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Dumping—One of Those Economic Myths[1]

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Dumping is one of the most poorly understood and contentious issues in trade policy. The primary reason is that the agreed definitions of dumping are not based on a solid economic foundation. This allows antidumping measures to be used for protectionist ends and to harass trade partners. While putting antidumping measures on a sounder economic foundation in international law may be difficult given their popularity with politicians, no progress can be made until economists provide a theoretically sustainable definition of dumping and devise a set of transparent criteria for determining if dumping is occurring. This paper explains the difficulties with the current definitions of dumping and outlines an agenda for future progress.

Keywords: dumping; international predation; price discrimination; protectionist

> *Senator Max Baucus, the highest ranking Democrat on the Senate Finance Committee, has sent a letter signed by 61 of the 100 U.S. senators to President Bush insisting that they would oppose any international trade agreement that weakened U.S. antidumping and other trade laws (May 7, 2001).*[2]

On Myths

In popular culture there are what are known as "urban myths". These are stories that are widely circulated and believed that, when subjected to close scrutiny and investigative research, are found to have no basis in fact. Another characteristic they share is that they tend to be persistent—parents are often mystified when their children relate as gospel an

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updated version of some long-forgotten story that was circulating when they were young. Frequently, the myth includes a mysterious bogeyman that adds to the tale's enduring appeal. Urban myths often transcend national and cultural boundaries. For the most part, urban myths are harmless diversions that entertain and, in their telling, provide a vehicle that facilitates social interaction.

In international trade law, however, there is a similar phenomenon of mythical proportions—dumping. Unlike its relatively benign "urban" counterpart, this "economic" myth imposes substantial costs on firms that engage in international commercial transactions, on taxpayers, and on consumers in importing countries. It wastes resources by encouraging rent seeking and requiring the preparation of complex legal arguments by both those bringing a case and the accused who must defend themselves. It allows governments to harass foreign firms. It reduces the credibility of the international trade law system and its institutions. Cynicism about antidumping actions is widespread among international trade professionals, but their criticism seldom extends beyond the difficulties associated with implementation and procedures—in short, criticisms seldom extend to debunking the myth itself. Here the blame rests squarely on the shoulders of economists, because dumping is an economic matter and one cannot expect trade lawyers, trade law administrators, or politicians to take an active part in exposing the myth. Economists need to return to the basics and provide an intellectually sound analysis of the dumping question. Without such basic groundwork, no progress can be expected in this most contentious area of international trade law. This paper attempts to outline the nature of the problem and to point the way toward a research agenda for economists.

Some cynics may argue that this would be wasted effort because antidumping is too convenient a mechanism for politicians seeking to deflect protectionist pressures for it ever to be given up. While antidumping actions certainly provide an escape valve in the domestic politics of protection in some countries, once can hardly expect legislators to propose changes to bad laws without a sound basis for doing so. As long as the myth remains common currency, no progress can be expected.

Why is Dumping a Myth?

Part of the economist's problem with analysing dumping is that it is already defined in international trade law. As a result, much of the current work on dumping takes the definition(s) as given and then seeks to analyse the effects of applying those definitions to a set of circumstances or a particular antidumping action. The heart of the dumping myth, however, lies with the logic that underlies the accepted definitions of dumping in international trade law. For members of the World Trade Organisation (WTO), antidumping actions are undertaken through domestic institutions but these national determinations are

subject to appeal to the WTO's dispute resolution system. National antidumping legislation varies in detail but, for WTO members, conforms to the WTO's Antidumping Agreement.[3]

Dumping refers to the pricing practices of firms engaging in international commerce and should not be confused with firms selling into an importer's market after receiving "unfair" subsidies. The latter are cases where countervailing duties can be applied. This point is made because the two are often used interchangeably in the press and common discourse. The definitions of dumping used in the Antidumping Agreement are as follows:

