CBO TESTIMONY

Statement of
Jan Paul Acton
Assistant Director
Natural Resources and Commerce Division
Congressional Budget Office

on
Proposed Antidumping Regulations
and Other Antidumping Issues

before the
Subcommittee on Trade
Committee on Ways and Means
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NOTICE

This statement is not available for public release until it is delivered at 11:00 a.m. (EDT), Tuesday, April 23, 1996.

CONGRESSIONAL BUDGET OFFICE
SECOND AND D STREETS, S.W.
WASHINGTON, D.C. 20515

Mr. Chairman and Members of the Subcommittee, I am pleased to appear here today to discuss U.S. antidumping law and policy and the proposed regulations to put in place the latest round of negotiations of the General Agreement on Tariffs and Trade (GATT). With me is Dr. Bruce Arnold, who prepared the Congressional Budget Office (CBO) study *How the GATT Affects U.S. Antidumping and Countervailing-Duty Policy* for this Committee in September 1994.

CBO's review of current U.S. policy and the proposed regulations led to the following findings:

- o U.S. antidumping law applies a different standard for judging pricing policies for imported products than antitrust law does for judging domestic products. Antidumping law serves primarily to protect U.S. firms from foreign competition, regardless of the impact on U.S. consumers and the economy. In contrast, our antitrust laws serve primarily to encourage competition and protect individual consumers and the economy from harmful pricing practices.

- o When a foreign exporter sells in the United States at a price below cost or at a price below the price it charges elsewhere, it almost always benefits the U.S. economy as a whole, except in the rare cases in which predatory pricing can be shown. Nevertheless, individual firms and their workers may be temporarily injured by such practices.

- Over time, U.S. firms seeking protection from foreign competition have come to rely almost exclusively on antidumping law rather than on antitrust law because it is easier for them to receive a favorable ruling.

- In reviewing antidumping cases brought before the Department of Commerce and the International Trade Commission (ITC), CBO found that plaintiffs have been successful in a high percentage of cases. Historically, once protection has been granted, it is extremely difficult to reverse. In effect, protection becomes permanent for the U.S. firm--sometimes extending more than 25 years. The Uruguay Round introduced a five-year sunset provision on antidumping restrictions. Consequently, such long-term protection may become less common.

- The main beneficiaries of U.S. antidumping law and policies are the firms and workers that are provided protection. The main economic losers are the owners of and workers in U.S. businesses that use imported goods, as well as U.S. consumers who pay higher prices for their goods and services. In addition, antidumping policy harms U.S. exporters as a whole because it leads to an adjustment in foreign exchange rates and a decline in the competitiveness of U.S. exports in

world markets. Moreover, foreign countries are following the U.S. lead by imposing antidumping duties on U.S. exports.

- The regulations proposed by the Department of Commerce carry forward existing U.S. antidumping policies with minor variations within the framework of the Uruguay round of the GATT negotiations. Although CBO has not had sufficient time to review those proposed regulations in detail, they do not appear to take into account their harmful effects on consumers and unprotected industries.

WHAT IS DUMPING AND WHAT ARE ITS EFFECTS?

Economists widely agree that in the vast majority of instances free markets result in a higher level of economic efficiency and output than would be likely to arise from government intervention. That conclusion is true for both domestically produced goods and internationally traded goods.

One exception to that general conclusion is when a firm has substantial size and market power to raise its prices above competitive market levels. The antitrust

and antidumping laws are concerned with possible pernicious results that can happen in those circumstances.

In addition, economists and other observers have long recognized a variety of specific circumstances--often noneconomic--that may justify special treatment for certain industries, unrelated to the specific issue of unfair price competition. Those circumstances include national security and security of supply, economies of scale and externalities in production, temporary relief and adjustment assistance, and strategic bargaining to liberalize trade. I will discuss those considerations later in my testimony.

What Are Dumping and Predatory Pricing?

