

An Evaluation on the GATT, the WTO's Agreement on Safeguards, and the Dispute Settlement Procedure

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GATT, DTÖ Korunma Önlemleri Anlaşması ve Anlaşmazlıkların Halli Mekanizması'na İlişkin Bir Değerlendirme

Abstract

This study focuses on evaluating the General Agreement on Tariffs and Trade (GATT) Article XIX, the World Trade Organization's (WTO) Agreement on Safeguards (AoS), and the Dispute Settlement Procedure (DSP) for the safeguards by developing a theoretical model. To make a fair comparison, we analyse the timing of the DSP, the political ties between the safeguard imposing country and the countries whose exports are affected from these duties, ex-ante against interim safeguard tariffs, and we present respective extensions over the model initially developed Beshkar (2009). For this purpose, a model design is introduced for GATT, WTO, and DSP to find the incentive-compatible agreement that maximizes political welfare under the AoS, aiming to extend Beshkar's analyses. We find that determining the safeguard tariff level at an interim step instead of ex-ante leads to the tariff that is politically the best for a country at that instant but does not necessarily lead to an optimal tariff. As a result, we reveal that WTO procedures do not always produce the best tariff options for the parties in safeguard measures.

Keywords : International Trade, Safeguard Measures, WTO, GATT, Trade Protection.

JEL Classification Codes : F10, F13, F19.

Öz

Bu çalışma, Gümrük Tarifeleri ve Ticaret Genel Antlaşması (GTTA) Madde XIX, Dünya Ticaret Örgütü (DTÖ) Korunma Önlemleri Anlaşması (KÖA) ve Anlaşmazlıkların Halli Prosedürü'nün (AHP) korunma önlemleri kapsamında teorik bir model kullanılarak değerlendirilmesine odaklanmaktadır. Adil bir karşılaştırma yapabilmek adına, Anlaşmazlıkların Halli Prosedürü'nün toplam süreci, korunma önlemi uygulayan ülke ile ihracatları mezkûr önlemden etkilenen diğer ülkeler arasındaki siyasi bağlar ile önceden planlanan korunma tariflerine karşı anlık hesaplanan tarifeler analiz edilmiş ve Beshkar (2009) modeline eklemeler sunulmuştur. Bu amaçla, Beshkar'ın analizini genişletmek amacıyla, AoS kapsamında siyasi refahı en üst düzeye çıkaran teşvik uyumlu anlaşmayı bulmak için GATT, WTO ve DSP için bir model tasarımı geliştirilmiştir. Korunma tarifelerinin önceden planlananlar yerine anlık olarak belirlenmesinin bir ülke için optimal tarifeye değil, politik olarak o anda uygulanabilecek en iyi tarifeye yol açtığı bulunmuştur. Sonuç olarak, korunma önlemlerine ilişkin olarak Dünya Ticaret Örgütü prosedürlerinin taraflar için her zaman en iyi tarife seçenekleri üretmediği ortaya koyulmaktadır.

Anahtar Sözcükler : Uluslararası Ticaret, Korunma Önlemleri, DTÖ, GATT, Ticari Koruma.

1. Introduction

One of the founding agreements of the World Trade Organization (WTO) is the Agreement on Safeguards (AoS) which regulates one of the widely used trade remedies called safeguard (SG) actions. This tool is a significant trade policy instrument to protect the domestic producers from unexpected and harmful import rises. According to AoS, WTO members may take SG duties to restrict imports of a product temporarily in order to protect a specific domestic industry from an increase in imports of any product which is causing, or which is threatening to cause, serious injury to the industry. SG actions are considered to be taken against fair trade practices such as *recent, sudden, sharp and significant enough import surges*. Unlike safeguards, the other trade measures like anti-dumping (AD) and the countervailing duties (CVD) are the actions against unfair trade practices.

WTO Members can apply SG measures in three forms which are tariffs, quotas and tariff rate quotas after conducting proper SG investigations. These investigations are initiated by the relevant authorities of the importing countries whose domestic industries claim to suffer due to rises in imports which cause injuries and economic/financial losses on domestic industries. Since these industries suffer due to large volumes of recent imports of a specific product, WTO permits members to investigate reasons for this surge and its link with the injury to the domestic industry within the framework of AoS.

According to the agreement, imports should cause serious injuries on profitability, level of sales, productivity, employment, capacity utilization rates of the domestic industry, as underlined by Article (4.2.a) of AoS. Besides, domestic industries are responsible for presenting written and oral claims to prove that they suffer due to the immediate rise in imports¹.

