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Harald Großmann\*

## Unilateral Action by the EC Against Unfair Trade Practices

*The European Community has a variety of instruments at its disposal to counter unfair trade practices, but there has long been considerable disagreement within the Community as to when and where they should be applied. To what extent would such measures endanger the benefits of international trade? Can any positive effects be expected?*

The world economy has undergone a continual process of integration ever since the end of the Second World War. In the main, this trend is to be welcomed, as it entails an intensification of the international division of labour and increased exploitation of the potential benefits of internalisation and locational advantages. However, the progressive integration of markets also generates additional strains, as comparative advantages depend to a decreasing extent on immutable locational factors or disparities in the national endowment with production factors. In addition to selective interference with the workings of foreign trade, domestic economic measures are increasingly having external side-effects, distorting competition and the structure of the economy not only in the country in which they are taken but in its trading partners as well.

In view of the changed economic circumstances, the question of how to achieve equal and fair competitive conditions has moved to centre stage. A satisfactory permanent solution appears to be possible only within the framework of an international competitive order that protects world trade against the distortions of competition by the state and private restrictions on it.<sup>1</sup> As long as multilateral arrangements are not in prospect, however, there is a temptation for individual states to take unilateral measures in order to impose the rules of "fair" world trade. Trade policy is given the task of countering distortions in competition and ensuring equality of opportunity between domestic and foreign firms.

The Community has a variety of trade policy instruments at its disposal to protect domestic firms against allegedly unfair practices by foreign enterprises and governments. Anti-dumping policy undoubtedly plays the greatest role. Between 1981 and 1990 the EC Commission initiated around 400 investigations, more than 250 of which resulted in the imposition of definitive duties or the acceptance of price undertakings by foreign exporters.<sup>2</sup> On the other hand, the Community only rarely made use of the possibility of imposing countervailing duties on subsidised imports from third countries.<sup>3</sup> The so-called new commercial policy instrument, which is designed to counter other illicit commercial practices by foreign countries that are not covered by the anti-dumping and anti-subsidy regulations but are incompatible with international law or with generally accepted rules, has also been used extremely sparingly so far.<sup>4</sup>

The Community's trade policy instruments have long been the subject of argument within the EC. Hitherto the Council of Ministers has had to decide by a qualified majority on unilateral countervailing and retaliatory measures proposed by the Commission. The Commission

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<sup>1</sup> Cf. C. C. von Weizsäcker and F. Waldenberger: Wettbewerb und strategische Handelspolitik, in: Wirtschaftsdienst, Vol. 72, No. 8, pp. 403-409; and H.-J. Vosgerau: Trade Policy and Competition Policy in Europe. Complementarities and Contradictions, discussion paper, Constance 1993.

<sup>2</sup> EC Commission: Ninth Annual Report of the Commission on the Community's Anti-Dumping and Anti-Subsidy Activities (1990), Brussels 1991.

<sup>3</sup> Only seven anti-subsidy actions were initiated between 1980 and 1991. See EC Commission: The European Community as a world trade partner, in: European Economy, No. 52, 1993, here p. 197.

<sup>4</sup> Cf. F. Schoeneveld: The European Community Reaction to the "Illicit" Commercial Trade Practices of Other Countries, in: Journal of World Trade, Vol. 26, 1992, pp. 17-24.

bemoans the inefficiency of the protracted decision-making procedures. As long ago as June of last year it was therefore proposed to reverse the procedure, so that the Council of Ministers could only oppose a proposal from the Commission by a qualified majority. This transfer of power to the authorities in Brussels found little favour with the member states that are regarded as liberal. France has now made fresh proposals aimed at making EC anti-dumping procedures "more rapid and automatic and less prone to political interference", while also broadening the Community's scope to take unilateral action against unfair trade practices.<sup>5</sup>

### The Community's Anti-dumping Policy

Under Community law, dumping is considered proven if products from a third country are sold in the EC internal market for less than their normal value. In determining the normal value, the EC Commission considers where possible the market price in the exporting country or the country of origin, making adjustments in cases where the characteristics of the exported goods differ from those of the same product in the exporting country. If no comparable product is available, the Community generally takes the estimated production costs plus a "reasonable" profit margin as the basis for calculating the normal value, or the export prices in another third country. Special rules apply to imports from countries with centrally controlled economies.

