1 Framework and Motivation

No aspect of the World Trade Organization (WTO) has received more attention than its dispute resolution provisions. In particular, a lot has been written about the disadvantages of the WTO’s dispute settlement procedure and enforcement mechanism. The defending parties have, for instance, a strong incentive to postpone the panel proceedings as countervailing measures – if any – are merely proactive; this is one of the main reasons why the enforcement mechanism is perceived as rather weak. Despite this and other drawbacks, the overall compliance rate with WTO dispute resolutions is surprisingly high; in 97.7% of all cases, the challenged actions get brought into compliance with the final ruling of the Dispute Settlement Body.

This paper seeks to test how financial markets evaluate the impact of WTO disputes on affected companies. At the first glance, this might seem impossible because WTO disputes can only be

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2 See e.g. Davey (2005), Guzman (2002), Palmet and Mavroidis (2004), or Petersmann (2006).
3 69% of all panel reports are appealed at the WTO Appellate Body. See http://www.worldtradelaw.net/dsc/database/appealcount.asp, June 04, 2007.
4 Only challenged actions that are still in place after a panel ruling are subject to possible countervailing measures. There are no retroactive or even punitive damage compensations in WTO law. See Art. 20 SCM Agreement.
5 The final ruling is in most of the cases the report of the Appellate Body. See supra note 3 and http://www.worldtradelaw.net/dsc/database/implementationprovision.asp, June 04, 2007.
filed by member states and always address the action of another state. Although companies are only indirectly affected by WTO disputes, there exists a subgroup of cases where the link between the disputes and the companies’ stock market evaluations is straightforward. These are cases in which a member state seeks to eliminate an actionable or prohibited subsidization for a specific corporation or industry in another country. In those disputes exists a limited number of beneficiaries which can easily be assessed. Therefore, subsidies cases are the best subgroup of WTO disputes to examine in an event study. According to the Efficient Market Hypothesis, the announcement of the WTO dispute settlement proceedings should have had a significant negative impact on the stock price of subsidy recipient if the firm benefited and if it could rationally be assumed that governmental support had to be withdrawn in the near future. If there is no abnormal return associated with the announcement of WTO anti-subsidy panels, then the financial markets might perceive the dispute resolution system as ineffective – i.e. that capital markets assume that the subsidization will not or only partially be withdrawn. Hence, this event study is supposed to test whether the well-known drawbacks of the WTO dispute resolution system get incorporated in the stock price (i.e. no statistically significant abnormal return) or not (i.e. an abnormal return should be associated with the announcement of WTO anti-subsidy panels).

To the author’s knowledge, up to now there exists no event study in the WTO context and only very few in an international context. This paper seeks to expand the existing Law and Finance

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6 Art. 5 and Art. 6 SCM Agreement.
7 Art. 3 SCM Agreement.
8 The ‘Specificity’ of a subsidy must be given to request a WTO dispute settlement procedure. See Art. 1.2 and Art. 2 SCM Agreement.
9 75 out of the total 363 WTO disputes involve violations of the SCM Agreement, Petersmann (2006).
10 More general trade barriers might benefit whole industries or groups which make an assessment of stock price effects hard to determine. However, subsidies cases are targeted on the subsidization of one a few specific corporations.
11 It might also be assumed that the subsidization will officially be withdrawn but continues in an indirect, less transparent way.
12 In this paper, an event study is defined as measuring the effects of events (like litigation announcements or court findings) on the valuation of private corporations.
research from the traditional domestic context to the international WTO level. It shall be tested whether the abnormal returns associated with domestic litigation can also be found for WTO subsidies disputes.

2 Outline of the Paper

2.1 Events under Investigation

The period of observation runs from the foundation of the WTO in 1995 to 2006. 75 out of the total 363 WTO disputes involve violations of the Agreement on Subsidies and Countervailing Measures (SCM). These 75 cases have been reviewed and so far reduced to a set of 46 cases where there are only one or a few unambiguous beneficiaries of the challenged governmental action. These beneficiaries have to be publicly traded corporations over the whole period under review. These restrictions might lead to a further reduction of the sample size to a third or a quarter of the total WTO anti-subsidization cases. For this sample group, the announcement of (a) the request for consultations, (b) the implementation of panels and (c) the panel rulings shall be determined as events under investigation. The list of cases can be found in Section 3, p. 4-6.

2.2 Methodology

The WTO subsidies cases involve various states and companies which make the use of the Market Model or Capital Asset Pricing Model for the calculation of the expected return very complex. So far, the simpler, but widely used Constant Expected Return Model is employed. In a later version of this paper, the Market Model or Capital Asset Pricing Model shall be used as benchmark models.

