other common situation requires an exception to the rules of the GATT/WTO. Many countries have decided to take multiple paths toward trade liberalization. The multilateral approach describes the process of the GATT, whereby many countries simultaneously reduce their trade barriers, but not to zero. The alternative approach is referred to as regionalism, whereby two to several countries agree to reduce their tariffs and other barriers to zero—but only among themselves. This is called a regional approach since most times the free trade partners are nearby, or at the very least are significant trading partners (though this isn't always the case).

In principle, a free trade agreement means free trade will be implemented on all products traded between the countries. In practice, free trade areas often fall short. First, they are rarely implemented immediately; instead, they are put into place over a time horizon of ten, fifteen, or even twenty or more years. Thus many free trade areas (FTAs) today are really in transition to freer trade. Second, FTAs sometimes exempt some products from liberalization. This occurs because of strong political pressure by some domestic industries. If a substantial number of products are exempted, the area is known as a preferential trade arrangement, or a PTA.

Perhaps the most important free trade area implemented in the past fifty years was the European Economic Community formed by the major countries in Western Europe in 1960 that ultimately led to the formation of the European Union in 1993. The term “union” refers to the fact that the area is now a customs union that not only includes free trade in goods and services but also allows for the mobility of workers and other factors of production. In addition, some of the core European countries have taken it one step further by creating and using the euro as a common currency, thus establishing a monetary union in addition to the customs union.

In the United States, an FTA was first implemented with Israel in 1986. An FTA with Canada in 1988 and the inclusion of Mexico with Canada to form the North American Free Trade Agreement (NAFTA) followed. Since the turn of the millennium, the United States has implemented FTAs with Jordan, Bahrain, Morocco, Singapore, Chile, Australia, the Central American Free Trade Agreement—Dominican Republic (CAFTA-DR), and Peru.

An FTA violates the GATT/WTO principle of most-favored nation because MFN requires countries to offer their most liberal trade policy to all GATT/WTO members. When an FTA is formed, the most liberal policy will become a zero tariff, or free trade. However, the original GATT carved out an exception to this rule by including Article 24. Article 24 allows countries to pair up and form free trade areas as long as the FTA moves countries significantly close to free trade and as long as countries notify the GATT/WTO of each new agreement. The simple logic is that an FTA is in the spirit of the GATT since it does involve trade liberalization.

As of 2009, over two hundred FTAs have been notified either to the GATT or the WTO. Many of these have been started in the past fifteen to twenty years, suggesting that regional approaches to trade liberalization have become more popular, especially as progress in the multilateral forum has slowed. This trend has also fueled debate about the most effective way to achieve trade liberalization. For example, is the regional approach a substitute or complement to the multilateral approach?