> *Article 2.1* For the purpose of this Agreement, a product is to be considered as being dumped, i.e. introduced into the commerce of another country at less than its normal value, if the export price of the product exported from one country to another is less than the comparable price, in the ordinary course of trade, for like product when destined for consumption in the exporting country.
>
> *Article 2.2* When there are no sales of the like product in the ordinary course of trade in the domestic market of the exporting country or when, because of the particular market situation or the low volume of sales in the domestic market of the exporting country, such sales do not permit a proper comparison, the margin of dumping shall be determined by comparison with a comparable price of like product when exported to an appropriate third country, provided that this price is representative, or with the cost of production in the country of origin plus a reasonable amount for administrative, selling and general costs and for profits.

It is important to note that these definitions are to be applied separately, not concurrently.

The first definition, *Article 2.1,* can be termed the "price-discrimination" definition. Stripped of its legal language, it says that a country may impose antidumping duties if a foreign firm sells its product in the importer's market at a price lower than in its home market. This is the WTO's preferred definition of dumping. The central question to ask is why price discrimination should be considered an "unfair" trade practice—*the proverbial foreign bogeyman choosing to sell at a lower price in a foreign market than he does at home.* It is easy for economists to show that price discrimination is simply a normal business practice —profit-maximizing activity—when a firm faces different demand curves in markets that can be separated (see the discussion of a price-discriminating monopolist in any intermediate microeconomics text, e.g., Mansfield, 1979, pp. 298-300). Price discrimination is generally recognised as normal business practice in domestic competition policy and is not illegal. Anyone who has ever purchased a discount airline ticket, availed themselves of a seniors'price, or used coupons in a supermarket is engaging in a transaction undertaken by a firm practising price discrimination. While customers paying the full price on airlines, etc., may sometimes complain, the complaint is not that the discount price should be done away with, but that they should be allowed to avail themselves of it. Of course, this is the opposite of a dumping complaint. As firms engaging in price discrimination do so voluntarily, it seems unlikely that they would lobby for it to be declared "unfair". The question

then becomes, why should a business practice that is not considered "unfair" domestically be considered "unfair" when practiced internationally? One of the definitions of dumping presented in *Article 2.2* may provide clues to the answer.

Before examining the second definition, it is instructive to delve into the origins of antidumping legislation. Canada has the unenviable distinction of having enacted the first antidumping legislation in 1904.[4] In reading the debates surrounding the introduction of special duties on undervalued products[5] it is clear that the intent of the "dumping" clause was to prevent exporters from reducing the value reported on their invoices to avoid paying the full value of customs duties, and not to offset price discrimination. The Minister of Customs, The Hon. William Patterson is clear on this point:

> If a man in another country wishes to sell his goods at 25 percent under the domestic price, that is a perfectly legitimate transaction as between the seller and the buyer (*Debates of the House of Commons, Dominion of Canada,* May 14, 1903, p. 3050).

He goes on to say:

> But the law makes it imperative on the Customs Department to see that the duty is paid on the value of that article in the country of production … (p. 3050).

The legislation, however, introduces the term "fair market value" to mean the price at which the imported good is sold in the exporter's domestic market, but only for the purpose of establishing the duty to be paid.[6] Implicitly, however, this wording suggested that a price less than this would be "unfair" and might be the source of later confusion regarding dumping.

Article 2.2 of the Antidumping Agreement provides two additional definitions, or tests, to be used in situations where the price-discrimination definition cannot be applied. The first is commonly referred to as the "third market test" and suggests that when no domestic market for a product exists, dumping can be deemed to be taking place when an exporting firm is selling at a lower price in one export market than in another export market—the firm is practising price discrimination. Again, this pricing practice can be easily explained as a normal business practice if the demand curves in the two markets are different. Further, as suggested above, price discrimination is not considered an "unfair" business practice in domestic markets.