Dumping refers to a foreign firm selling a product in the United States at a price below cost or at a price below that at which the firm sells the same product in its home market. The last is a particular example of what economists describe as "price discrimination," which is the practice of charging different prices to different groups of customers. U.S. antidumping law imposes antidumping duties on low-priced imports in order to deter dumping or at least offset its effects. However, antidumping law applies only to foreign firms selling in the U.S. market--a point I want to emphasize. When engaged in by domestic firms in the U.S. market, the same pricing

practices are perfectly legal and not subject to special duties or any other punishment or offset.

Predatory pricing is the intentional selling of a product at a loss in order to drive competitors out of business. The seller thereby establishes increased market power that it can then use to raise its price above the competitive market level and increase profits. U.S. antitrust law is currently interpreted to prohibit predatory pricing by any and all firms, regardless of whether they are domestic or foreign.

Dumping and predatory pricing are not the same thing, and most dumping is not predatory pricing. Many people think that the sales below cost that antidumping laws prohibit must represent predatory pricing, since firms are in business to make money and would therefore never intentionally sell at a loss without some ulterior motive. In fact, however, sales below cost occur frequently in free markets for all kinds of nonpredatory reasons. For example, during recessions the profits of many firms drop into the red, which means that those firms are selling below cost. They continue to sell their products, however, because the sale price remains high enough to cover variable cost plus part of the fixed costs that they would continue to incur even if they quit selling.

Frequently, introducing a new product involves losses until the product becomes established in the marketplace and the firm works all of the bugs and kinks

out of its production and sales operations. Other reasons for below-cost pricing include loss leaders in sales, life-cycle pricing, legal constraints, and many others. Domestic firms engage in below-cost pricing and price discrimination in the U.S. market frequently with almost no legal constraint. Prohibiting foreign firms from doing so, as antidumping law does, puts them at a distinct disadvantage and deprives U.S. buyers of the benefits of lower prices.

Early in this century, when the first U.S. antidumping law was passed, pricing by domestic and foreign firms was treated similarly, if not identically. Antitrust law was interpreted to prohibit predatory pricing by domestic firms, and dumping was defined in a manner that approximated predatory pricing. Over time, however, antidumping law and policy have evolved along a path of ever-increasing protection for U.S. firms from imports and decreasing concern for consumers and the economy as a whole. Today, U.S. antidumping law and policy make no attempt to single out predatory pricing.

The Effects on the U.S. Economy of Predatory Pricing, Below-Cost Sales, and Price Discrimination

Even when pursued by domestic firms in the U.S. market, predatory pricing impairs economic welfare because it leads to monopolies, which in turn cause economic

inefficiency and raise concerns about social equity. When foreign firms engage in predatory pricing in the U.S. market, it is even worse because it eventually results in U.S. firms and consumers paying monopoly prices to foreign firms. However, domestic and foreign firms seldom employ predatory pricing because only rarely does it succeed in driving competitors out of business and even more rarely is it a profitable strategy. By contrast, nonpredatory price discrimination and sales below cost generally provide net benefits to the economy receiving the lower price, and both are relatively common.

Clearly, the U.S. economy benefits when it purchases a product for less than the cost to produce it. The alternatives are to produce the product domestically--and thereby incur the entire cost of production--or else to purchase it elsewhere for a price equal to or greater than the cost of production. Either way the cost to the economy is greater than the cost of purchasing the dumped product.

Similarly, the U.S. economy also benefits when it obtains a product at a lower price than other countries can obtain it. When such products are purchased by firms that produce other goods, the lower price gives U.S. firms a competitive advantage over foreign firms. For example, if the antidumping laws result in a substantial increase in the price of semiconductor chips or flat-panel displays in the United States, computer manufacturers have an incentive to take their production operations overseas in order to get their chips and displays at lower prices. Similarly, actions

that increase the price of steel increase the problems that U.S. automobile manufacturers have competing with manufacturers in Japan.