As noted, Members have the opportunity to take SG measures to preclude the destructive flows of these imports into their country, within the framework of the article of AoS. The investigations under the AoS must fulfil certain requirements such as including public notice for hearings and presenting evidence of measures being in the public interest.

In a nutshell, AoS aims to: (i) clarify and reinforce General Agreement on Tariffs and Trade (GATT) disciplines, particularly those of Article XIX; (ii) re-establish multilateral control over SGs and eliminate measures that escape such control; and (iii) encourage structural adjustment on the part of the industries adversely affected by increased imports, thereby enhancing competition in international markets².

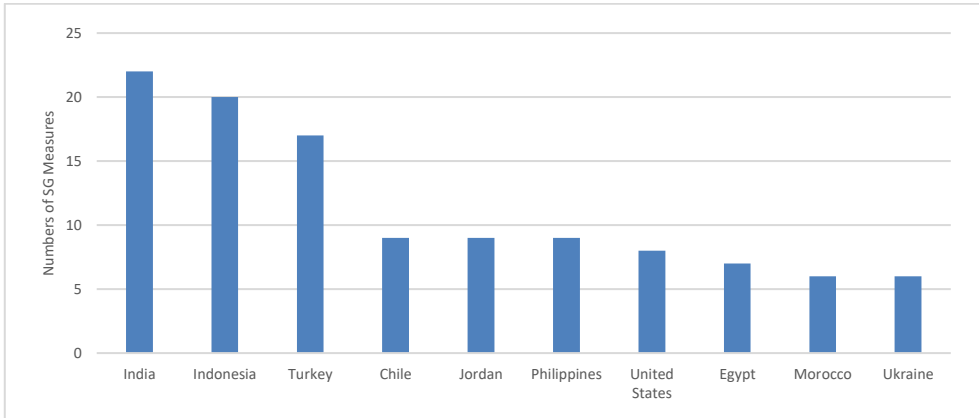
Despite of the fact that AoS is one of the major agreements of WTO, it is highly criticized because of having unclear wording and mechanisms which complicate its implementation in some cases. There are also some complaints lodged at Dispute Settlement Procedure (DSP) following the disagreements concerning the applications of the SG actions.

¹ See WTO's *Analytical Index: A Guide to WTO Law and Practice* (2012) for the details.

² WTO, *Agreement on Safeguards*, <https://www.wto.org/english/docs_e/legal_e/25-safeg_e.htm>, 13.03.2020.

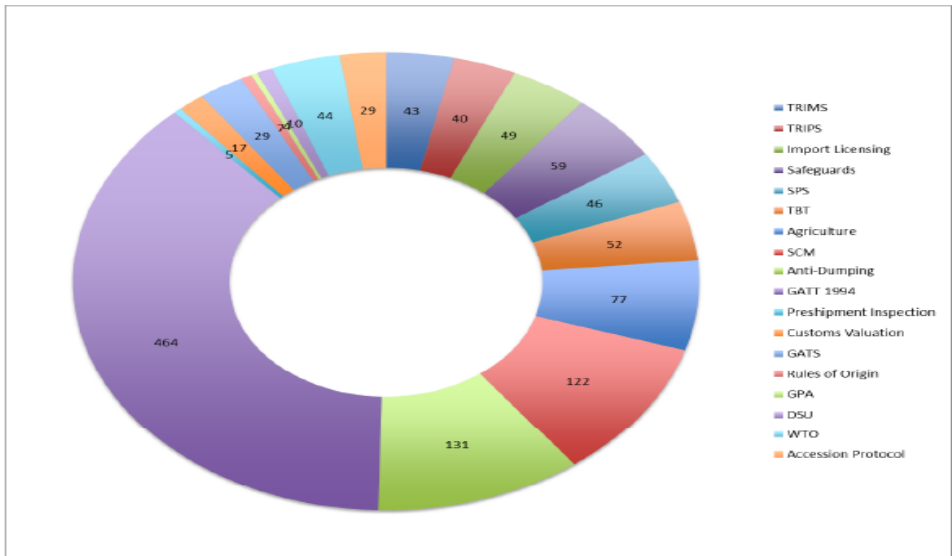
Although there are rather criticisms against particular aspects of SGs, they are still one of the frequently referred trade actions. Chart 1 shows the top 10 most frequent users of SG measures in the world in 1995-2019.

Chart: 1
Top 10 Most Frequent Users of SG Actions (1995-2019)



Source: Author's Own Calculations; WTO, *Safeguard Statistics (1995-2019)*, <https://www.wto.org/english/tratop_e/safeg_e/safeg_e.htm>, 20.03.2020.