The second definition in *Article 2.2* suggests that dumping is taking place when the price the firm charges in the importing country is less than the firm's costs, where cost is taken to include a normal rate of return—something very similar to what economists would call the total cost of production. In *Article 2.2.1* the definition is further clarified as meaning "prices below per unit (fixed and variable) costs of production plus administrative, selling and general costs". In short, dumping is selling below cost. Again, this makes for

good rhetoric—*the evil foreign bogeyman selling below cost dumping his products in our markets at prices we can't compete with.*

If the selling-below-cost criterion were applied domestically, however, one suspects it would be a rare firm that could consistently avoid being in violation of the law. Firms do not always sell at a break-even price or above. Firms lose money at times. Markets cycle, recessions occur, businesses misjudge markets and have sales to dispose of inventory. The question then arises, why should foreign firms be held to a higher standard than domestic firms? Of course, this definition means that in times of low prices firms in both countries may be losing money, but a foreign exporter can be charged with dumping for following exactly the same pricing strategy as domestic firms.

Thus, as currently defined, dumping does not appear to be an "unfair" business practice. It is an economic myth that can, however, be exploited by those seeking protection. Of course, they have the force of international trade law behind them.

International Predation

While it is relatively easy to dismiss the current definitions of dumping as business practices that should not be of concern for public policy makers, a nagging feeling of unease probably remains. Selling below cost and charging a lower price in one market than in others might, at an intuitive level, seem to characterize predatory pricing—selling below cost to drive competitors out of a market so that a monopoly is attained, and along with it future monopoly profits. In the short run the losses in the market preyed upon can be covered from other markets where the firm enjoys a degree of market power and super-normal profits. Predatory pricing is considered an "unfair" business practice in many jurisdictions and domestic competition policy is used to deal with it. It could certainly be argued that it might not be possible to apply domestic competition law to firms operating in a foreign country but exporting their product at a predatory price. As a result, an international trade remedy might be an alternative policy option that could be considered.[7]

The WTO's Antidumping Agreement appears to go some way toward recognizing that to be a public policy problem, selling below cost must be more than simply a short-run "sale" to reduce inventory.[8] With regard to observed prices below cost, *Article 2.2.1* states that they may be ignored in the determination of normal value

> …if the authorities determine that such sales are made within an extended period of time in substantial quantities and at prices which do not provide for the recovery of all costs within a reasonable period of time.

Whether this can be taken to be a recognition of price predation is not clear. In any case, the "selling-below-cost" definition is not to be used together with the "price-discrimination" definition in dumping determinations.

While using the "price-discrimination" definition and the "selling-below-cost" definition together may be a necessary condition for predatory pricing to occur, it is not a sufficient condition. It is a necessary condition because, while pricing in the importer's market at a lower price than in the firm's home (or third) market may cause losses for domestic firms in the importer's market, if the foreign firm is not selling below cost it is simply more efficient. Selling at a lower price because one is more efficient is not a public policy problem—it is the essence of competition.

A pricing strategy that combines selling below cost and price discrimination, however, does not necessarily indicate predatory behaviour. Firms can lose money in the short run. A price-discriminating monopolist could easily be losing money in both markets.[9] Of course, if those market conditions persist, then the firm will have to exit both markets. While it is waiting for markets to recover, however, it is not preying upon competitors in the lower-priced market—it is simply pricing to minimise its losses.

In a similar fashion, a firm with the ability to price discriminate may be covering its costs in the high-priced market but not covering its costs in the low-priced market.[10] One concrete illustration is the pricing strategy followed by domestic airlines where the prices charged to business customers who must travel on short notice more than cover the average cost of a flight spread over a plane relatively full of business customers. The discount prices for a few last-minute standby passengers do not cover the average cost of a flight, but it is still in the airline's interest to fill the seats with customers, even at a lower fare. This is not predatory pricing even if both price discrimination and selling below cost in the low-priced market are being practised simultaneously.