Even if the EC Commission considers dumping to be proven, an investigation will not necessarily lead to the imposition of anti-dumping duties or the acceptance of price undertakings. For example, no countermeasures are taken if the Commission finds that no industry in the Community has been harmed by the dumping or that it is not in the interests of the Community to take anti-dumping measures. However, between 1981 and 1990 the lack of proof of damage led to the waiving of countermeasures in less than 18% of all cases. Conversely, anti-dumping measures are taken in almost all cases in which EC producers are found to be injured by dumped imports.<sup>6</sup>

As various model-based analyses demonstrate, import dumping in a context of imperfect competition in internationally segmented markets may well have positive

economic effects for the importing country.<sup>7</sup> It is true that the profits of the domestic industry competing with the imports fall, but on the other side of the coin consumers benefit from low prices. These may be households whose real incomes rise as prices fall, but also firms, whose international competitiveness is increased by the purchase of cheap inputs or whose domestic sales rise owing to the positive real income effects. A truly serious threat to the Community may, if at all, come from companies in third countries that want to drive their competitors in the EC out of the market so that they can then abuse their dominant market position to raise prices.

Such "predatory" dumping is rather unlikely, however. For one thing, the attacking foreign firm must fear that sound EC suppliers will be able to withstand price wars for an extended period. It must also contend with the possibility that the attempt to offset initial losses or reductions in profits by raising prices later will attract new competitors or enable the return of suppliers previously driven from the market.<sup>8</sup> "Predatory" dumping is essentially a problem of information that can be overcome more effectively by improving the state of information than by erecting trade barriers.<sup>9</sup> However, caution must be exercised if dumping occurs in connection with subsidies and barriers to market entry.

In practice, it is extremely difficult to prove that economically damaging dumping strategies are being pursued, as it is almost impossible to forecast in detail what market results can be expected. For this reason alone, there cannot be an optimum anti-dumping policy. Because of their very approach, the criteria applied by the EC Commission are incapable of drawing a dividing line between harmful and harmless dumping, as they place the emphasis on the protection of domestic competitors but ignore the effects of dumping on competition itself, i.e. the benefits to European consumers and/or downstream industries. The situation is further complicated by the fact that the Commission's method of calculation overestimates dumping margins.<sup>10</sup> As a result, investigations seldom conclude that dumping has not taken place.<sup>11</sup>

<sup>5</sup> D. Buchan: Paris to wheel out big trade guns for EC, in: *Financial Times* of 22.7.1993, p. 5.

<sup>6</sup> EC Commission: Ninth Annual Report, op. cit.

<sup>7</sup> See for example J. A. Brander and P. R. Krugman: A "Reciprocal Dumping" Model of International Trade, in: *Journal of International Economics*, Vol. 15, 1983, pp. 313-321.

<sup>8</sup> Cf. L. Philips: *The Economics of Imperfect Information*, Cambridge University Press 1988, pp. 197 ff.

<sup>9</sup> For example, Selten shows convincingly that predatory pricing is an irrational strategy in a world of enterprises with an infinite planning horizon and which are perfectly informed at all times about the actions of their competitors. See R. Selten: The Chain Store Paradox, in: *Theory and Decision*, Vol. 9, 1978, pp. 127-159.

<sup>10</sup> The biases of EC anti-dumping law are documented by C. Norall: New Trends in Anti-dumping Practice in Brussels, in: *The World Economy*, Vol. 9, 1986, pp. 97-111; and B. Hindley: Dumping and the Far East Trade of the European Community, in: *The World Economy*, Vol. 11, 1988, pp. 445-464.

<sup>11</sup> Between 1981 and 1990 this occurred in only about 3% of the investigations begun during the same period. See EC Commission: Ninth Annual Report, op. cit.

The greater the protection afforded by economically unjustified or excessive anti-dumping measures, the greater the associated threat to competition, for only if it is possible to keep potential competitors out of the market can firms exercise market power and do cartels have a chance of long-term survival. It is disturbing that more than 20% of the investigations initiated in the eighties under Articles 85 and 86 of the EEC Treaty, which relate to concerted action between firms and abuse of a dominant position respectively, involved products that were also the subject of anti-dumping actions. Similarly, around one-quarter of the anti-dumping investigations begun between 1980 and 1989 related to products manufactured by Community firms against which anti-cartel proceedings were brought.<sup>12</sup>

#### Costs of Wrong Decisions

A few efficient exporters from third countries, particularly from Japan, tried to get round the anti-dumping provisions by transferring the final assembly of their products to the Community or by channelling exports

via other non-Community countries. In order to prevent the circumvention of protection measures by means of superficial transfers of production, in 1988 the Community added a new paragraph 10 to Article 13 of its anti-dumping and anti-subsidy Regulation of 23rd July 1984 so that anti-dumping measures could be extended to so-called "screwdriver" plants.<sup>13</sup> There can be little objection to tightening justified defensive measures, but regulations to prevent circumvention reinforce protection and magnify its detrimental effects where punitive customs duties or price undertakings are economically unfounded or excessive.

