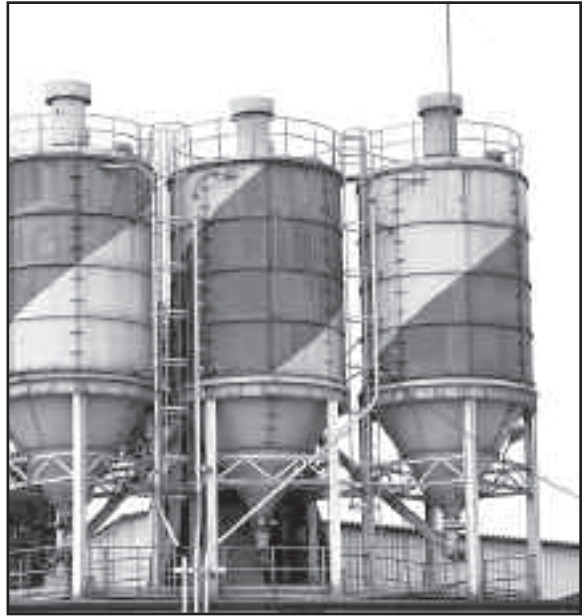


Countering Market Distortions

In the more-than-a-century long debate on AD-CVD laws a number of arguments have been raised to support them in various national and international forums. It would be impossible to analyze all of them in any short paper or even series of tomes, but there are three critical rationales for AD-CVD laws that deserve special attention: (1) to counter market distortions, (2) to provide an interface mechanism between economies – particularly with regard to non-market economies, and (3) – safeguarding political support for trade liberalization.



Subsidies

U.S. countervailing duty laws – sometimes known as anti-subsidy laws – were created to insulate the U.S. market from the injurious impact of foreign subsidies. They were embraced by the global trading system through the General Agreement on Tariffs and Trade (GATT) and later the WTO – as a method to partially counteract the impact of subsidies in the world marketplace and discourage subsidization.

Although subsidies remain fairly common in agriculture and a number of industrial sectors – notably steel production – there is no debate that they have many negative economic effects.⁴ Obviously, they adversely impact other competitive non-subsidized producers and workers in third markets. But they also

⁴ Some categories of agricultural subsidies, including those decoupled from production levels are believed to be less distorting of trade than subsidies that are linked to production.

cause a cascade of other problems, including burdening the taxpayers in the country paying the subsidy and distorting resource allocation within the subsidizing country as resources are channeled to subsidized sectors and away from non-subsidized sectors. They also encourage other countries – as has certainly been the case in agriculture – to adopt similar subsidies leading at times to escalating subsidy wars and hopelessly distorting true comparative advantage. Except for some possible narrow exceptions, the economic condemnation of trade-distorting subsidies is universal.

The importance of disciplining subsidies increases as border measures, such as tariffs, and other trade restrictions are reduced as trade is liberalized. More open markets allows the impact of subsidies to more easily impact global markets as goods move more freely over national borders, which makes subsidy disciplines and remedies all the more important.

The “best” response to subsidies from an economic perspective is eliminating them, but this is often not a practical option. The WTO does have rules on subsidies, but many subsidies are beyond the effective reach of these rules because of the limits of WTO subsidy provisions and limitations in the dispute settlement process. As a practical matter, the primary tool available to counter the injurious effects of subsidies is the application of countervailing duties. In those cases in which subsidies are identified and the imports of subsidized products are injuring producers in the domestic market, a country can impose a duty (usually referred to as a countervailing duty) equivalent to the size of the subsidy.

Countervailing duties do not eliminate all of the negative impacts of subsidies; indeed, a countervailing duty is limited to the calculated amount of a subsidy even if that subsidy’s effects are much greater. For example, even if a subsidy helps an industry drive a competitor from the market or develops a revolutionary new technology, only the face value of the original subsidy—not the long term harm—is offset by the countervailing duty.

Still the duty at least partly offsets the negative impact on producers in the country applying the duty. The imposition of duties can also discourage continuation of the identified subsidy program and deter other programs from being initiated. However, the negative effects in the country granting the subsidy – taxpayer costs, distortion of resource allocations, etc. – continue.

Sanctuary Markets And Industrial Subsidies

The case for employing countervailing duties to promote free trade is simple, but the parallel arguments for antidumping laws are more complex. Antidumping laws aim to counter sales of imports at below the sale price in the home market or below the cost of production. Antidumping duties are applied on a company basis whereas countervailing duties are normally applied to all companies within the country extending subsidies.