Chart: 2
Agreements Raised in WTO Disputes (1995-2018)



Source: *WTO Dispute Stats (1995-2018)* <https://www.wto.org/english/tratop_e/dispu_e/disputats_e.htm>, 29.04.2020.

Chart 2 demonstrates the numbers of the WTO agreements raised in disputes between 1995 and 2018. As illustrated, safeguards rank the fifth with 59 cases among total disputes.

In this paper, we intend to investigate trade skirmishes and WTO's DSP within the framework of SGs. In order to analyse, we follow the model suggested by Beshkar (2009). We introduce a model of GATT, WTO and DSP and find the incentive-compatible agreement that maximizes political welfare under the AoS aiming to extend Beshkar's analysis. We also focus on investigating the welfare effect of the transition from GATT to the WTO in terms of political welfare. The contribution of the paper to the literature is unique in the sense that our model concentrates developing a model of the DSP within the framework of AoS while most of other studies explored the informational roles of the GATT and WTO to analyse trade agreements. Introducing a model of DSP, we model a signalling mechanism related to AoS processes. The reason why we chose this method is to offer a mechanism design approach to study one of the most important trade agreements shaping world trade. A good extension for the study would be to implement similar design analysis taking other types of trade barriers into account. The paper is organized as follows: Section 1 introduces the basics of SG actions under GATT and WTO, Section 2 presents the literature review, Section 3 establishes a comparison of GATT and WTO particularly in terms of AoS and DSP, Section 4 introduces the model and the extensions, and Section 5 conveys the conclusions.

2. Literature Review

Research on trade remedies have been object of study of many economists, in particular trade economists who lead the research starting from the 90's of the last century. In the last three decades, many valuable and crucial contributions were made, and economists enriched datasets and renovated methodologies mainly for the SG applications by different countries, such as United States of America (USA), Canada or the EU. Although various researches have been made in relation to SG actions and their impacts so far, some gaps in the literature still remain, particularly concerning lack of AoS and DSP that warrant further attention.

Firstly, in spite of the high numbers of empirical works on trade remedies, the studies that focused on SG actions and AoS are less than the studies that analysed ADs and CVDs.

A seminal work on trade remedies is by Baldwin and Steagall (1994). The authors focus on trying to evaluate the economic factors that best explain the decisions emitted by the International Trade Commission of the U.S. (USITC), regarding the claims of the American domestic industry associated with antidumping duties, countervailing duties and SG measures during the eighties. As for the SG measures, the authors estimate a Probit model with which they predict the probability that the ITC will generate a decision in favour of or against the domestic industry with regard to the claims for SG, the explanatory variables considered were: the percentage change in the ratio income/sales, a proxy of the rate of benefit and employment of the firms and the percentage change of the real gross

national product. The variables were statistically significant, indicating the weight of firm-specific economic factors and aggregate economy-specific factors in ITC decisions.

In another work of interest, Bown (2013) examined with empirical data how Turkey exercised and administered a flexible trade policy during the period 2008-2011, in which those responsible for Turkish trade policy had to resist great pressure from domestic industry to introduce changes in the partially liberal import regime maintained by this nation. The author points out that in the application of SG, AD and CVD policies, the impact on imports towards 2011 was around 4%. In addition, the flexibility of trade policy also resulted in the extension of the duration of the SG and AD measures outlined. In turn, Turkey introduced changes in tariffs that affected 9% of imports of manufactures and 10% of imported product lines.

Apart from that, there were some -still not many- pioneer studies that explored the informational role of the WTO and the DSP. For instance, Beshkar's (2009) theoretical model aimed at analysing trade agreements under WTO that decreased the trade frictions but did not have a positive effect on the governments to receive higher payoffs. The author underlined WTO courts improve the self-enforceability of trade agreements like SG. His model was similar to Bagwell and Staiger (2005) and Feenstra and Lewis (1991), and he used a similar mechanism design approach. The writer's model was different than the others as he concentrated on presenting a model of DSP and the way that DSP's role in solving unconformities.

Feenstra and Lewis (1991) set up a framework where two countries negotiate over the volume of trade and transfer of rents under levels of political pressure. They found that globally optimal trade policies occur when the home government has no incentive to overstate (or understate) the pressure for protection. According to Beshkar (2009), the policy instrument used by Feenstra and Lewis (1991) to compensate the affected exporting countries is an export restraint that allows the exporting countries to share the rents generated from higher protection while they are illegal under the WTO.

Analysing the informational role of the WTO, the study by Furusawa (2003) focused on modelling WTO as an institution which is perfectly observing the true state in the defending country, while the court option is costly and initiating a formal dispute depends on various conditions.