A study by Messerlin and Noguchi<sup>14</sup> into the anti-

<sup>12</sup> P. A. Messerlin: Anti-dumping Regulations or Pro-cartel Law? The EC Chemical Cases, in: *The World Economy*, Vol. 13, 1990, pp. 465-492.

<sup>13</sup> Council Regulation (EEC) No. 2423/88 of 11th July 1988 on protection against dumped or subsidised imports from countries not members of the European Economic Community, in: OJ L 209 of 2.8.1988.

<sup>14</sup> P. A. Messerlin and Y. Noguchi: *The EC Antidumping and Anticircumvention Regulations; A Costly Yet Futile Exercise. The Case of the Photocopier*, 1991.

Roger Blanpain/Tadashi Hanami (Eds.)

## Industrial Relations and Human Resource Management in Japanese Enterprises in Europe

Belgium, France, Germany, Italy, The Netherlands and The United Kingdom

In this book, the authors, leading academics from Japan and 6 EC-Member States, look particularly at the industrial relations and human resource management practices in Japanese subsidiaries in Western European countries. This was done not only on the basis of desk studies, but also and especially by way of interviewing local actors, local management and representatives of employees. In order to be as comprehensive and representative as possible they wanted the study: 1) to focus as much as possible on subsidiaries of Japanese multinational enterprises, which operate in most if not all of the countries under review: Belgium, France, Germany, Italy, the Netherlands and the United Kingdom, 2) to pay attention to the manufacturing as well as the service industries. They also envisaged examining whether and in what way Japanese management adapted to local practices in the host countries, and whether it introduced Japanese practices into the European subsidiaries and if so, which ones.

This research is in fact the first attempt of a group of scholars to penetrate in the world of Japanese business in Europe.

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dumping proceedings against imports of Japanese photocopiers illustrates the costs of wrong anti-dumping decisions. The anti-dumping and anti-circumvention measures cost European consumers a total of about 422 million ECU a year, twice the value of the annual output of the four companies described by the Commission as the Community photocopier industry. The benefit derived from the protection measures was absolutely nil. Indeed, the complaining firms increasingly became distributors of Japanese-made photocopiers. There was not even the hint of an attempt to close the gap with the Japanese competitors by investing in research and development.

### **Countervailing Measures against Subsidies**

There is relatively little danger that companies themselves will be in a position to limit competition effectively by pursuing dumping strategies; the greater fear is that international trade will be impaired by state interference. Subsidies are one of the state's favourite means of exerting influence. If foreign producers are being assisted by their governments, the same symptoms as occur with dumping will often appear. For example, production subsidies may mean that neither the domestic nor export prices of a product cover the average production costs. Moreover, export subsidies give the firm an incentive to engage in international price discrimination. In such circumstances, it is quite possible that the EC will resort to anti-dumping measures to ward off subsidised imports.

Subsidies that increase exports to a higher level than would be the case if competition were not impeded not only frequently cause producers in third countries to adopt pricing behaviour similar to that of dumping, they also have many similarities as regards their macro-economic consequences. The beneficiaries of subsidised imports – at least in static terms – are again European consumers, while the competitive pressure on EC industries competing with imports intensifies. As in the case of dumping imports, it can be very tempting for the Community simply to accept foreign subsidies as a gift and not to impose countervailing duties. On the other hand, it cannot be ruled out that foreign subsidies will harm the domestic economy, particularly if they help establish or consolidate market dominance by foreign manufacturers.

The crucial difference between corporate dumping strategies and state subsidies is that politicians and bureaucrats do not have to bear the financial consequences of their mistakes. If the electorate sees the

promotion of particular industries as responsible action on the part of politicians, their chances of re-election even improve. At the same time, the administrative machinery gains respect, influence and power with "its" clientele. Foreign producers who pursue dumping strategies, on the other hand, must fear being driven out of the market. To that extent, countervailing EC duties against foreign subsidies are more justified than punitive duties or forced price undertakings to ward off corporate dumping. The EC could also find it difficult to foster behaviour consistent with competition in member states if it were seen to tolerate discrimination against domestic firms.<sup>15</sup>

### **Lack of Transparency**

Subsidies are not always used to promote or protect companies. Foreign subsidies that offset market imperfections or correct distortions in competition can be justified on the grounds of allocation theory. Research promotion is a frequently cited example of economically acceptable subsidies. If the macro-economic benefit of new technology is higher than the micro-economic yield, the state can ensure a desirably high level of research by creating financial incentives for those who generate positive externalities. Foreign subsidies paid on environmental grounds can be justified in a similar way. The possibility that industrial policy interests may sometimes gain the upper hand can certainly not be excluded, however, as is also the case with subsidies motivated by considerations of income distribution or security. The Community is therefore faced with the difficult question as to the extent to which possible distortions of competition are unavoidable if third countries are to achieve their objectives.