While it is clear that disciplining a firm's pricing strategy (as opposed to tariff avoidance) was not the objective of Canada's original antidumping law, by the 1920s the clear intent of antidumping was the disciplining of "unfair" business practices perpetrated internationally. The seminal economic work on dumping is Jacob Viner's 1923 *Dumping: A Problem in International Trade.*[11] Viner states:

> But sufficient justification is to be found … for confining the term dumping to *price-discrimination between national markets* (original emphasis)(p. 3).

Viner is extensively quoted to this day by those who study dumping. A wide variety of international trade texts simply develop a short-run price discrimination model in an international context in their sections on dumping. Of course, this reflects the current definition in international trade law. It is a circular problem.

Predatory pricing means that a firm has chosen a pricing strategy that does not maximize profits in the short run. Instead, it is willing to give up profits in the near term on the expectation that it will reap the benefits of monopoly profits in the long run. If nothing else, this means analysing a firm's pricing strategy using the traditional short-run models of

economists is not useful. Hence, there appears to be a relatively clear direction for removing the economic aspects of the dumping myth. The challenge for the economics profession is to formally model predatory pricing and then to devise simple but unambiguous tests that can be used for establishing international norms. One suspects that the challenge may not prove an easy one but until the task is accomplished little of positive value can be added to the debate on dumping.

Economists have not given a great deal of attention to predatory pricing. The reason is that it is not a common practice of firms. This is because it is not an efficient method for monopolizing a market. A firm practising predatory pricing in a market must endure a long period of losses in forcing competitors out of business, suffer those losses over a large proportion of the market's sales, and may not be able to prevent the re-entry of competitors when it attempts to raise the price in subsequent periods. McGee (1958) makes a very strong case that, if a firm's objective is to monopolize a market, it is much less costly to do so through a strategy of mergers and acquisitions than it is through predatory pricing. This is reflected in the weighting given to the two topics in domestic competition legislation. One suspects that if predatory pricing became the only criterion for dumping, it would be such a rare occurrence that it would cease to be a concern. There is, however, a situation where international predatory pricing might become a concern. This would be when a country has policies to limit the take-over of domestic firms by foreign companies. With the merger or acquisition avenue closed off, foreign firms that see an opportunity to monopolize a market may well choose an alternative strategy such as predatory pricing. Whether this happens or not is an empirical question. In any case, the major users of antidumping actions currently are economies that are relatively open to foreign direct investment.

Conclusion

Without the development of a better theoretical underpinning for dumping, it will be difficult to justify reform—and to debunk the myth. Part of the problem is that the current WTO Antidumping Agreement has no clearly stated objective. According to Koulen (1995), in the agreement there are no

> …preambular considerations on questions of fundamental objectives and principles of antidumping action (p. 232).

One is struck by the absence of any rationale for the agreement, and it moves immediately to the definitions. With a strong theoretical justification for predatory pricing being the problem that antidumping should address, it might be possible to have it included as the agreement's rationale. It is often argued that instead of worrying about reforming antidumping, the way forward is the international application of competition policy. While

over the long run this may be a desirable solution, in the near term the differences in the national systems of competition policy, along with its wide ranging scope, will probably preclude an agreement on its use to police international commerce. Predatory pricing is a much narrower issue.

If prevention of predatory pricing were to be adopted as the international rationale for antidumping actions, one suspects that it would be too narrow for protectionists, who find solace and relief in the current application of antidumping actions. As presently constituted, antidumping measures can be used to attempt to reduce imports every time international markets decline. The poor economic rationale also allows protectionist interests to threaten foreign competitors and to use existing domestic mechanisms for harassment through the costs required to prepare defences. The WTO already has mechanisms to deal with surges of imports, the safeguard clauses. These clauses offer a strictly protectionist measure that is mutually agreed by the members of the WTO. Safeguards have been agreed to because countries understand that rapid changes in international market conditions can impose unacceptable economic (and political) costs on society. Unlike dumping, there is no "economic" rationale that is used to justify the invocation of safeguards. Safeguards provide protection. Safeguards could be renegotiated to provide greater assistance to domestic protectionists if dumping were to be given a better theoretical rationale.