In the case of products purchased by final consumers, U.S. consumers obviously benefit by being able to purchase products at lower prices than consumers in other countries must pay. If anyone is to complain about price discrimination, it should be the firms and consumers in countries forced to pay the higher price, not those in the United States getting a lower price.

A domestic analogy illustrates how U.S. antidumping law treats foreign price cutting differently from domestic price cutting. If a department store had a sale in which it sold some products for less than those products cost the store, no consumer would complain to the store that it was being unfair. Similarly, if the store gave a particular consumer a better price than it gave others, that consumer would not be likely to complain. Yet that is exactly what the United States does as a consumer of products of foreign firms. Through our antidumping laws, we prohibit foreign firms from giving us a good deal. We insist that they not sell to us at a price below cost, and we insist that they give us no better a deal than they give their own citizens.

One might argue that consumers would certainly object if the department store sold below cost or practiced price discrimination for the purpose of driving its competitors out of business so that it could then jack up its prices sky high. That

practice, indeed, would be bad for the consumer and for the economy generally. Monopoly prices and lack of competition cause economic inefficiency and raise concerns of equity and fairness. That kind of behavior, however, is not mere selling below cost or price discrimination—it is predatory pricing. However, U.S. antidumping law and policy make no attempt to restrict imposing antidumping duties to the few cases that could represent predatory pricing.

By contrast, in cases of predatory pricing under the antitrust laws, the Federal Trade Commission and the courts do attempt to zero in on predatory pricing. They tend to look for evidence of such factors as prices below average variable cost (not just below average total cost), large enough market share and sufficient barriers to other firms' entering the market to make a monopoly and subsequent price increases feasible, and local price cutting in particular markets rather than general price cutting in all markets. In short, mere price discrimination or selling below average total cost is not usually sufficient for demonstrating predatory pricing.

The difference between antidumping law and antitrust law as it relates to predatory pricing is aptly characterized by two observations: (1) antitrust law protects consumers and the efficiency and productivity of the economy, whereas antidumping law protects certain producers at the expense of consumers and the efficiency and productivity of the economy, and (2) antitrust law seeks to preserve competition, whereas antidumping law seeks to restrict it.

Who Benefits and Who Is Harmed by
Laws Against Below-Cost Sales and Price Discrimination?

Imports sold below cost or below the price at which they are sold in the exporter's home market benefit the U.S. economy as a whole, but they can injure individual firms and their workers.

Workers who are potentially affected by dumping are worried about losing their jobs. Permanent loss of one's job can be quite costly. It may take months to find another job, and the new job might not be as good as the one lost. In a full-employment economy, however, both displaced workers and capital can be expected to find reemployment eventually. In that respect, as in other aspects of dumping, the economic effects of job loss are the same whether the causes are domestic or foreign. Thus, the main beneficiaries of antidumping law are import-competing firms and their employees and to some extent the communities surrounding them.

However, antidumping law protects firms and workers at the expense of the rest of the economy. The sectors of the economy that are hurt by antidumping law include consumers and consuming industries that use imported goods as inputs for production. Firms in those industries are put at a competitive disadvantage in the international marketplace when antidumping laws force them to purchase inputs at higher prices than their competitors pay abroad. That disadvantage can create

incentives for domestic firms to move their operations abroad to avoid antidumping duties on their imported inputs.

Another, less obvious but no less significant, U.S. group hurt by antidumping law is U.S. exporters. They are harmed in two ways. First, other countries are following the U.S. example in imposing antidumping laws. Moreover, some of them have aimed the enforcement of their laws especially at U.S. exporters in retaliation for the United States' use of its antidumping law.

The second way U.S. exporters are hurt is less visible. The primary effect of trade protection is to reduce U.S. imports. Since domestic savings and investment--which determine the trade balance--are unlikely to change, reduced imports will lead to reduced exports. To put it another way, if the United States effectively refuses to buy imports by putting up trade barriers such as antidumping laws, foreign countries will have fewer dollars with which to buy U.S. exports.