The lack of transparency in the granting of subsidies makes it as difficult to identify inappropriate foreign subsidies as it is to formulate countermeasures. Subsidies comprise a whole range of activities, from financial grants and tax concessions, via loans on preferential terms and capital investments that would not be made by private investors, to excessive prices paid in the field of public procurement and many other hidden measures. In view of the confusing multitude of possible forms that subsidies can take, it is hardly surprising that Community law does not define the concept of subsidy but merely indicates some characteristics which may give cause for imposing a countervailing duty.

### **Protection of Intellectual Property**

In order to be able to combat effectively other illicit commercial practices the new commercial policy instrument was added to the Community's armoury in

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<sup>15</sup> Cf. J. Bhagwati: *Geschützte Märkte*, Frankfurt 1990, here pp. 38 f.

1984.<sup>16</sup> Council Regulation 2641/84 provides in particular for the suspension or withdrawal of liberalisation measures, the raising of existing customs duties and the introduction of quantitative restrictions in response to illicit commercial practices by foreign countries. The yardstick for assessing the behaviour of third countries consists essentially in the provisions of the GATT, the codes based on the GATT and other international agreements. Regulation 2641/84 gave companies a direct right to apply for countermeasures but did not extend the Community's powers over trade policy.

The Community has made only sporadic use of its new commercial policy instrument so far. Almost all cases have involved disputes with third countries over the protection of intellectual property. New products and improved production processes do not fall like manna from heaven but are generally the result of costly research. Intellectual property rights create the necessary incentive to invest in research and development by giving the inventor or the researching company the exclusive right to exploit the innovation for a specified period. On growth grounds, the Community tends to advocate the establishment of high material standards, whereas less developed countries often set more value on the rapid spread of new technical knowledge.

As inadequate protection for intellectual property rights in third countries could undermine research efforts in the Community in a situation of free trade, trade countermeasures can legitimately be discussed in this context. It must not be forgotten that higher standards not only bring advantages but also entail costs; nevertheless, it appears necessary to defend certain minimum standards. The resulting threat to international trade could be reduced if the Uruguay Round were concluded. The draft agreement contains provisions that go much further than existing international treaties on the protection of intellectual property and also set out detailed instructions for the issue of implementing regulations at national level. It is also planned to give the supervisory function to GATT. It could then hear complaints from contracting parties and where appropriate even permit them to impose sanctions that went beyond the sector involved.

### Complaints about Social Dumping

The French complain that the countries of the Third World and the former Eastern bloc in particular would not rely primarily on their comparative advantages but would

establish their position in European markets only by means of deliberate environmental and social dumping. The public debate revolves around the fear that increased imports from third countries whose environmental regulations, working conditions or wages are far below the EC level would squeeze out Community products. It is therefore argued that the danger of a rise in unemployment must be met by taking trade protection measures, as otherwise the Community's high environmental and social standards could not be maintained.

It is true that above-average social standards in the Community entail cost and locational disadvantages for domestic industry, which may lead to the transfer of some manufacturing activities to cheaper third countries. This is undoubtedly a danger in industries where uniform technology is used to produce standardised, internationally tradable goods. In these circumstances, international competitiveness comes down solely to a question of labour costs. It would be a mistake, however, to see the erection of trade barriers as an appropriate permanent means of defending high social standards. In order to ensure long-term prosperity, the Community should not cling on to the manufacture of products that can be made more cheaply in third countries but should instead turn to the manufacture of higher-value goods.

The complaints about social dumping have essentially nothing to do with unfair trade practices. Differences in wages and working conditions are not distortions of competition, but are usually the result of international disparities in labour productivity. The exploitation of locational advantages arising from more favourable wage and other labour costs, including other social expenditure, is a legitimate part of locational competition. One is doing third countries no service by forcing them to bring their working conditions up to the EC level. Raising minimum standards may reduce the scope for higher wages, create unemployment and thus make it more difficult for underdeveloped countries to catch up. It therefore makes no sense to try to require third countries to adopt working conditions, wages or even social benefits on a par with those in the Community.