Unlike safeguards, antidumping actions rest on flawed economic arguments that are trotted out to justify protection. This clearly confuses the issue and sometimes acts in the interests of protectionists. While it is clear that some politicians will fiercely resist changes to the current antidumping mechanism, it is also clear that before any progress can be expected a better economic rationale is required. Without efforts in this direction by the economics profession, one suspects that dumping myths and their assorted international bogeymen will be related by future generations in the same way as recurring urban myths.

Endnotes

1. The research assistance of Shari Boyd of the Estey Centre for Law and Economics in International Trade in the preparation of this manuscript is gratefully acknowledged.
2. *USEMBASSY.IT—International Trade,* Senator Baucus on Protecting U.S. Laws in International Trade, May, 7, 2001, http://www.usembassy.it/file_o5/alia/al050710.
3. Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994, http://www.wto.org/english/docs-_e/legal_e/19-adp.pdf.
4. *An Act to amend the Customs Tariff,* 1897, Clause 19 (Special duty on under-valued goods, p. 115), Chapter 11, *Statues of Canada,* 4 Edward VII, 1904, Ottawa.
5. The term "dumping" seems to have its first official recognition in these debates. For example, when introducing the Bill the Minister of Finance, the Hon. W.S. Fielding used the phrase "In what is commonly called the dumping clause …" (*Debates of the*

House of Commons, Dominion of Canada, June 28, 1904, p 5738) and in the same debate T. Birkett made the following statement: "Then, I would like to point out how difficult it is going to be to carry out the antidumping clause" (p. 5742).

6. The full text of the clause is:

> Whenever it appears to the satisfaction of the Minister of Customs, or any officer of customs authorized to collect customs duties, that the export price or actual selling price to the importer in Canada of any imported dutiable article, of a class or kind made or produced in Canada, is less than the fair market value, thereof, as determined according to the basis of value for duty provided in The Customs Act in respect of imported goods subject to an *ad valorem* duty, such article shall, in addition to the duty otherwise established, be subject to a special duty of customs equal to the difference between such fair market value and such selling price (*An Act to amend the Customs Tariff, 1897,* Clause 19 (Special duty on under-valued goods, p. 115)), Chapter 11, *Statues of Canada,* 4 Edward VII, 1904, Ottawa).

   In the *Act respecting the Duties of Customs* of 1886 "fair market value" in terms of "valuation for duty" is defined as:

> Whenever any duty *ad valorem* is imposed on any goods imported into Canada, the value for duty shall be the fair market value thereof, when sold for home consumption in the principal markets of the country whence and at the time when the same were exported directly to Canada (*An Act respecting the Duties of Customs,* 1886, Clause 58 (Calculation for Value of Duty, p. 316) Chapter 33, *Revised Statutes of Canada,* 49 Victoria, 1886, Ottawa).

7. The use of an international trade remedy, however, is far from a forgone conclusion. Before the relative efficacy of using an international trade remedy as a policy response to international predation can be determined, an acceptable definition of the problem, and an evidential test must be developed.
8. For predatory pricing, the correct measure of cost to consider should be total cost (average total cost per unit) because this is the cost that must be recovered by the firm over the period this pricing strategy is followed. Some economists have used marginal cost criteria in their conventional analysis of dumping.
9. Formally, in a model of a price-discriminating monopolist the prices charged in both markets could be below average total cost at the loss-minimizing quantity the firm chooses to produce. The firm will continue to operate in the short run as long as the total revenues generated from sales in both markets exceed total variable cost.
10. Formally, in a model of a price-discriminating monopolist, the price could be above average total cost at the loss-minimizing quantity the firm chooses to produce but below average total cost in the low-priced market. The firm will continue to operate in the short run as long as the total revenues generated from sales in both markets exceed total variable cost.
11. An accessible version was reprinted in 1966—see Viner (1966)

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