In another interesting study, Maggi (1999) concentrated on investigating the role of the WTO which is to disseminate information on deviations in order to facilitate multilateral punishments.

Rosendorff (1996) studied the SG clause and AD generated voluntary export restraints (VER) in trade agreements while he claimed VER lowers the volume of trade by more than the expected duty.

Grossman and Sykes (2007) and Sykes (2004) investigated the history of WTO Appellate Body's adverse rulings in respect of SGs. They went over the DSB's rulings and

found that DSB's final decisions in respect of SG cases are not satisfactory and that the safeguards jurisprudence under the WTO is in a state of confusion. These studies revealed that the DSB under WTO and GATT Article XIX did not work well to solve legal problem related to SG measures.

Park (2008) in a similar setting to Riezman's (1991) investigated the subject of enforcing international trade agreements through forming third-party trigger strategies when each country can secretly raise its protection level through concealed trade barriers.

3. Safeguards under WTO and GATT: Why are AoS and DSP Problematic?

As studies investigated different aspects of SGs, we concentrate on exploring why AoS and DSP mechanism don't work well in settling SG related trade discrepancies in real life. We base our analysis on Beshkar's (2009) model, suggest extensions and provide an overview of tweaks in order to show why AoS and DSP fail to operate perfectly under WTO.

Firstly, we are of the view that AoS causes various problems between WTO members because of its vagueness. For instance, countries sometimes impose SGs that are higher than optimal. Although AoS and GATT XIX require countries to impose decent and temporary SG measures, in reality, most of the countries choose to apply SG tariffs have higher than optimal levels to protect their domestic producers for a quiet long period of time. Thus, we think this necessitates having the safeguard tariffs determined at the interim step of the game, instead of *ex ante*³.

Secondly, agreement allows countries to determine at will when taking their decisions on the amount of the final duties as it doesn't suggest precise methodologies for the countries on calculating the SG duties and retaliation. This causes countries to employ different methods when determining duty levels. Although AoS does not specify the exact levels of the SG measures to be implemented as a result of the investigations, Article 5.1 of AoS necessitates safeguard-imposing countries to raise its trade barriers only to the extent necessary to prevent or remedy serious injury and to facilitate adjustment. However, there are no positive assertions the details on choosing and computing SG measures e.g. tariffs, quotas, tariff rate quotas.

Thirdly, the SG actions are generally taken under political pressures, particularly when domestic industries insist on protections against flow of imports and request the import taxes to be increased as high as possible. Actually, political pressure by the domestic firms is a significant part of the game when the government authorities determine the levels and duration of the SG duties.

Fourthly, the countries, whose exports are subject to SG actions, basically have two options if duty applying countries set very high tariff rate as a result of SG investigations: i) The exporting countries might refrain from taking the final SG duties to the WTO level. And, this will favour the SG imposing countries. ii) The exporting countries might prefer

³ See Section 4.1 of this paper for the details.

taking the final measure to the DSB level. These processes might take more or less 1-2 years (or even longer) for the non-binding final decisions to be taken. This period is generally adequate for the domestic producers to gain market power thanks to the high tariff rates. In this respect, the penalty under GATT is immediate for deviating from prior agreements while WTO has the penalty delayed by the arbitration process. Although DSB seems to be an optimal mechanism, it causes the Member countries to apply even very high SG rates since they can easily remove SG actions before the announcement of DSB's final decisions. That is why imposing an immediate penalty (as in GATT) can be even more fruitful.

As a fifth point, DSB is often criticized recently since it does not always work properly to solve the problems between countries on applied SG actions⁴. Firstly, some of the underdeveloped or developing countries do not move final SG decisions to the DSB level because they don't have experiences at WTO level to win the cases. There are some rare cases when some unfairly determined SG actions are not taken to DSP because of political or commercial ties between SG imposing country and the countries whose exports are affected from these duties, as the injured party do not want to eradicate ongoing commercial relations⁵.

The vagueness of AoS also cause unfair practices to arise concerning concessions. In fact, retaliation is one of the beleaguered parts of AoS. According to the agreement, the SG-affected countries have the opportunity to ask for retaliation negotiations with the party which impose the duties, as noted by Article 8.1 of AoS. As a matter of fact, AoS does not explicitly enlarges upon the retaliation process. The only article on compensation is the Article 8.1 which draws a very general framework about the trade concessions⁶.

At this juncture, let's consider country A imposes a definitive SG duty on the imports of steel rebars, and the total amount of loss of the exporting country B due to this is 20 million USD. Under these circumstances, country B may request the same amount of concessions from country A. The law warrants country B to restrict the imports of "any country A origin-product" as a concession to cover 20 million USD loss as a result of SG measure⁷.