When Protection from Imports May Be Appropriate

Despite the broad agreement that freer trade is almost always better for the economy as a whole than trade restrictions, trade protection can sometimes be appropriate in supporting national objectives. Those circumstances generally involve noneconomic

considerations or periods of temporary disruption and transition rather than the pricing practices addressed by antidumping law. Some specific examples are worth noting.

First, national security considerations may lead the United States to try to preserve domestic capability to produce certain key products that would be difficult to create rapidly during a period of threat or conflict. Those products could include advanced technology applications, weapon systems, or critical materials that are inputs to defense capability. Existing U.S. policies--including stockpiling and procurement policies--seek to ensure such capability, and they may represent a more effective and efficient approach than antidumping policies.

Second, certain market conditions may justify a departure from total free trade. Those conditions include situations in which there are increasing returns to scale or positive benefits to the country from having a specific industry in the United States for which firms in that industry would not naturally be compensated by the normal workings of the market. In such cases, strategic trade theory has shown that carefully chosen market intervention by the government can offer certain benefits. However, empirical research to date has indicated that those benefits are quite small and that it is very difficult to determine which industries are likely to accrue such benefits. As a result, even some of the early proponents of strategic trade theory have concluded that a general policy of free trade is preferable.

Third, proponents of trade restrictions also note that departures from completely free trade may be helpful in the long run by providing temporary relief to assist the recovery of an industry or the transition to a new economic reality. In the United States, there has long been support from many quarters for temporary restrictions to ease the adjustment to unexpected disruptions from imports. Specifically, the section 201 escape clause provides for temporary restrictions to ameliorate surges of imports that are injuring a domestic industry. The idea is to smooth the transition and adjustment, not to eliminate the need for adjustment.

Finally, the act of getting rid of its own protection will generally help a country's economy regardless of what its trading partners do with their trade barriers. In practice, however, trade negotiators may use bargaining chips to achieve the overall objective. In trade negotiations, countries usually try to get their partners to get rid of barriers in exchange for eliminating their own restrictions.

Although each of those considerations could provide a basis for restricting trade, the antidumping laws and regulations that the Commerce Department uses to restrict trade do not take into account any of those reasons for protection. Moreover, as will be discussed later, antidumping law is not a good substitute for the section 201 escape clause.

HOW DOES ANTIDUMPING LAW CURRENTLY FUNCTION?

Although modern antitrust law as it relates to predatory pricing applies to imports as well as domestically produced goods, it is virtually never used in the case of imports. Competing firms are almost always the ones to bring cases against aggressive pricing by foreign and domestic firms. In the case of imports, they can obtain protection much more easily under antidumping law than they can under antitrust law.

However, antidumping law has replaced more than just antitrust law. Antidumping law is now a fairly general source of protection from foreign competition with very little relation to the fairness of that competition. Over the years, the Commerce Department's procedures have evolved in the direction of making it more and more difficult for foreign firms to defend themselves successfully against charges of dumping. Indeed, the main hurdle to an industry seeking protection under antidumping law is to demonstrate that it has been injured by the imports, not that the imports are dumped.

The Department of Commerce found dumping in 93 percent of the 339 cases that came before it for final determination from 1980 through 1992, whereas the International Trade Commission found injury in only 66 percent of the 315 cases that subsequently went to final determination. From 1988 through 1992, the numbers were even more lopsided: the Commerce Department found dumping in 97 percent

of the 126 cases that came before it for final determination, whereas the ITC found injury in only 59 percent of the 122 cases that subsequently went to final determination. Thus, although the Department of Commerce found dumping quite often in the cases it reviewed, according to the ITC, about 30 percent to 40 percent of those cases involved no economic harm to competing firms.

Those statistics suggest that the main hurdle in antidumping cases is establishing injury, not proving that the competition is unfair. The purpose and function of the section 201 escape clause is to protect domestic industries from injurious surges in import competition. The degree of injury that must be demonstrated in antidumping cases, however, is less than that required in section 201 cases. For that and other reasons, the section 201 escape clause is now seldom used. A domestic industry generally finds it much easier to obtain protection under antidumping law. However, using that law as a general source of protection from imports has several disadvantages.

