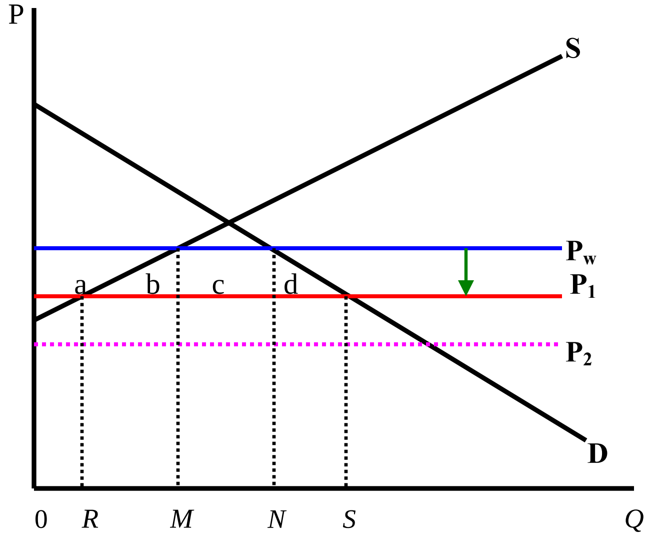
[Lecture 10] The Conduct of U.S. Commercial Policy (Pushing Exports)

In major trade legislation passed since 1934, Congress has authorized systematic reduction in American trade barriers in exchange for negotiated reductions in foreign barriers. On the other hand, Congress has provided American businesses with alternative mechanisms for seeking and obtaining relief from foreign competition. These procedures define the rules of legal commercial activity and allow for assistance, in the form of higher levels of protection, from either unfair *or* fair foreign competition. In this section we want to discuss in detail some of these measures.

1. Dumping

Dumping (Sales at less than fair value, LTFV) is defined as selling a product in a foreign country at a price that is lower than the price charged by the same firm in its home market or at a price below costs of production.
Let's discuss the economics of dumping first.



At P_w, MN units will be imported (world price).
If exporting countries were to lower the price they charged for their products, say P_1, then they would be dumping in the U.S. market.
U.S. consumers will benefit. Domestic producers would lose. However, the gain to consumers would exceed the loss to domestic producers, so the U.S. welfare would rise.
An obvious question emerges from this analysis.
If foreign dumping is good for U.S., why does Congress legislate against it?

What would happen if exporting country now charges P_2 instead of P_1? P_2 is below the intercept of the domestic supply curve, so this "***predatory dumping***" will drive U.S. firms from the market. Without any competition from domestic firms, it is sometimes argued that foreign firms would stop charging such low prices and begin to behave as monopolists. While this makes a good story, there is no documented evidence that predatory dumping has ever occurred or that it could ever occur (why?).

Now, under what circumstances is dumping likely to occur? One scenario involves a foreign industry that has some degree of market power both in its domestic market and in its foreign market. Because of this market power, the firm can set its own prices and does so in a fashion that maximizes its profits from selling in the two markets. If the firm different demand curves in the two markets, and if it is not possible to resell the goods between markets, then the firm will charge different prices in the two markets (it will practice ***international price discrimination***).

International price discrimination is one possible explanation for dumping. Dumping could also occur if a foreign firm were to receive a production or export subsidy from its government. Such a subsidy would help defray the costs of production, thereby allowing a firm to charge a price below its marginal cost. When a firm dumps in world markets under these circumstances, the taxpayers in the firm's home country, in effect, are picking up part of the tab for consumption that occurs in countries where the good is sold. Why don't you send "thank-you" note to Japan or Korea?

2. Anti-Dumping Law

Current antidumping law provides that under certain conditions, a special tariff (in addition to any normal duty) be imposed on foreign goods sold in U.S. and priced at *less than fair value* (LTFV).[*]

Special Tariff (Dumping Margin) = [(Higher) Fair market value] − [Actual (lower) selling price]

To have the special tariff imposed, it is necessary to show that the dumping has materially injured a domestic industry or threatens to injure a domestic industry (***injury test by DOC and ITC***).