⁴ DSB is a type of WTO mechanism established within WTO when the definitive SG duty applied by a SG imposing country is opposed by the SG-imposed country.

⁵ There would need to be some external utility factor at the decision phase for going to arbitration. This definitely introduces efficiency distortions. So, there is probably some level of ties where GATT outperforms WTO.

⁶ Article 8.1 of AoS is as follows: "A Member proposing to apply a safeguard measure or seeking an extension of a safeguard measure shall endeavour to maintain a substantially equivalent level of concessions and other obligations to that existing under GATT 1994 between it and the exporting Members which would be affected by such a measure, in accordance with the provisions of paragraph 3 of Article 12. To achieve this objective, the Members concerned may agree on any adequate means of trade compensation for the adverse effects of the measure on their trade."

⁷ For instance, let's consider country A has a comparative advantage in producing bags, and country B decides to restrict the import of bags from country A, as a concession. It is not possible for country A to predict which sector will be chosen by country B for demanding retaliation. For instance, in our case above, the compensation on bags will disfavour bag producers in country A, which apparently has nothing to do with SG duties on steel rebars.

In addition to this, retaliation is not juristically an option if WTO courts finds the SG duty in compliance with the defending country's obligations which causes the Members to impose higher tariffs causing the DSP mechanism to get injured. Beshkar (2009) claims that if an agreement on compensation is not reached between the parties, the affected countries will be free to withdraw substantially equivalent level of concessions (retaliations) initially negotiated with the party which has taken the SG action. Under the AoS, however, a safeguard-imposing country can avoid paying compensation or facing retaliation in the first three years of implementing the measure if a panel of experts designated by the WTO finds the measure in compliance with the defending country's obligations. This loosening of the safeguard discipline has been hard to support theoretically, as it motivates parties to employ more protectionist policies⁸.

We think that Members would prefer a less ambiguous AoS and a better-functioning DSP. That is why a model under WTO, when there is a public monitoring, is not always preferable to the model without DSP. GATT can be better than the current WTO safeguards mechanisms due to improved welfare. On a contrary argument, Beshkar (2009) notes that the governments' gains from transition to WTO are twofold. First, AoS reduces the pain to the governments from protecting their industries in periods of high political pressure, by restricting the use of the retaliation actions. Second, under the auspices of the agreement, the governments will be protecting their troubled industries more vigorously under high political pressures which might cause divergences from the most politically efficient tariff.

Accordingly, in the next section, we introduce the basics of the theoretical model and extensions in detail⁹. All of those are natural extensions of the model, but they all make the model more complex and a bit harder to solve. They also don't really impact the direction, though would increase the magnitude, of the welfare results.

4. Model and the Extensions

4.1. Interim Tariff Calculation

Following the political objective functions produced by Baldwin (1987) and Beshkar (2009), we assume that the governments' aim to maximize a weighted sum of their producers and consumers surplus, along with tariff revenues with a relatively more weight on their import-competing sectors' surplus¹⁰. The political weight on the welfare of the import-competing sector in the home (foreign) country are depicted by $\hat{\theta}$, $\hat{\theta}^*$ ¹¹.

A similar pattern by Beshkar (2009) presumes that the home governments' welfare drawn out of sector x as a function of the home import tariff can be denoted by:

⁸ See page 6 of Beshkar (2009).

⁹ Our extensions do not aim to address the political economy of why a country would want to return to GATT or a more defined WTO.

¹⁰ It is assumed that higher weight will be given to the welfare of a sector, which has higher political pressure on the government.

¹¹ $\hat{\theta}, \hat{\theta}^* > 1$.

$$u(\tau; \theta) \equiv \varphi_x(\tau) + \theta \pi_x(\tau) + T(\tau) \quad (1)$$

where x and y are two distinct goods, p represents the price, τ shows the import tariffs, $\varphi_x(\tau)$ is the home consumers' surplus from the consumption of the goods i.e. x and y , $\theta \pi_x(\tau)$ depicts the home producers' surplus from the sales of these goods, and the tariff revenue is $T(\tau) = \tau M_x(p_x(\tau))$ while M_x is the import demand for good x in home country.

In addition to this, the home governments' welfare from sector y as a function of the foreign import tariffs can be denoted by:

$$v(\tau^*) \equiv \varphi_y(\tau^*) + \pi_x(\tau^*) \quad (2)$$

where $u(\tau; \theta) + v(\tau^*)$ shows the political welfare of the home government, which can be separated in functions of the home and foreign tariffs.