In the United States, there are parallel concepts, sometimes called “predatory pricing”, enshrined in U.S. antitrust laws. Some argue that if a foreign company is willing to sell its products at low prices — even at below the cost of production —

that is actually a good thing and the United States should import as much as they are willing to sell; sort of an international equivalent of “buying on sale.”

Though superficially appealing, this view overlooks both the motivations of foreign companies in dumping in the U.S. market and the competitive impacts that dumping has on the domestic market. While it is possible that currency changes, accounting issues, and the like could result in an imported product being sold below the home market price or below the cost of production it is unlikely, that these “accounting errors” or other unusual circumstances would persist long enough to cause injury to the domestic industry as defined by U.S. law and the WTO. Certainly, in those cases in which a company or group of companies is dumping into the U.S. marketplace for years, it is clear evidence of market distorting practices by the dumping companies. Sales at a loss are not a sound long-term business strategy.

In most cases, continued injurious dumping are a result of one of several practices, including the maintenance of a sanctuary home market, the application of subsidies, or the consequences of a non-market economy government. The sanctuary market has been perhaps the most common explanation for ongoing dumping in the manufacturing sector; it is certainly one of the factors in play in the widely discussed cases of dumping in the semiconductor⁵ and steel⁶ industries. In essence, a sanctuary market is a home market that is largely closed to imports due to a combination of tariff and non-tariff barriers.

As a result, the companies within this closed market are able to maintain high profits, which can then be used to finance long term dumped sales in open markets with the aim of building market share. Competitors based in open markets are thus faced with the double prospect of being denied access to export markets, as well as having to deal with intense price competition at home.

To say the least, this presents a difficult and unfair competitive environment as sanctuary market competitors take sales from open market competitors regardless of true comparative advantage. Although consumers in the importing market may realize short-term gains, the long-term costs are real, and consumers within the home market of the dumper face similar losses due to higher prices from monopoly rents. The sanctuary market creates several related impacts including losses from distorted trade flows, the loss of competitive production, and the resulting distortions in investment patterns.

While opening the sanctuary market to competition would help remedy this problem, it is not a realistic course of action. As a practical matter, antidumping duties are one of the few timely remedies available to companies in relatively open markets facing sanctuary market competitors engaged in dumping. The

5 Laura D’Andrea Tyson, *Who’s Bashing Whom? Trade Conflict in High-Technology Industries* (Washington, DC: Institute for International Economics, November 1992); and Fred Warshofsky, *The Chip War* (New York: Charles Scribner, 1989).

6 Thomas R. Howell, William A. Noellert, Jesse G. Kreier, and Alan Wm. Wolff, *Steel and the State: Government Intervention and Steel’s Structural Crisis* (Boulder, CO: Westview Press. 1988).

application of antidumping duties also lowers the incentives for countries to maintain sanctuary markets in order to build domestic industries. Over the years, many major U.S. industries including – steel⁷, semiconductors⁸, and tires⁹ – have turned to antidumping laws as a partial answer to dumping from sanctuary markets.

Subsidies are also one of the root causes of dumping. In a typical case, government subsidies are used to build industrial facilities in order to create manufacturing employment. These subsidies result in more facilities being built around the world than the market demand can support. In down economic times, the artificially large production capacity allows individual companies to continue to produce and sell even if the sales do not fully recover the cost of production. In this way they can maintain market share, maintain employment and narrow losses by covering at least part of the cost of production.

Patterns similar to that described above have been found in industries involved in dumping disputes, including agriculture¹⁰, steel¹¹, and, more recently, lumber.¹² In cases like these dumping is one aspect of the market distortion created by the initial government subsidy. In some cases, these subsidies could also be addressed through countervailing duties, but it is often easier to prove unfair pricing than it is to trace the history of subsidies, which may have been in place for decades and therefore hard to document.

Non-Market Economies

In recent years, antidumping cases have focused heavily upon products imported from China. In fact, almost a quarter of the U.S. antidumping cases initiated over the last five years have involved Chinese products.¹³ In part, these cases are likely the result of the size of the Chinese economy and its relatively recent and rapid entry into the world economy.

Equally important, the Chinese cases, like cases involving Russia and other former Eastern European communist countries, are the result of non-market economics. Over the last twenty years, most of the former communist bloc countries have adopted increasingly market based economies.

