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Free versus Fair Trade: The Dumping Issue

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Trade liberalization has had little effect on the use of antidumping tariffs—tariffs imposed on imports judged by a government to be unfairly priced. As more countries resort to such tariffs, questions arise about the merits of this form of trade protection, particularly when other remedies are available to industries hurt by import competition.

In recent years, the international community has made significant progress in lowering trade barriers. The Uruguay Round of trade negotiations, the North American Free Trade Agreement, and the Information Technology Agreement are eliminating or sharply reducing tariffs and customs duties on imports in many areas of the world. In addition, these agreements are dismantling nontariff barriers to trade, including quotas on exports of textiles and apparel and the export restraints that protected such major U.S. industries as steel and autos in the 1980s (see box).

Although these agreements have removed many impediments to trade, they have done little to curb the use of one type of barrier—the antidumping tariff.[1] A government may impose such a tariff on imports from select countries if it determines that the imports are being sold at less than a fair price—or *dumped*—in domestic markets and that the pricing of these imports is harming, or threatening to harm, domestic producers of the same goods. In the past, the United States has been the principal user of such tariffs, but many countries are now implementing antidumping orders. Indeed, as the trade agreements phase out other forms of protection, recourse to antidumping actions is likely to become much more common.

In this edition of *Current Issues in Economics and Finance*, we examine the rising use of antidumping tariffs and review the claims made for and against this type of trade barrier. Although we cannot evaluate these claims in detail, our analysis points to problems in both the theory and the application of antidumping regulations. Following our discussion of these problems, we identify alternative remedies available to industries coping with unfair competition.

The Growing Use of Antidumping Tariffs

The use of tariffs to target specific imports began in 1904, when Canada sought to discourage a U.S. manufacturer from selling steel to the Canadian railroads. The first U.S. antidumping law was passed in 1916, and subsequent revisions of the law have made it progressively easier for domestic firms to get protection against imports perceived as unfairly priced.

The prevalence of antidumping tariffs worldwide has increased sharply in the 1990s (see table). At the beginning of the decade, the United States had 193 antidumping orders in place, while all other member countries in the World Trade Organization had roughly 212. By 1997, U.S. orders totaled 294, while the number for other member countries jumped to 538.[2]

Two features of this increase are noteworthy. First, many more developing nations are now resorting to this form of protection. Countries such as Argentina, Brazil, India, Mexico, South Africa, and Turkey account for much of the new use of antidumping tariffs. Second, the share of antidumping orders directed against U.S. exports has grown.[3] If the latter trend continues, U.S. producers stand to lose considerable business as tariffs raise the price of their goods in foreign markets.

In light of the rapid spread of antidumping tariffs and the prospect of reduced sales for U.S. exporters, some reconsideration of the value of this tool is in order. We begin by looking at the arguments that have been advanced for and against the tariffs.

Two Perspectives on Antidumping Actions

To some observers, antidumping tariffs are a useful means of shielding domestic firms and workers from the unfair pricing practices of foreign firms. These tariffs ensure that foreign producers will not set such low prices on their exports that domestic producers competing for the same customers are forced out of business. Proponents also argue that these tariffs are a fairly benign form of protection. Because the charges apply only to the products of a subset of foreign firms, domestic consumers have the option to purchase the same goods from other foreign firms—at a price that may still be lower than that charged by U.S. producers.

Lowering the World's Trade Barriers

Three multilateral trade agreements have significantly reduced tariff restrictions in the 1990s:

- The Uruguay Round of the General Agreement on Tariffs and Trade, completed in 1994, will lower member countries' tariffs on manufactured goods by more than one-third by 1999. It sets upper bounds on tariff levels for 99 percent of the goods imported by developed countries and for 70 percent of the goods imported by developing countries.

- The 1994 North American Free Trade Agreement immediately eliminated tariffs on half of all U.S. exports to Canada and Mexico and, by the year 2000, will eliminate most of the remaining tariffs. In 1997, the average tariff rate on Mexican imports from the United States was 2.9 percent, down from 10.0 percent in 1993, while the average tariff rate on U.S. imports from Mexico had dropped to 0.8 percent from 4.0 percent over the same period.

