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Phedon Nicolaidis*

Anti-competitive Effects of Trade Policy

Because GATT rules permit countries to take anti-dumping action, anti-dumping measures have come to be regarded as an integral part of the trade landscape. But is it really necessary to have both a domestic competition policy and an external anti-dumping policy, given that both policies aim to promote competition?

The 1980s were a decade of market deregulation and privatisation of state-owned industries.¹ In almost all advanced countries governments were being converted to the merits of free markets and the benefits of unfettered competition. By contrast, during the same decade the trade policies of major countries came to rely much more heavily on instruments that had a particularly disruptive effect on the functioning of the market system.

By most accounts there has been a significant increase in protectionist measures that manage trade flows rather than merely make imports more expensive. While until the early 1970s the use of quantitative restrictions by industrial countries was largely confined to textiles and agriculture, now there is an array of measures intended to control either the amount that foreign firms export or the price at which they sell their products (e.g. voluntary export restraints). Perhaps what is even more serious is that with the Uruguay Round in a stalemate proposals for strategic or bilateral, results-oriented, policies are becoming politically more appealing. Such proposals have the support of some prominent academics and have already gained considerable following in the policy-making and business communities in the United States and the European Community.²

As tariffs have been gradually reduced through successive GATT rounds, the influence of other, mainly domestic, policies on trade flows has become increasingly apparent. Advocacy of bilateralism and trade management is based on the belief that countries such as Japan will not "play" by the rules of a liberal trade system and that their formal and informal policies and business practices give their firms an unfair advantage that has to be explicitly neutralised. Trade measures designed to counteract perceived unfair, distortionary or predatory foreign policies can be effective only by threatening retaliation; i.e. exclusion from the importing country's market. This, however, raises a question which has received almost no attention from those who favour

aggressive trade policy. Why are existing competition policies not used to address the problem of unfair or predatory foreign practices?

The purpose of this article is to ask that question in relation to anti-dumping policy. Because GATT rules permit countries to take anti-dumping action, anti-dumping measures have come to be regarded as an integral part of the trade landscape. But prevailing practice should not be left unchallenged. Why is it necessary to have both a domestic competition policy and an external anti-dumping policy, given that both policies aim to promote competition? This article argues that anti-dumping policy is inherently anti-competitive while it has none of the objectives, and potential merits, of strategic trade policy.

American, European and Japanese anti-trust laws and competition policies share the same primary objectives which are control of monopolies and prevention of collusion among firms.³ They attempt to achieve these objectives by rules which regulate the behaviour of firms and the structure of their industry. In general these rules impose restrictions on vertical and horizontal mergers and agreements, non-market means of raising prices and reducing sales or trade (e.g. refusal to sell to particular customers), tied sales, predatory pricing and impediments to market entry.

During the past two decades, as markets are becoming increasingly international, in the USA and several EC countries competition policy has shifted away from strict

¹ Cf. Alberto Pera: Deregulation and Privatisation in an Economy-Wide Context, OECD Studies, Vol. 12, 1989, pp. 159-204.

² Cf. Rudiger Dornbusch: Is there a Case for Aggressive Bilateralism and how Best to Practice It?, in: Robert Lawrence and Charles Schultze (eds.): An American Trade Strategy: Options for the 1990s, Washington, DC, 1990; Walter Grunsteidl: An Industrial Policy for Europe, in: European Affairs, Vol. 4, No. 3, 1990, pp. 14-21; Robert Lawrence: How Open Is Japan?, in: Tokyo Club Papers, Vol. 4, No. 2, 1991, pp. 11-38.

³ Cf. special issue of The Antitrust Bulletin, Vol. 35, No. 2, 1990; EC Commission: EEC Competition Policy in the Single Market, Luxembourg 1989.

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regulation of market conduct.⁴ Behaviour which was previously likely to be seen as anti-competitive is now perceived more favourably as part of the dynamic process of competition for the development of new technologies and products. Size is also thought to be less of a problem. Rivalry across national boundaries can help check potential power.