But the transition is far from complete. Some countries, like China and Vietnam, while adopting market reforms, maintain an avowedly communist government. Even in those countries that have shed their communist past – at

7 See note 5.

8 See note 4.

9 Gary Hamel and C.K. Prahalad, “Do You Really Have a Global Strategy,” *Harvard Business Review* (July-August 1985: 139.)

10 *Hard Red Spring Wheat From Canada*, 68 Fed. Reg. 57,666 (USITC October 6, 2003) (amended final determination).

11 *Certain Stainless Steel Plate From Belgium, Canada, Italy, Korea, South Africa, and Taiwan*, 70 Fed. Reg. 38,710 (USITC July 5, 2005) (review).

12 *Softwood Lumber from Canada*, USITC Pub. 3509, Inv. Nos. 701-TA-414 and 731-TA-928 (May 2002).

13 International Trade Administration, Dept. of Commerce, Washington, DC, available at <http://ia.ita.doc.gov/stats/inv-initiations-2000-2005.html>.

least avowedly – there remain many state-owned enterprises and many state-built resources which still contribute to other sectors in those countries. For example, government-built dams still generate electrical power in Russia, which has a competitive impact upon industries in which electricity is an important input. China has an enormous educated labor pool over which the government has significant control. Among other things, that control can keep wages below a market determined level providing a cost benefit for the many manufacturing industries that have established operations in China.

The products manufactured in non-market economies (NMEs) have long posed problems for western market economies. The surge in antidumping cases involving China is just the latest and largest example of this trend, but it goes back decades and involves products as seemingly obscure as golf carts from Poland.

Western countries – chiefly the United States and Europe – have struggled to find a set of rules to deal with NME imports. It seemed of little value to identify specific subsidies in an economy in which all inputs from energy to labor were at least in concept subsidized. Similarly, it was difficult to identify a meaningful cost of production in a market in which costs were largely set by the government and some inputs were essentially “free.”

These problems led both Europe and the United States to develop special rules to govern trade with non-market economies. These NME anti-dumping rules rely heavily upon finding outside market economy prices to serve as surrogate prices for the prices of goods and services in the NME economy. In this respect, they are different from other uses of antidumping laws; rather than trying to offset market problems created by subsidies, sanctuary market, or other distortions, NME antidumping rules attempt to set a fair market price for NME imports from which “normal” commerce can proceed. Given the large volume of global imports from China – totaling \$660.1 billion in 2005¹⁴ and the fourth largest source of U.S. imports¹⁵ – a mechanism for determining the appropriate price for imports causing injury to producers in the U.S. market is necessary to address economic and political problems that would otherwise arise. NME laws have also played a role in addressing Russian exports, Vietnamese exports, as well as other NME country exports

U.S. and European trade laws both include a process for treating NMEs as normal market economies once certain benchmarks of market economics have been achieved. In China’s case, its WTO accession agreement sets an outside period of 15 years from accession on the application of special NME antidumping rules to Chinese imports.¹⁶ Until that time, NME procedures are one set of

14 People’s Republic of China, General Administration of Customs, (available at <http://www.uschina.org/statistics/tradetable.html>.)

15 Foreign Trade Division, U.S. Census Bureau, Washington, DC, available at <http://www.census.gov/foreign-trade/statistics/highlights/top/top0512.html>.

16 World Trade Organization, Accession of the People’s Republic of China, WT/L/432 ¶(15)(d) (Nov. 23, 2001).

tools, among others, to govern trade between seemingly incompatible economic systems. Absent these procedures, calls for broad restraints on Chinese products would no doubt grow.

Political Safeguards

As noted in the introduction, rules against dumping and subsidization of exports have a history much older than the world trading system. While that framework emerged just after WW II, the first anti-dumping law was passed in Canada in 1904 and AD laws were adopted by most western countries early in the 20th Century.¹⁷ Rather than being a barrier to trade, or to the global system, AD-CVD laws are part of the foundation which allowed global trade to grow.

The economic and business rationales for AD-CVD laws have already been discussed, but there is a closely related political role that also warrants consideration. AD-CVD laws provide “rules of the road” for trade that allow it to expand and grow while addressing unfairness that would otherwise provide a rationale for constraining trade more broadly. Thus, rather than being the tools of modern protectionism, as some critics have asserted, they provide one safeguard to prevent blunt protectionism from arising as well as smoothing the way for greater acceptance of trade arrangements like the WTO.