The governments would choose the best τ to maximize $u(\tau; \theta) + v(\tau^*)$. The non-cooperative (Nash) tariff as a function of political pressure is denoted by: $\tau^N(\theta) = \arg \max u(\tau; \theta)$. If the governments managed to set tariffs in a cooperative manner, the politically efficient home tariff would be, $\tau^{PE}(\theta)$, which has to maximize $u(\tau; \theta) + v(\tau)$. We end up with the joint payoff of the home and foreign governments from an import tariff at home, which is given as the following:

$$\tau^{PE}(\theta) = \arg \max u(\tau; \theta) + v(\tau) \quad (3)$$

Pressures by the sectors are assumed to be realized through probability distributions, denoted by p where $\Pr(p)$ shows high pressure from one industry while no pressure is depicted by $1 - p$.

Following a similar setting, we consider a two-step tariff schedule (l, s) is available for the governments to negotiate ($l < s$) after they decide to follow a specific regime which is either GATT or WTO. Accordingly, governments are expected to choose among negotiated low tariff which is " l ", for their low-pressure industries, and " s " for vice versa. Each country privately observes its domestic state and makes a public announcement about it, denoted by $\hat{\theta}$ and $\hat{\theta}^*$ where $\hat{\theta}, \hat{\theta}^* \in \{\underline{\theta}, \overline{\theta}\}$ ¹². The tariff agreement under GATT is contingent on the reports of the governments about their respective state of the world (i.e. political pressures)¹³ Obviously, DSP cannot observe the state perfect fully, thus its final decision might be misleading.

Table 1 demonstrates GATT strategy profiles (i.e. set of tariffs) set by the governments, where in case of low political pressures, the governments will prefer choosing

¹² Assumption: $\{\underline{\theta}, \overline{\theta}\}$ are such that $\tau^{PE}(\overline{\theta}) < \tau^N(\underline{\theta})$

¹³ States of the world are realized and each government learns its own state privately. Countries publish reports about their state of the world while WTO announces state of world in the defending country. GATT doesn't offer such a mechanism.

"l", for all of their imports, while imposing a negotiated higher SG tariff "s" is preferable for the home government under high political pressure (i.e., $\hat{\theta} = \bar{\theta}$) on the import of the good. In response to this announcement, which is $\hat{\theta} = \bar{\theta}$, the foreign government will also apply "s" on the imports of that good that is in competition with a low-industry pressure, and vice-versa. If both countries represent their state of the world rightfully, the expected per-period payoffs to the home and foreign governments per each period is denoted at below table:

Table: 1
GATT Strategy Prole

Home/Foreign Country	$\bar{\theta}$	$\underline{\theta}$
$\bar{\theta}$	(s,s), (s,s)	(s,l), (s,l)
$\underline{\theta}$	(s,l), (s,l)	(l,l), (l,l)

Source: Beshkar (2009).

The solution to the unconstrained maximization of $P^G(l, s)$ can be noted as follows for GATT¹⁴ i.e. $\max_{l,s} P^G(l, s)$ where $P^G(l, s)$ is the expected per-period welfare of a country under GATT as a function of the negotiated tariffs, l and s ¹⁵.

$$P^G(l, s) = p[u(s, \bar{\theta}) + v(s) + u(s, \underline{\theta}) + v(s)] + 2(1 - \rho)[u(l, \underline{\theta}) + v(l)]^{16} \quad (4)$$

GATT's solution to the negotiator's problem requires maximizing the welfare function, which is $\max_{l,s} P^G(l, s)$.

The solution to the unconstrained maximization of $P^G(l, s)$ is as follows:

$$l^G = \arg \max [u(l, \underline{\theta}) + v(l)] \equiv \tau^{PE}(\underline{\theta}) \quad (5)$$

$$s^G = \arg \max [u(s, \bar{\theta}) + v(s) + u(s, \underline{\theta}) + v(s)] \quad (6)$$

$$\text{And we end up with: } \tau^{PE}(\underline{\theta}) = l^G < s^G < \tau^{PE}(\bar{\theta}) \quad (7)$$

In addition to the standard setting, according to our analysis, if the high tariff is set after the revelation of political pressure under GATT, Equation (6) becomes:

$$s^* = \arg \max \rho = [u(s, \bar{\theta}) + u(s, \underline{\theta}) + v(s) + v(s)] + (1 - \rho)[u(s, \bar{\theta}) + u(l, \underline{\theta}) + v(s)v(l)] \quad (8)$$

$$= \arg \max = [u(s, \underline{\theta}) + v(s)] + \rho[u(s, \underline{\theta}) + v(s)] + (1 - \rho)[u(l, \underline{\theta}) + v(l)] \quad (9)$$

The last term has no effect on the maximization and the second term is scaled by ρ . This is because the country does not take into account the situation where it has low political

¹⁴ i.e. Negotiator's problem under GATT.