- The Information Technology Agreement, passed in 1997, will eliminate customs duties on computers and telecommunications equipment by January 1, 2000. The agreement affects roughly $1 trillion in world production and $600 billion (or about 10 percent) of world trade.[a]

The Uruguay Round and the North American Free Trade Agreement have also led to the dismantling of many nontariff barriers. As a result of the Uruguay Round, about one-third of the textile and apparel exports to the United States that were originally subject to quotas under the 1973 Multi-Fiber Arrangement will be freed from them in 1998; less distortionary tariffs will replace the quotas. Another 18 percent of these exports will be freed from quotas by 2002 and the remainder by 2005.[b] The North American Free Trade Agreement removed import quotas on those Mexican textile and apparel products that met strict rules-of-origin requirements. All other quotas, including those on agricultural goods, are to be replaced by tariffs.[c]

The Uruguay Round also addressed "voluntary export restraints"—a type of barrier often used in the 1980s to protect U.S. industries such as steel and autos. A country subject to a voluntary export restraint agrees to limit the quantity of products it exports to another country, usually because it wishes to avoid some more costly restriction on its exports. The industry protected by this arrangement benefits from both the reduced number of competing imports and the higher unit price of those imports. The Uruguay Round calls for the elimination of all voluntary export agreements between countries by 1999.[d]

[a] Computers, semiconductors, semiconductor manufacturing equipment, telecommunications products, computer software, and some scientific equipment are covered by the Information Technology Agreement. The United States exports more than $100 billion of these goods annually.

[b] Hufbauer and Elliott (1994) estimate that U.S. restrictions on imports of apparel cost the American consumer $21 billion in 1990, with the cost per U.S. job saved equal to $144,000. Also see Krueger (1995) for a discussion of the cost of protectionism.

[c] Although textile and apparel products that do not meet origin requirements will be subject to tariffs, the rates will be lower than those on textile and apparel imports from other countries.

[d] Informal agreements between firms are not explicitly ruled out, but such agreements would likely violate antitrust law.

In addition, this type of trade barrier may be preferable to quotas because the cost it imposes on domestic consumers is largely a fixed one. When a government places a tariff on a given import, the additional cost borne by consumers will not increase appreciably if demand rises. But when a government establishes an import quota, it fixes the supply of that import, so that a rise in demand will drive up the cost of this barrier to consumers over time.

Critics of antidumping tariffs claim that this instrument, like all trade barriers, hurts the economy by directly raising the prices that consumers and manufacturers must pay for goods. Although the tariffs are designed to protect domestic industry, they may in the long run hurt the sales of export-oriented domestic firms if the countries required to pay the charges choose to retaliate. Antidumping regulations also create the potential for abuse: domestic producers may allege dumping by foreign rivals solely to stifle competition and to keep their own prices high. Finally, critics question the argument that antidumping tariffs affect goods and countries selectively. They argue that by placing an antidumping tariff on the product of one group of foreign firms, a government is in effect serving notice that it will take action against all foreign firms that price that product aggressively. As a result, firms that are not named in the antidumping action will very likely react to the implied threat of tariffs by adjusting the price of their product upward.[4]

A thorough investigation of these arguments is beyond the scope of this article. We can, however, gain some insight into the debate by looking more closely at both the reasoning that underlies antidumping regulations and the methods used to implement those regulations. We find that there is, in fact, little economic basis for the use of antidumping tariffs or for the standards applied in dumping investigations.

The Theory behind the Regulations

Antidumping regulations are built on the notion that foreign firms, if undeterred, may engage in a form of predatory pricing. According to this notion, foreign firms—especially those that have acquired large profits from lax antitrust enforcement or high import barriers in their own market—may set very low prices in the export market as part of a scheme to drive domestic producers out of business. Once these firms have gained a controlling share of the export market, they count on boosting their prices to recover the losses incurred earlier.

