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Snipings

The rubric 'Snipings' is intended for contributions which, while rigorous, are shorter and therefore less extensively developed and documented than our standard length articles. This offers, among other things, an opportunity for early analyses targeting topical policy issues affecting the multilateral trading system. Submissions – which should be in the 1,500 to 4,500 word range – are reviewed by independent referees.

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CONGRESSIONAL BUDGET OFFICE
U.S. Congress
Washington, DC 20515

Douglas Holtz-Eakin, Director

March 2, 2004

Honorable Bill Thomas
Chairman
Committee on Ways and Means
U. S. House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

This letter and attachment are provided in response to your request of February 12, 2004, for an economic analysis of the Continued Dumping and Subsidy Offset Act of 2000 (Public Law 106-387), focusing on how that act benefits, harms, or distorts economic activity in the United States.

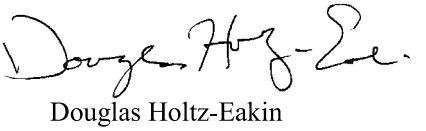
Although it is not possible to provide a precise estimate of the effects of antidumping and countervailing duties on the economy, it is generally acknowledged that whatever gains might occur in terms of perceptions of the fairness of trade come at a cost in terms of lower output for the economy as a whole and lower overall economic well-being of the citizenry. The Continued Dumping and Subsidy Offset Act of 2000 increases that cost by providing incentives for more U.S. businesses to pursue more antidumping and subsidy complaints.

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The law subsidizes the output of some firms at the expense of others, leading to inefficient use of capital, labor, and other resources of the economy. It discourages settlement of cases by U.S. firms and will lead to increased expenditure of economic resources on administration, legal representation of parties, and various other costs associated with the operation of the antidumping and countervailing-duty laws. To the extent that other countries adopt comparable policies, the law may lead to further interference in the ability of U.S. exporters to compete in the global trading system. Finally, the World Trade Organization (WTO) Appellate Body has ruled that the act violates the WTO agreement, leaving the United States vulnerable to retaliation against its exports, although the amount of that retaliation has not yet been determined.

I hope the attached discussion is helpful to you. If you have any questions or concerns, please contact me (226-2700) or Roger Hitchner, the Assistant Director for Microeconomic and Financial Studies at (226-2940).

Sincerely,



Douglas Holtz-Eakin
Director

Attachment

cc: Charles B. Rangel
Ranking Minority Member

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Economic Analysis of The Continued Dumping and Subsidy Offset Act of 2000

Introduction

The Continued Dumping and Subsidy Offset Act (CDSOA) of 2000 was enacted on October 28, 2000, as part of the appropriations act for Agriculture, Rural Development, Food and Drug Administration, and Related Agencies programs for the fiscal year ending September 30, 2001. CDSOA requires that the revenues from antidumping and countervailing duties on a given import be distributed on an annual basis to the domestic producers that were either petitioners or interested parties supporting the petition in the case that resulted in the duties being levied on that import. Under CDSOA, $231 million in duty revenues was distributed in 2001, $330 million in 2002, and $293 million in 2003.[1] The Congressional Budget Office (CBO) projects that distributions will total $3.85 billion from 2005 through 2014. On June 16, 2003, the World Trade Organization (WTO) Appellate Body agreed with the ruling of an earlier panel that CDSOA violates the WTO agreement by providing remedies for dumping and subsidies beyond those permitted by the agreement. The United States is therefore vulnerable to retaliation—the amount has not yet been determined—if it does not repeal or modify the law.

In addition to the prospect of foreign retaliation against U.S. exports, the distributions mandated by CDSOA are detrimental to the overall economic welfare of the United States because (1) they encourage the filing of more antidumping and countervailing-duty cases, resulting in more duties that on balance harm the economy; (2) they subsidize the firms receiving them, preventing resources from flowing to higher-value activities in other firms and industries; and (3) they increase the private and public cost associated with the operation and implementation of the laws. They also discourage settlement of cases by U.S. firms, which has mixed effects on the economy.

Antidumping and Countervailing-Duty Laws and Their Effects

The antidumping and countervailing-duty (AD/CVD) laws provide for the imposition of duties on imports to offset the effects of certain practices of foreign

1. All years referred to in this analysis are federal fiscal years. CDSOA distributions for 2001 and 2002 are from the Web site of the U.S. Bureau of Customs and Border Protection. The distribution for 2003 is from the appendix of the President's *Budget of the United States Government, Fiscal Year 2005*.