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14 The selection criteria might need to further refinement.
15 The affected companies are based and traded in different countries.
16 Statistical models like the Constant Expected Return Model are widely used to estimate the expected return. See Bhagat and Romano (2002), p. 145.
2.3 Data and Sources

For the specification of the event days, their publication in the Wall Street Journal is used. The daily stock data is obtained from Bloomberg. 200 daily returns of the period preceding every announcement period are used for the determination of the expected return.17 Because daily data is used, the return is measured through the closing prices.18

2.4 Preliminary Results

The first preliminary results for a small sample group seem to support the hypothesis that the financial markets perceive the WTO dispute resolution system as rather ineffective, i.e. no statistically significant abnormal return could be measured for the announcement days. This constitutes an interesting finding because abnormal returns have widely been found for lawsuits in the domestic context.19 The anticipated effects of the lawsuits got immediately incorporated in the respective stock prices – in accordance with the Efficient Market Hypothesis. The same should have been true for the announcement WTO dispute settlement proceedings if the financial markets perceived the WTO dispute proceeding as an effective mean to end the challenged subsidization.

3 WTO subsidies disputes

The six Aircraft Disputes are the first subgroup of subsidies cases that were examined. They constitute an interesting subgroup as a lot of national prestige and interest is attached in the aircraft industry. This might induce a higher reluctance of the states to comply with a negative finding of the Dispute Settlement Body.

17 Also 100 and 200 day periods shall be tested.
19 For an overview of domestic lawsuit event studies see Bhagat and Romano (2002), pp. 154-160.
3.1 *Aircraft Disputes*

- Brazil – Export Financing Programme for Aircraft (DS 46)
- Canada – Measures Affecting the Export of Civilian Aircraft (DS 70)
- Canada – Measures Affecting the Export of Civilian Aircraft (DS 71)
- Canada – Export Credits and Loan Guarantees for Regional Aircraft (DS 222)
- European Communities – Measures Affecting Trade Large Civil Aircraft (DS 316)
- United States – Measures Affecting Trade Large Civil Aircraft (DS 317)

3.2 *Other most relevant WTO subsidies cases*

- Argentina – Measures Affecting Imports of Footwear (DS 121, DS 123 and DS 164)
- Australia – Subsidies Provided to Producers and Exporters of Automotive Leather (DS 126)
- Brazil – Measures Affecting Desiccated Coconut (DS 22)
- Canada – Measures Affecting the Importation of Milk and the Exportation of Dairy Products (DS 103 and DS 113)
- Canada – Certain Measures Affecting the Automotive Industry (DS 139 and DS 142)
- European Community – Measures Concerning Meat and Meat Products (‘Hormones’) (DS 26)
- Guatemala – Anti-Dumping Investigation Regarding Portland Cement from Mexico (DS 60 and DS 156)
- India – Patent Protection for Pharmaceutical and Agricultural Chemical Products (DS 50 and DS 79)
- India – Quantitative Restrictions on Imports of Agricultural, Textile and Industrial Products (DS 90-94 and DS 96)
- Indonesia – Measures Affecting the Automotive Sector (DS 146 and DS 175)
- Japan – Taxes on Alcoholic Beverages (DS 8, DS 10 and DS 11)
- Korea – Definitive Safeguard Measure on Imports of Certain Dairy Products (DS 98)
- United States – Imposition of Countervailing Duties on Certain Hot-Rolled Lead and Bismuth Carbon Steel Products Originating in the United Kingdom (DS 138)
- United States – Anti-Dumping Measures on Certain Hot-Rolled Steel Products from Japan (DS 184)
- United States – Countervailing Duties on Certain Corrosion-Resistant Carbon Steel Flat Products from Germany (DS 213)
• United States – Anti-Dumping Duty on Dynamic Random Access Memory Semiconductors (DRAMS) of One Megabit or Above from Korea (DS 99)
• United States – Anti-Dumping Act of 1916 (DS 136 and DS 162)
• United States – Standards for Reformulated and Conventional Gasoline (DS 2 and DS 4)
• United States – Tax Treatment for ‘Foreign Sales Corporations’ (DS 108)
• United States – Measures Treating Export Restraints as Subsidies (DS 194)
• United States – Preliminary Determinations with Respect to Certain Softwood Lumber from Canada (DS 236)
• United States – Safeguard Measure on Imports of Fresh, Chilled or Frozen Lamb from Australia (DS 177 and DS 178)
• United States – Measure Affecting Imports of Woven Wool Shirts and Blouses from India (DS 33)
4 Bibliography