This view of foreign firms' strategy, however, rests on questionable assumptions. Foreign firms that radically underprice their goods in order to eliminate competition in export markets are unlikely to escape the attention of the authorities in countries with strong antitrust laws. In addition, these same firms cannot realistically expect to raise prices high enough to offset the losses from dumping their goods. Economic reasoning tells us that any substantial increase in prices will invite other exporters to enter the market—exporters that can sell their goods at a lower price and thereby deprive the dumping firms of their hard-won gains in market power. If foreign firms cannot be sure of earning the high profits that will compensate them for the heavy costs of predatory behavior, they have no incentive to take losses on their export sales. Thus, firms are unlikely to engage in dumping schemes.

The flawed economics that make the very concept of dumping questionable are also evident in the criteria used to determine whether dumping has occurred. In the next section, we examine how complaints of unfair pricing are investigated. Although we focus on the review process in

Antidumping Orders in Force by World Trade Organization Members

Country	1990 Total	1990 Against U.S. Exports	1997 Total	1997 Against U.S. Exports
Developed countries				
Australia	11	0	41	4
Canada	95	12	90	16
European Economic Community	95	3	135	2
Japan	—	—	2	0
New Zealand	7	0	26	1
United States	193	—	294	—
Developing countries				
Argentina	—	—	26	0
Brazil	—	—	23	5
Colombia	—	—	1	0
India	—	—	19	2
Israel	—	—	2	0
Malaysia	—	—	4	0
Mexico	4	2	81	19
Peru	—	—	6	0
Philippines	—	—	3	0
Singapore	—	—	2	0
South Africa	—	—	25	4
South Korea	—	—	11	3
Thailand	—	—	2	0
Turkey	—	—	35	0
Venezuela	—	—	4	2
Total, excluding the United States	212	17	538	58
Total	405	17	832	58

Source: World Trade Organization (1998).

Note: Data do not include price undertakings or provisional duties.

the United States, our analysis has wider applicability. Negotiators at the Uruguay Round, while forgoing restrictions on antidumping tariffs, took the step of approving the broad outlines of the U.S. approach to evaluating antidumping petitions, making U.S. practice the pattern for all World Trade Organization members. Consequently, some weaknesses of the U.S. review process may emerge in other countries' dumping investigations.

How the Regulations Are Implemented: The Review Process

The review process is set in motion when a U.S. industry files a petition claiming that a particular foreign good is being dumped in the domestic market. Two agencies have responsibility for investigating this claim. The International Trade Administration (ITA), a division of the Department of Commerce, determines whether the price charged for the foreign good is unfairly low, while the International Trade Commission (ITC) determines whether the domestic industry is being injured by the imported good. The agencies render preliminary and final verdicts. If both rule in the affirmative in the preliminary stage, then the foreign producers must deposit tariffs in an escrow account to bring prices up to a level deemed fair by the ITA. If the agencies eventually exonerate the producers, then the tariff revenue is returned. But if the agencies' final verdict is that dumping *has* occurred, the producers have the choice of either continuing to pay the tariff or raising prices to the specified level.

Evaluating Import Prices

One approach used by the ITA to evaluate import prices is to compare the price of a particular good in the foreign firm's own market with the price charged for that same good in the United States. A finding that the home market price is higher than the import price is regarded as strong evidence of dumping.[5]

Such a standard ignores the fact that setting different prices in different markets is consistent with normal business practices. In markets that are not perfectly competitive, firms have discretion to decide how much prices should be marked up over costs. Unless goods move freely between markets, the markup can vary according to differences in local supply and demand conditions. For example, firms will charge less in markets composed of consumers who are especially responsive to price (either because of tastes or because of the ready availability of competing goods). Under antidumping regulations, however, reducing prices in response to market-specific conditions is illegal.