¹⁵ $P^G(l, s)$ can be also interpreted as the expected joint welfare of the home and foreign governments as a function of the home tariffs.

¹⁶ When home and foreign countries apply s on all of their imports, the home country will get $u(s, \bar{\theta}) + u(s, \underline{\theta})$ from its importing sectors and $2 * v(s)$ through its exporting sectors.

pressure while the other country has high political pressure as this calculation is after it is already revealed that the home country has high political pressure. Hence, the tariff under GATT is higher than in Beshkar (2009), but we still have:

$$s < \tau^{PE}(\bar{\theta}) \quad (10)$$

The calculation for the low tariff remains unchanged in this case. Due to this, we have:

$$\tau^{PE}(\underline{\theta}) = l^G < s^G < \tau^{PE}(\bar{\theta}) \quad (11)$$

As noted above, the best incentive-compatible negotiated tariff schedule under GATT is given by

$$(l^G, s^G) \text{ while } \tau^{PE}(\underline{\theta}) = l^G < s^G < \tau^{PE}(\bar{\theta}) \quad (12)$$

The fact that these incentive constraints are not binding suggests that the GATT's instantaneous reciprocity principle imposes more punishment than necessary to keep the governments truthful in disclosing their private information¹⁷.

As the model by Beshkar (2009) determines the safeguard tariff level ex ante instead of at an interim step which leads to an optimal tariff being applied, not the tariff that is politically best for a country at that instant. Again, this doesn't affect the direction of the welfare results, though would probably imply higher SG tariffs in the model.

4.2. This Issue of DSP Timing

Member countries have the opportunity to initiate SG investigations to temporarily restrict imports of specific products to protect their domestic industries. In consequence of these investigations, they can either apply extra tariffs, quotas or tariff rate quotas to decrease the imports or terminate the investigations without applying any measures. Beshkar (2009) underlines that the countries, which intends to take a SG measure only take into account the situation of their domestic industries, do not consider adverse trade and production issues that can occur in foreign countries, particularly when home countries are free to designate the levels of safeguards; thus they opt for setting a tariff that is higher than politically optimal level.

In case conflicts occur over the investigations, and preliminary and/or final measures, the countries may apply WTO for the establishment of panels and DS Body in order to settle the disputes.

The DSP is an important phase within WTO established to deal with unsolvable disagreements between the Members. Concerning SG applications, WTO courts are

¹⁷ Under WTO, the maximization for the high tariff is: $\arg \max u(s, \bar{\theta}) + (1 - \gamma)v(s) + \gamma(1 - \rho)u(s, \underline{\theta}) + \dots$. This results in a higher tariff under political pressure than in Beshkar's (2009).

sometimes criticized because of failing in solving problems particularly due to the "time issue" in real life. When SGs are taken to the DS levels, normally it takes 1-2 years for DSB come to a final decision since the DSP are highly detailed and time-consuming processes. Since SGs are exceptional and temporary measures aiming to help the domestic producers to cope with international competition and considering SG actions are only applied for 3 years (or even less); the SG duties sometimes expire before the final decisions are taken by the DSB. This causes problems to arise related to application periods of the duties.

For instance, interestingly, when the SG imposing countries realize that DSB's final decisions might be against them during the course of the DSP, they remove the SG duties before the expiration dates. Skyes (2004) properly states that defending country usually benefits from prolonging the dispute process since it can continue its disputed measure with impunity throughout the process. Therefore, the seemingly biased ruling pattern of the DSB might be attributable to this selection problem.

Most of the existing models don't capture the timing of the DSB processes in detailed. Herein, Beshkar (2009) indicates that the completeness of trade agreements can have a substantial effect on the resulting tariff rates under the GATT. Under WTO, however, contract incompleteness may not have such substantial effects if the WTO court can fill the gap in the agreement ex post.

In reality, it might take multiple years for the DSB to settle the issues. In this respect the country, which applies the SG measures, gets most of the benefits until DSB acts; while the counterpart, which is affected from the duties, have to wait for some time for the DSB processes to be finalized. Under these circumstances, we think that editing the payoffs (under Section 4.1) to reflect this timing is an option. Our intuition is that it will not change the welfare results but would make it more likely for countries to impose SGs as the benefits are higher.