This relaxation in competition rules has been precipitated by developments in the fields of public choice and industrial organisation. Public choice theory showed that attempts to impose detailed rules on firm conduct resulted in the "capture" of the regulators by the regulated industry. Rules were framed in such a way that favoured incumbent firms which had a much better understanding of their industry than competition authorities. Rules on conduct inadvertently created legal barriers to the entry of potential rivals.⁵ Developments in industrial organisations also focused on the effect of entry barriers on the structure of industry and the conduct of firms. High market concentration was found not to lead to monopoly behaviour in "contestable" markets, i.e. with no entry and exit barriers.⁶

Although to date competition policies still ban outright collusion, restrictions on conduct are significantly more relaxed. More attention is now given to the removal of entry barriers. By contrast, as explained in the following sections, trade policy in general, and anti-dumping policy in particular, impose severe restrictions on both conduct and market entry.

Any trade impediment which results in market segmentation has a prima-facie anti-competitive effect. There are, however, instances in which trade policy either has no significant influence on competition or may even promote international competition.

□ First, in markets with many firms or with homogeneous products trade barriers need not generate monopoly rents. In this case the effect of trade barriers is similar to that of different tax rates on products such as oil. As a result, the retail price of petrol varies from country to country, yet this

variation is not an indication that the markets in high-tax, high-price countries are less competitive than those in low-tax, low-price countries.

□ Second, some trade policies impose no outright impediments to trade, even though they may have an indirect impact on trade flows. For example, trade authorities may implement adjustment programmes to help individual firms to recover from a sudden surge in imports. Other trade policies are aimed at promoting particular business activities, such as exports or R&D programmes. These policies may be discriminatory but they may also succeed in encouraging competition in oligopolistic markets (e.g. Airbus) or where there are externalities discouraging firms to invest in projects with long gestation periods.

□ Third, trade policies may explicitly seek the removal of foreign impediments to trade (e.g. reciprocity). Removal of foreign barriers may have a beneficial effect on competition because it stops foreign firms from subsidising their exports with revenue from their protected, home-market, sales. This kind of cross-subsidisation is in some cases a strong deterrent to the entry of new firms in oligopolistic markets. Of course, reciprocity requirements are credible only when they are accompanied by threats for restrictions on foreign products. Even when they succeed in forcing foreign governments to liberalise their markets they may still impose other costs on the economy. For example, the prospect of retaliatory protectionism may discourage otherwise competitive firms from expanding aggressively their market share.

Given that policies which restrict trade and discriminate in favour of particular firms may still have a positive effect

⁴ Cf. D. Armentano: *Antitrust Policy*, Washington, DC, 1986; John Kay et al.: *Privatisation and Regulation*, Oxford 1986.

⁵ Cf. George Stigler: *The Economic Theory of Regulation*, in: *Bell Journal of Economics*, Vol. 2, 1971, pp. 3-21.

⁶ William Baumol et al.: *Contestable Markets and the Theory of Industrial Organisation*, New York 1982.

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on competition, it is imperative to make a distinction between anti-competitive and neutral or pro-competitive policies. In order to make this distinction it is necessary to consider how trade policy affects market structure and the behaviour of firms. That is, the question that needs to be asked is whether trade measures enable firms to reap monopoly rents. For example, voluntary export restraints (VERs) which are estimated to affect about 15% of world trade force foreign governments to allocate quotas to their exporters. This is equivalent to quantity collusion among producers. VERs also enable domestic firms to reap monopoly rents.⁷ Quantitative restrictions on imports, unlike tariffs, allow firms to charge a higher price for any given amount of imports.

Anti-dumping measures encourage collusion and generate monopoly rents because they are inadvertently directed against firms seeking to expand their market share and because they impose price floors that protect incumbent firms. Yet, anti-dumping policies are supposed to prevent practices aimed at subverting competition.