Other problems exist with this standard. First, in comparing import prices with the prices charged in the foreign producer's home market, the ITA must adjust for differences in product characteristics. Such adjustments involve a heavy reliance on the judgment of the agency's investigators. Second, if the foreign firm does not supply adequate or appropriate data on the prices it charges in its own market, the ITA is permitted to turn to the petitioning U.S. industry for the relevant information—known as "best information available." Foreign firms have criticized this arrangement, noting that the price information they are asked to provide is difficult to collect and format, particularly if they use accounting methods that differ from those employed by U.S. firms.

An alternative standard used to evaluate import prices involves comparing the import price of a particular good with the cost incurred by the foreign firm in producing that good. If the firm does not make a sufficient profit, then the price is judged to be too low. Once again, the economics of such a standard are questionable. Applying this standard to, say, U.S. firms would require them to maintain a government-specified profit margin, not just in all their operations but in each category of goods manufactured. A loss or too small a profit on the sales of any particular good would be evidence of wrongdoing. Such losses, however, are commonplace in a market economy. For example, firms may reduce prices and accept a lower level of profit when they want to build a market for new products or to counter faltering sales of an existing product.

Evaluating Injury

To investigate whether a domestic industry has been harmed by low import prices, the International Trade Commission collects data on output, sales, imports, capacity utilization, profits, cash flow, employment, and wages. Although a considerable amount of information is amassed, there are few explicit rules for interpreting this information. The ITC is required only to determine whether the injury—or threat of injury—to the domestic industry is "material"—defined as "not inconsequential, immaterial, or unimportant."[6] Coupled with a finding that the import price on a particular product is too low, a finding of material harm will lead the government to impose an antidumping tariff on that product.

Like the criteria for evaluating import prices, the standard for determining injury presents significant problems. A standard of material harm is significantly lower than the standard of serious injury used in antitrust cases involving domestic firms. Any increase in imports that comes at the expense of domestic firms would appear to be sufficient evidence of harm.[7] Consequently, it is not surprising that the majority of injury claims are accepted. From January 1980 to July 1997, such claims were rejected only 12 percent of the time after the preliminary investigation and 17 percent of the time after the final investigation.

Since ITC members rely largely on their own judgment in interpreting the data they collect, identifying the variables that carry the most weight is difficult. This lack of transparency increases the uncertainty for foreign firms trying to plan their export strategies. It also makes it difficult to establish a clear link between the behavior of particular foreign firms accused of dumping and a commission ruling that a domestic industry has been hurt. Indeed, attempts by researchers to identify the factors that lead to affirmative injury decisions suggest that this link is a weak one. A recent study found that the ratio of U.S. imports from *all* countries to consumption was correlated with a government finding of material injury (Baldwin and Steagall 1994). But there was no evidence that a change in the value of imports from *particular* countries had any effect on the injury rulings. A second factor that proved to be a good predictor of an affirmative ruling was a decrease in an industry's capacity utilization. This finding suggests that imports are often judged to be harmful in industries that are experiencing difficulties on other fronts.

Alternatives to Antidumping Tariffs

Antidumping regulations clearly fall short of providing a sound and reasonable response to foreign competition. But what other remedies are available to domestic industries threatened by the actions of foreign rivals?

In the United States, there exists a well-developed system of antitrust laws to protect domestic commerce from the unfair business practices of individual firms. Such laws could be relied on to resolve allegations of unfair conduct in international trade. Charges of predatory pricing behavior by foreign producers could thus be dealt with in the same way as similar charges against a U.S. firm.

Recourse to antitrust law would have an important advantage over antidumping appeals. As noted earlier, antidumping tariffs present some potential for abuse. A domestic industry that wishes to keep its prices high can file an antidumping petition against foreign firms in order to pressure the firms into setting prices that match those of domestic firms. The foreign firms may yield to this pressure to avoid the high legal and administrative costs of defending themselves against the dumping claim. In this case, the domestic industry is essentially forcing the foreign firms to collude with it in keeping the prices of goods high. Such schemes would be much more difficult to carry out if complaints of unfair pricing were handled by the antitrust authorities—a group whose chief responsibility is to uncover manipulative and collusive behavior.