The simplest way to account for a time differential between GATT and WTO's DSP would be to use the discounted present value of multiple years. For GATT, there is no change in the derived tariffs as each term in the equation would end up multiplied by the same factor. (*For instance, in the case of looking at 3 years this would be $(1+\delta+\delta^2)$*).

Under DSP, the payoffs change as for the first two years a country can implement a high tariff without any retaliation while the DSP process happens. It is only in the third year when there is a chance for retaliation to be approved. This will increase the high tariff as there is even less punishment.

Granted the above is a simplistic extension. It doesn't look at political pressure changing, and possibly lessening, over the years. Also, it doesn't use the interim calculations demonstrated in the former section.

4.3. Capturing Political Ties

We think that Beshkar's (2009) paper falls short on since it includes no model of political ties between countries. The political ties between countries might cause the final SG decisions might not be taken to the DS level, so WTO cannot give a ruling on them. The payoffs would need to be altered to reflect the cost of initiating a DSB process against for instance, a friendly country. This again would not affect the direction of the welfare results but would make it more likely for friendly countries to institute SG duties due to this inter-country pressure.

Modelling political ties is the hardest alteration as how one adds these ties will affect the results. One way is to add a discounted version of the political utility function of the other country to each countries' political utility. This will change the results under both GATT and WTO as countries are internalizing their externalities¹⁸.

Another way is to fully map out the decision game of when to take a country to through the DSP. Then have the payoff of the deciding country depend on the payoff of the other country. This game is not played out in Beshkar's (2009) paper, as the author just assumes that when a country faces a high tariff, they will initiate the DSP process.

5. Conclusion

In this paper, we introduced a model of GATT, WTO and DSP and find the incentive-compatible agreement that maximizes political welfare under the AoS aiming to extend Beshkar's analysis. The contribution of the paper to the literature is unique in the sense that our model concentrates developing a model of the DSP within the framework of AoS while most of other studies explored the roles of the GATT and WTO (not DSP) to analyse trade agreements. In this respect, we aimed at modelling interim tariff calculations and DSP timing through offering extensions and tweaks. A public signal is sent firstly on DSP correlated with the true state of the world as the countries are allowed to set their tariff policies on this signal under WTO. Beshkar (2009) found in his paper that if this signal involves a sufficiently high level of accuracy, then trade agreements under the AoS provides higher political welfare than does trade agreements under the corresponding GATT SG clause¹⁹. Our model determines the safeguard tariff level at an interim step instead of ex ante where this leads to a tariff that is politically best for a country at that instant, not the optimal tariff being applied. Our analysis results in a higher tariff under political pressure.

First of all, we think that DSP does not always offer timely and fair services which cause WTO procedure to be suboptimal than expected. WTO procedures do not at -all times- produce the best tariff options for the parties (affected country vs. imposing country) in case of the SG. In this respect, we are of the view that a game theoretical approach on tariffs

¹⁸ This requires redoing the analysis in the paper and can be considered as an extension.

¹⁹ See page 26 of Beshkar (2009).

would be the best option as an economic variable. Therefore, it is not always accurate to claim that WTO procedure produces more social welfare when compared with GATT.

We also view that WTO procedure does not always produce the best results under DSP. These are strongly linked with the DSP not performing well in all cases and the SG tariffs are easily manipulated due to vagueness of AoS causing the Members to take their decisions at will, particularly when determining the final SG duties and concession rates. Besides, the political ties sometimes cause the WTO procedure not to work properly as well. Some countries even do not take the final decisions to the DSP considering their existing commercial ties with other countries.

A possible method to engage political ties into the model might be adding a discounted version of the political utility function of the other country to each countries' political utility that might change the results under GATT and WTO. This paper might be extended by constructing new versions of political utility functions.

Introducing a model of DSP, we offer a mechanism design approach related to AoS. One of the major limitations of our study is that we only focused on GATT, WTO and DSP processes where AoS lied at the centre of our study. Considering that AD and CVDs also trigger similar DSP processes, an engrossing extension to this paper might be expanding analysis for other trade policy instruments. In short, good extensions for the study would be to implement similar design constructions for trade institutions taking other types of trade barriers into account.

As policy implications, the study reveals that WTO procedure does not always produce the best results under DSP. One can assert that, in real life, the governments will not always be able to coordinate on a more politically efficient tariff schedule under the WTO while DSP does not constantly increase the self-enforceability of trade agreements. For this reason, detailed revisions might be beneficial in reorganizing the DSP processes in terms of AoS, where all Member countries are equally treated while DSP produces timely and best tariff options for every Member country.

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