### Environmental Dumping

The situation is similar with regard to environmental protection, provided cross-border environmental damage is not involved. It is completely in accordance with the principles of the international division of labour for goods to be produced where the necessary factors of production are particularly abundant. In those circumstances it is not a disadvantage if production activities with a heavy environmental impact move elsewhere; instead, it creates the necessary conditions for improved environmental

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<sup>16</sup> Council Regulation (EEC) No. 2641/84 of 17th September 1984 on the strengthening of the common commercial policy with regard in particular to protection against illicit commercial practices, in: OJ L 252 of 20.9.84.

quality in the Community. Trade restrictions against third countries would run counter to the Community's own environmental objective in this situation.<sup>17</sup>

In contrast to purely local environmental problems, the solution of global problems requires a minimum harmonisation of environmental standards at international level. If environmental damage spreads beyond national frontiers, it is quite feasible that pollution levels in the Community will not decrease even if above-average environmental standards are introduced. In this case, trade restrictions may prove to be an appropriate economic measure to reduce the incentive for third countries to profit as free-riders from the Community's stringent environmental policy.

The EC could also take trade sanctions to induce third countries to open up their markets. If one accepts the validity of traditional foreign trade theory, it would be in countries' own interest to refrain from imposing trade restrictions, as in this way they could increase their own prosperity and at the same time create an incentive for other countries to follow their example. If one steps out of the ideal world of traditional trade theory, welfare gains as a result of trade and industrial policy interventions do not seem quite such an aberration.

In fact, however, the new foreign trade theory not so much justifies protectionist measures as explains why they are introduced. Politicians clearly overestimate their ability to increase prosperity and raise living standards by interfering with trade. An alternative explanation for the existence of measures in restraint of trade is provided by the political economy of protection, whereby policy-makers are not motivated exclusively by economic interests.

### **Opening-up of Third-country Markets**

The strategy of aggressive measures to bring about the opening-up of third-country markets entails high risks, as the Community itself would benefit if it did not impose trade sanctions. It is true that even greater welfare gains could be achieved if other countries were also prepared to reduce restrictions on market access; whether trade sanctions are the appropriate key to unlock third-country markets depends essentially on the way in which politicians assess the economic and political consequences.

For various reasons, third countries could therefore categorically refuse to reduce restrictions on market

access despite the imposition of trade sanctions by the Community, and might even resort to countermeasures to force the EC to back down, thereby triggering an escalation of retaliatory measures. Aggressive action to force the opening-up of foreign markets might, however, be successful against countries whose governments were too weak on their own to force through liberalisation against the opposition of interest groups at home.

### **Conclusions**

Unilateral countermeasures by the Community aimed at neutralising the harmful effects of foreign trade practices or persuading foreign companies and governments not to take or maintain measures that harm or distort competition are essentially acceptable on economic grounds. Ideally, this would preserve efficient resource allocation, as the direction and scale of trade remain unchanged. In many cases, however, it will not be possible to determine the precise scale of competitive distortion and certainly not to eliminate its harmful effects by means of countervailing measures or retaliatory action. Instead, there is a danger that the attempt to establish equality of opportunity will further impede competition and the international division of labour.

Just identifying trade practices that distort competition is extremely difficult. For that reason, economic policy-makers are usually forced to take countermeasures even if companies have got into trouble owing to their own shortcomings. In a deliberate perversion of the economic principle that the exploitation of the advantages of locational differences enhances national and international prosperity, the only form of "competition" advocated is that conducted on equal terms. Given a level playing field, so the theory goes, our industry will compete with any in the world.

In order to prevent the argument of the absence of equal opportunity being used as a pretext for sealing off the EC internal market, unilateral Community countermeasures should be used only in the few exceptional cases in which interference with trade by foreign governments or deviations from internationally recognised regulatory standards have clearly had negative economic consequences. It is hardly feasible to lay down general codes of conduct, however. The transfer of powers of decision to the EC Commission will not solve the problems, but only make it easier for protectionist interests to have their way. The swift handling of proceedings is undoubtedly desirable, but not at the cost of the necessary care. To that extent, the EC's sluggish mechanism for taking decisions on trade matters has a positive side, in that it reduces the danger of hasty reaction to trade disputes.

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<sup>17</sup> Cf. H. Siebert: *International Aspects of Environmental Allocation*, in: H. Siebert (ed.): *Environmental Scarcity: The International Dimension*, Tübingen 1991, pp. 1-14.