Although antitrust law may offer a future solution to the problem of unfair international competition, an existing remedy for industries under pressure from imports is the safeguard action.[8] A safeguard action places tariffs or quotas on imports for a limited period only—typically four years. This form of protection is designed to give domestic firms and their workers the opportunity to make the adjustments necessary to cope with competition.

The standard for establishing injury is stricter under a safeguard action than under antidumping regulations. Although the domestic industry does not have to show that foreign firms are pricing their goods unfairly, it does have to demonstrate that it has sustained *serious* injury from an increase in imports. This requirement raises the bar for obtaining government assistance considerably and discourages trivial or unscrupulous allegations of harm.

A second advantage of the safeguard action over antidumping tariffs is that it makes the economic costs of protectionism more transparent. Because the safeguard action is designed to give domestic industries temporary relief from competition rather than to penalize foreign competitors, a foreign country that is subject to such an action will receive compensation.[9] Thus, if the United States resorts to a safeguard action against Italian producers of wine, it will have to satisfy the Italian authorities by making a concession of some kind—for example, by reducing tariffs on imports of pasta. Such a step will, of course, make it more difficult for U.S. producers of pasta to compete with their foreign rivals. In this way, the compensation requirement gives safeguard actions a cautionary force: governments relying on these actions are reminded that efforts to restrict the free exchange of goods ultimately entail some injury to domestic industries.

Conclusion

As the international trade agreements of the 1990s progressively weaken or eliminate most barriers to trade, countries fearing an influx of imports are likely to increase their use of antidumping tariffs. Such tariffs are, however, ill conceived in many ways. The threat that they are meant to address—predatory pricing on the part of foreign competitors—is more apparent than real; as we have seen, countries have little economic incentive to engage in such schemes. Moreover, the procedures used to review dumping allegations are themselves questionable. Pricing practices that are a normal part of domestic commerce are taken as evidence of illegal behavior, and the standard of proof for establishing injury is exceedingly low.

Antidumping remedies are available to all countries that belong to the World Trade Organization, and it is evident that more countries are taking advantage of them. Like all moves toward trade liberalization, reform of dumping laws will come only when countries decide that the economic costs of protection exceed the benefits of sheltering domestic industries from foreign competition.

Notes

1. The Uruguay Round imposed only minor restrictions on the use of antidumping tariffs. It eliminated some methods of calculating tariff rates and added a requirement that existing tariffs be reevaluated every five years. Negotiators also stipulated that the World Trade Organization could arbitrate disputes over how a particular investigation of dumping charges was performed. Efforts to bring about more substantial changes—such as allowing the World Trade Organization to judge the merits of an antidumping decision—were unsuccessful. See Grimwalde (1996) and Horlick (1993).

2. The figures on worldwide use of antidumping tariffs at the beginning of the decade are as of June 1990; the 1997 figures are as of December.

3. China, which has often been accused of dumping by U.S. firms, recently started evaluating a charge of dumping against a U.S. manufacturer of cardboard.

4. Prusa (1994) and Staiger and Wolak (1996) argue that antidumping petitions can be an effective tool for pressuring importers.

5. The ITA has rejected less than 3 percent of the domestic claims of unfairly low import prices since 1980; in all other cases, it has ruled that tariffs are justified. The tariff rate imposed on imports from 1980 to 1993 averaged about 30 percent. See U.S. International Trade Commission (1995), Table 3-1.

6. The ITC does not consider the impact of higher prices on U.S. consumers or manufacturers.

7. Kelly and Morkre (1998) find that most of the industries whose allegations of harm have been upheld by the ITC experienced only minor revenue losses.

8. The only U.S. industry currently enjoying safeguard protection is broom manufacturing. The tomato industry failed to obtain safeguard protection in 1995 and again in 1996.

9. However, the country taking the action can, under certain circumstances, defer the compensation for up to three years.

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