There have been numerous instances in the last half century where serious concerns about products ranging from lumber to agriculture to steel have been addressed through the use of AD-CVD laws. AD-CVD laws have been cited positively in congressional debates on many recent trade agreements¹⁸ and AD-CVD laws have repeatedly demonstrated broad, bipartisan support in Congress.¹⁹ If AD-CVD laws did not exist, these arguments would not have been possible. This could have slowed or halted the approval of major trade agreements and undermined U.S. public and congressional support for trade liberalization.

Further, though these details are sometimes missed by critics, AD-CVD laws include several built-in limits to constrain their scope and duration. To assess either AD or CVD duties, a petitioning domestic industry must demonstrate the existence or imminent threat of “material injury” from imports. This test has historically resulted in more than one-third of the cases brought in the United States being rejected. In accordance with WTO rules, AD-CVD cases are regularly reviewed and face a “sunset” review after five years. The implementation of these laws is reviewable by U.S. courts, WTO dispute settlement panels and in some cases, panels convened under free trade agreements. In short, there are numerous institutional reviews built into the system to ensure that the application of AD-CVD laws is precisely defined, time limited, and transparent.

17 Jacob Viner, *Dumping: A Problem in International Trade* (Chicago: University of Chicago Press, 1923).

18 149 Cong. Rec. 10,530-33 (July 31, 2003) (Statement of Sen. Baucus); also see the Senate debate of the U.S.-Chile and U.S.-Morocco Free Trade Agreements.

19 H.R. 3283, 109th Cong. (2005), and related debate thereof; S. Con. Res. 55, 109th Cong. (2005); and S. 2020, 109th Cong. § 407 (2006).

If the United States did not have AD-CVD laws as a route for addressing concerns over unfairly traded imports, it is unlikely that those concerns would simply disappear. They would likely have considerable political potency, and could result in various ad hoc measures to limit imports, which might well not have the institutional reviews and safeguards built into AD-CVD laws.

Some would rightly suggest that safeguard provisions built into the WTO – often referred to as Section 201 in U.S. trade law— fill much the same function. The safeguard or “escape clause” provision allows a country to impose limitations on imports for a time – generally four years – if imports cause or threaten to cause “serious” economic injury to domestic industries. This is a higher injury test than applied in AD-CVD actions. The framers of the WTO recognized that economic dislocations and resulting political problems stemming from imports were a serious threat to the world trading system and created the safeguard provision as a safety valve.

Although useful in some cases, the safeguard provision has a number of shortcomings when compared to AD-CVD laws. First, safeguard actions deal with all imports – fairly traded or not. They provide no ongoing remedy in cases where there are systemic market distortions and as such, are not effective in addressing the causes of unfairly traded imports. Second, the serious injury test blocks relief in all but the most egregious cases and thus provides limited relief. This problem is made more serious owing to the fact that WTO dispute panels have been highly skeptical of most safeguard actions brought before them,²⁰ including those imposed by the Bush administration in response to a record surge in steel imports²¹.

Third, the safeguard remedy is subject to political considerations and therefore is viewed by potential users as unreliable. The AD-CVD remedy, in the United States, is just the opposite – a legal/administrative remedy. If an industry meets the requirements for relief (dumping or subsidies, plus injury test causation), it is entitled to relief, reviewable by a court. In the safeguard process, establishing the elements for relief under the law (serious injury and substantial causation) entitles an effected domestic industry to nothing; it merely triggers a political decision-making process in which the discretion of the Executive Branch is nearly complete. These distinctions mean in practice that safeguard relief, as currently structured, is rarely a viable option for U.S. industries seeking relief from imports.

The interesting political reality then is not just that AD-CVD laws have coexisted with the world trading system since its inception, but that the existence of AD-CVD laws has also built political support for that system. They are the

20 Appellate Body Report, United States - Safeguard Measures on Imports of Fresh, Chilled or Frozen Lamb Meat from New Zealand and Australia, WT/DS178/AB/R (May 1, 2001); and Appellate Body Report, Chile - Price Band System, WT/DS207/AB/R (Sept. 23, 2002).

21 Appellate Body Report, United States - Definitive Safeguard Measures on Imports of Certain Steel Products, WT/DS259/AB/R (Nov. 10, 2003); and John K. Veroneau and Katharine J. Mueller, A High Bar for U.S. Safeguards, *China Business Review*, March-April 2006.

most practical avenue for addressing concerns over unfairly traded imports. By channeling those inevitable concerns into a limited and transparent mechanism they have supported efforts in the United States – and likely other countries – to move forward with trade liberalization.