First, in the past antidumping law did not have the restrictions that the section 201 escape clause had to ensure that protection is granted only temporarily for the purpose of aiding adjustment and only in cases in which the benefit to the protected industry outweighs the harm to the rest of the country in economic, foreign policy, and security matters. Further, to get an antidumping order revoked, a foreign firm usually had to get a determination from the Commerce Department that it had ceased

dumping, and such a determination was difficult to obtain. Hence, for all practical purposes, protection under antidumping law tended to become permanent. Some outstanding antidumping cases have been in effect for more than 25 years.

Permanent protection of industries is almost always detrimental to the economy and is contrary to the basic thrust of U.S. trade policy since World War II, which has supported the philosophy that all countries should eliminate trade barriers. The Uruguay Round introduced a five-year sunset provision on antidumping restrictions. The restrictions may be extended if a review determines that dumping would be likely to continue or to recur. At this stage, it is too early to know if that sunset provision will terminate most dumping-related restrictions. But if it does, it will represent a pro-competitive change in U.S. trade law.

Second, other countries have begun to follow the U.S. lead. They are now using antidumping laws to protect their industries, and many of them are targeting U.S. exports in retaliation for U.S. use of antidumping laws against them. The new World Trade Organization (WTO) agreement puts the imprimatur of world approval on much of U.S. antidumping policy and as such may hasten that development. Therefore, not surprisingly, although support for U.S. antidumping law and procedures among import-competing firms remain strong, sentiment against them is rising in the growing community of U.S. exporting and importing firms.

Third, even in those cases in which protection is considered desirable, antidumping law sometimes provides inadequate protection. It applies only to imports of the product in question from particular countries or firms and not to all imports of the product from any source. Therefore, it can be--and sometimes is--circumvented either by the firm on whose products the duties are imposed or by the impersonal workings of the international market. Consequently, the United States has had to devote considerable attention in recent years to modifying antidumping law to make it apply to upstream dumping, downstream dumping, dumping routed through third countries, and various other routes by which antidumping orders have been circumvented.

THE URUGUAY ROUND, IMPLEMENTING REGULATIONS, AND PROPOSED SHORT-SUPPLY LEGISLATION

U.S. antidumping law constitutes protection of domestic industries from foreign competition without regard for the fairness of that competition or for the economic welfare of the country. As such, it is an anomaly in U.S. trade policy, which in most areas favors free trade and opposes protection. Similarly, the provisions in the General Agreement on Tariffs and Trade have also been an anomaly.

In the Uruguay Round of GATT negotiations, which created the new World Trade Organization, antidumping law and policy were major issues of discussion. A result of the negotiations was a new Antidumping Code for the WTO. By and large, that new code serves to ratify most of current U.S. antidumping policy.

Although the new code does not require major revisions to U.S. policy, it does require minor reforms of some of the more protectionist aspects of that policy. To carry out the Uruguay Round Agreement, the Congress passed the Uruguay Round Agreements Act, which went into effect on January 1, 1995. On February 27, 1996, the Department of Commerce proposed new regulations to carry out the antidumping provisions in the act.

CBO has not yet had a chance to study those new regulations in depth. We assume that they are generally consistent with the new Antidumping Code and as such that they do not change the basic character of U.S. antidumping policy. In some instances, the Commerce Department had some leeway in the extent or character of changes it could choose to make while remaining consistent with the new Antidumping Code and the Uruguay Round Agreements Act. In addition, proposed short-supply legislation would permit the department to suspend antidumping restrictions under certain economic conditions. If the department uses that leeway to reduce the protection U.S. antidumping law affords to domestic industries, the results should benefit the economy, increase the equality of treatment of domestic and foreign

firms, and make antidumping policy less inconsistent with the rest of U.S. trade policy. If the department uses the leeway in the opposite direction, the reverse will be true.