Anti-dumping Policy

Trade authorities usually justify their anti-dumping actions on the grounds that unrestrained imports at abnormally low prices (i.e. below cost or below the home-market price) would wipe out domestic industry and would facilitate the emergence of foreign monopolies. Anti-dumping measures, however, never really restore "normal" prices. I have examined the economic effects of anti-dumping measures in more detail elsewhere.⁸ In this article I only indicate in broad terms why existing anti-dumping regulations are anti-competitive in their objectives, methods and instruments.⁹

Their supposed primary objective is to safeguard "fair" competition. But they deny foreign firms the right to behave in the same way as domestic firms which are free to underprice each other. It is often argued that foreign firms derive an unfair advantage from trade barriers that protect their home markets. (Note that this argument applies only to instances of dumping at prices below home prices. It

cannot by itself apply to dumping below cost in the absence of trade restrictions.) Even if this argument were valid it could not justify existing policies because anti-dumping authorities do not attempt to measure the magnitude of that unfair advantage, nor do they consider possible disadvantages caused by other artificial distortions in the exporters' home market.

Another objective of anti-dumping regulations is to prevent injury caused to domestic firms by dumped imports. In principle, no punitive action is taken against imports unless there is found both dumping and injury. Trade authorities, particularly in the EC, seem to show little or no concern about whether injury is caused to a competitive industry or an oligopolistic industry.¹⁰ If dumping is used as a market entry strategy it is more likely to be resorted to by firms attempting to break into oligopolistic industries in which incumbent firms are already protected by entry barriers of their own creation which need not be illegal. In this case, prevention of injury to incumbent firms further weakens competition.

Some of the methods of enforcing anti-dumping regulations would be inadmissible under many domestic competition laws.¹¹ Trade authorities make arbitrary assumptions about the cost structure of foreign producers. There is secrecy in the calculations of relevant market shares, costs, profit margins etc. Affected foreign producers never learn exactly how injury and dumping margins are determined. In general, proceedings are not transparent, nor are they always economically meaningful.¹²

Punitive action takes the form of either tariff-like duties or price undertakings. Duties allow gains in the production efficiency of foreign exporters to be transmitted through the price mechanism. But trade authorities often insist that foreign firms do not reduce their prices because they believe that they "absorb" levied duties. In effect, that insistence creates an informal price floor. Price undertakings create formal price floors. In either case, competition is weakened.

The question which arises now is whether anti-dumping policy may be justified (i.e. contributes positively either to the domestic economy or to the functioning of a liberal trade system) not in terms of safeguarding competition but on the grounds that it seeks to offset the effect of foreign unfair practices. That is, using competition policy may not

⁷ Cf. Maciej Kostecki: Marketing Strategies and Voluntary Export Restraints, Discussion Paper No. 90-11, École des Hautes Études Commerciales, University of Montreal, September 1990.

⁸ Phedon Nicolaides: The Competition Effects of Dumping, in: *Journal of World Trade*, Vol. 24, No. 5, 1990, pp. 115-131.

⁹ Recent studies have criticised arbitrary and biased anti-dumping actions which have breached the spirit, if not the letter, of relevant GATT provisions. However, these studies do not question why it is thought necessary to retain separate anti-dumping and competition regulations. A preliminary discussion of the intrinsic anti-competitive effects of anti-dumping rules and how they may be made more competition-oriented can be found in Phedon Nicolaides: The Conduct of Anti-dumping Policy, in: *Außenwirtschaft*, Vol. 45, No. 4, 1990, pp. 425-435; and in Phedon Nicolaides: EC Anti-dumping Policy, in: *Tokyo Club Papers*, Vol. 4, No. 1, 1991, pp. 127-149.

¹⁰ Cf. Patrick Messerlin: *Anti-dumping Regulations or Procartel Law?*, mimeo, The World Bank, 1990.

¹¹ Cf. John Jackson and Edwin Vermulst (eds.): *Antidumping Law and Practice*, Ann Arbor 1989.