(Visit at http://www.usitc.gov for further information regarding dumping investigation.)

As of December 31, 2001, about 350 antidumping duties were in place against foreign products. Products involved in these cases included a wide variety of steel products from many countries; shop towels from Bangladesh; pencils, paper clips, and garlic from China; semiconductors from Korea; and kiwi fruit from New Zealand. Of the duties, 86 percent (271) were imposed after 1985. Of the 896 cases initiated between 1980 and 2000, 100 were against Japan, 74 against China, 61 against Korea, 55 against Germany, and 54 against Taiwan. On average, antidumping duties are 10 to 20 times higher than MFN tariffs. Tariffs this high are a remarkably effective mechanism to reduce foreign competition. In a recent study, Thomas Prusa argues that U.S. antidumping duties cause the value of imports to fall by 30 to 50 percent.[†]

3. Countervailing Duty (CVD) Law

One possible cause of dumping is the provision of production or export subsidies by foreign governments to their firms or industries. Congress views such subsidies as an unfair trade practice regardless of whether or not dumping actually occurs. U.S. trade law provides for **countervailing duties (CVD)** to offset the effects of any subsidy[‡] (in direct or indirect ways) allocated for the production or export of a good that is subsequently imported into U.S. CVD is a tariff designed to raise the price of an imported product to its fair market value.

In addition to U.S. law against subsidies, WTO administers a subsidy agreement reached as part of the Uruguay Round negotiations (three categories of subsidies-**prohibited**, **actionable**, and **non-actionable**).

All CVD have to be terminated within five years of their imposition unless the authorities determine on the basis of a review that the expiry of the duty would be likely to lead to continuation or recurrence of subsidization and injury.

4. Unfair Foreign Practices: Section 301 (a.k.a. "Super 301")

If foreign governments engage in policies or practices that burden, restrict, or discriminate against U.S. commerce, the U.S. may impose restrictions against the products of that country in the event that an agreement cannot be reached to end the offensive practices. Section 301 is a provision in

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[*] The antidumping statute is found in Section 731 of the Tariff Act of 1930, as amended. The first antidumping law was passed in 1916. The basis for the current statute is a law passed in 1921. To my knowledge, there is no U.S. law that prevents U.S. firms from dumping in foreign markets.

[†] See Thomas J. Prusa, "On the Spread and Impact of Antidumping," *Canadian Journal of Economics* (2001)

[‡] **Direct cash payments**, **tax credits**, or **loan with artificially low interest rates**. And ***upstream subsidies*** that lower the input costs for manufacturing sectors will be also included.

U.S. trade law that requires the U.S. government to negotiate the elimination of foreign unfair trade practices and to retaliate against offending countries if negotiations fail.

5. The Escape Clause: Section 201

U.S also provides a mechanism for domestic firms to seek protection from fairly traded foreign goods. This mechanism is known as the **escape clause**. It provides that the president may withdraw or modify trade concessions made to foreign countries and impose restrictions on imports of any article that causes or threatens serious injury to a domestic industry producing a similar or directly competitive good.

For an excellent policy analysis of the escape clause, see Gary Hufbauer and Ben Goodrich, "Steel Policy: The Good, the Bad, and the Ugly," International Economics Policy Briefs, Institute for International Economics, January 2003 at http://www.iie.com/publications/pb/pb03-1.pdf.

6. Other Measures

There is a provision (Section 337) that restricts unfair methods of competition, such as patent or copyright infringement. And Section 406 provides relief from market disruption by imports from Communist countries (the cases are much like escape clause cases, except that the test for injury is much weaker).

There are restrictions on trade in goods considered vital to the national defense. For instance, the government extended voluntary export restraint agreements (VERs) with foreign producers of machine tools. Several agencies of the U.S. government must discriminate in favor of American goods according to the federal "Buy American" act.