¹² Cf. Brian Hindley: Dumping and the Far East Trade of the EC, in: *The World Economy*, Vol. 11, No. 4, 1988, pp. 445-463.

be the most efficient way of dealing with unfair or distortionary foreign practices. The rest of this article argues that neither is anti-dumping policy as it is currently pursued.

Non-competition Objectives

Trade authorities may accept that their policies have anti-competitive effects. In this context trade policy is loosely defined as consisting of border restrictions, other market-entry restrictions or public support of individual firms. Indeed it may be argued that the objective of trade policy should be precisely to promote domestic firms at the expense of foreign firms. There are at least six different interpretations of this argument.

- First, countries "should" levy optimum tariffs that exploit their power in international markets (i.e. predatory behaviour).
- Second, countries "should" impose trade restrictions on the products of those countries that refuse to open up their markets (i.e. aggressive reciprocity).
- Third, there "should" be punitive measures against countries that do not follow liberal domestic policies (i.e. fair trade).
- Fourth, some industries are "too important" to be left to the vagaries of international cut-throat competition (i.e. national security).
- Fifth, the economy as a whole "benefits" from either trade restrictions or support programmes for specific industries (i.e. positive externalities).
- Sixth, competition policy, as it is currently applied, may be a third-best instrument for correcting distortions that originate in other countries.

The first five interpretations have already been analysed exhaustively in the literature.¹³ In general, strategic trade policy seeks to promote particular industries or correct particular market distortions or cause the removal of particular foreign obstacles to trade. In principle, strategic policy has well-identified targets. If anti-dumping policy has any strategic pretensions then it has dismally failed because it hardly ever identifies the objectionable foreign practices that are to be eliminated.

It appears that no major study has been undertaken on the question whether trade policy is superior to competition policy in redressing foreign anti-competitive influences on the domestic economy. Nonetheless, there

are several reasons for which competition policy may be thought to be a third-best policy:

- First, if competition policy aims explicitly to offset the effect of particular foreign policies it will need to have extraterritorial jurisdiction. Although both the US anti-trust law and EC competition rules have some extraterritorial application, it has so far been limited. Extraterritoriality is not an objective that has been pursued vigorously. If countries attempt to offset each other's policies the end result may be a negative-sum game whereby no one wins.
- Second, it may be difficult to quantify the magnitude of the unfair advantage that a foreign policy confers. In this sense the task of reciprocity requirements, for example, may be easier because they only seek the removal of certain barriers without attempting to assess their economic effects. Moreover, some policies would be outside the scope of competition rules because they have no direct effect on foreign exports (e.g. Japan's rice restrictions).
- Third, in certain industries the objective of trade policy is to protect the domestic market or open up foreign markets so that domestic firms can grow to an economically efficient size. Even if competition policy could prevent foreign firms from growing through unfair means, it would still not be able to promote directly the growth of domestic firms. Moreover, in the absence of trade measures, competition rules may not be triggered before the domestic market share of national firms shrinks to such a low level as to prevent them from competing effectively in international markets.

These reasons indicate that some trade measures may be justified on the grounds that they preserve future, if not present, competition. In addition, it may be argued that existing competition rules focus too much on the state of national markets and ignore other relevant factors that affect competition as markets are becoming more international, either through trade or investment.

Conclusion

The reasons which make competition policy a third-best instrument also imply that prevailing anti-dumping practice cannot be justified on the grounds that it serves particular strategic objectives. Most anti-dumping actions neither seek the removal of foreign unfair measures, nor are they commensurate with the magnitude of those measures. They do not even identify the foreign measures that enable foreign firms to dump their products abroad. Trade authorities are still left with the task of explaining why they do not use instead the normal provisions of domestic competition policy.

¹³ Cf. Paul Krugman (ed.): *Strategic Trade Policy and the New International Economics*, Cambridge, Mass., 1986; Robert Lawrence and Charles Schultze (eds.), *op. cit.*