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producers and governments that are considered by some people to be unfair—the antidumping law for imports that are priced too low, and the countervailing-duty law for imports that have been subsidized.[2]

The antidumping law effectively provides for duties on imports sold at prices that are lower than either the price of the same good in the producer's home market or the cost of production (including a minimum rate of profit), whichever is higher.[3] Duties are imposed if the imports cause "material injury" (a low standard of injury) to the competing domestic industry. The duty rate is set equal to the percentage by which the import price is below the home-market price or cost, whichever pertains.

Countervailing-duty law provides for imposing duties on imports that have been subsidized by their producer's government.[4] For most such imports, duties are imposed if the subsidized imports cause material injury to the U.S. industry producing a like product. The duty rates are set equal to the rate of subsidy by the foreign government. In the rare cases in which the foreign subsidies at issue are part of a predatory pricing scheme—that is, the practice of selling a product or service at a loss to drive competitors out of the market with the ultimate objective of raising prices and capturing higher profits—countervailing duties can be beneficial to the economy, but in most cases they are harmful. Nevertheless, many people support countervailing-duty law because they view subsidized imports as unfair competition for domestic producers and their employees.

Antidumping law originated nearly a century ago out of concern about predatory pricing. Successful predatory pricing, whether of imports or domestically produced goods, is harmful to competition and thereby to the efficiency and productivity of the economy. However, the pricing behaviors addressed by antidumping law have expanded considerably over time: few dumping cases today involve predatory pricing, and the law makes no attempt to restrict duties to such cases. For the most part, the pricing practices that antidumping law currently addresses are neither unfair nor outside of the normal practices of foreign and domestic businesses alike. Sales by foreign sellers in the United States at prices below those at which the good is sold in the home market are an example of "price discrimination." Price discrimination—the practice of charging different customers different prices that do not reflect differences in the cost of providing

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2. See Congressional Budget Office, *How the GATT Affects U.S. Antidumping and Countervailing-Duty Policy* (September 1994) for a detailed exposition of the history, rationale, and economic effects of U.S. antidumping and countervailing-duty laws.

3. Many other countries have similar laws, which may be acceptable to the WTO if carefully drafted.

4. Again, many other countries have similar laws, and when properly constructed they are legal under the WTO.

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the product—by domestic firms in the U.S. market is common. Sales below cost—the other target of the antidumping law—are also normal occurrences. Common examples are loss leaders intended to get customers into stores in hopes that they will purchase more expensive products and the liquidation of excess inventories accumulated because a seller overestimates demand for a product and sells it at a loss to receive at least some revenue.

Antidumping and countervailing duties raise the cost to U.S. firms and consumers of obtaining the products in question. To the extent that the duties drive imports from the market and cause increased production by the competing domestic industry, advocates of these policies point to an economic gain. However, those direct effects are only part of the story. As a general rule, the domestic resources (capital, labor, land, and so forth) used by the domestic industry to produce that increased output would have, in the absence of the duties, been used to produce other products or services with a higher value.[5] On balance, the net effect of the AD/CVD laws is to steer resources from higher-value to lower-value uses. Measured broadly, the policies are harmful to overall U.S. economic well-being.

Use of the Antidumping and Countervailing-Duty Laws

At the beginning of 2000—the year in which CDSOA was passed—the United States was among the most aggressive users of antidumping and countervailing-duty laws in the world.[6] At that time, it maintained 267 AD/CVD orders, the most of any country. The European Union (EU), in second place, maintained 148. From 1995 through 1999, the United States initiated an average of 26.4 antidumping cases per year, putting it behind the EU with 38.8 and South Africa with 27.0. The United States imposed an average of 16.4 new antidumping orders annually over those years, putting it behind the EU. The prominence of the AD/CVD laws as tools of U.S. trade policy can be explained by the ease with which domestic petitioners can bring actions against importers (foreign exports) in U.S. administrative procedures to burden foreign competitors with a duty.

Historically, the largest user of the AD/CVD laws has been the steel industry. Currently there are 131 active antidumping orders relating to iron and steel mill products, 30 relating to iron and steel pipe products, and 30 relating to other iron

5. On balance, the evidence supports that general proposition for the long term. However, some workers who have lost their jobs to import competition might take a considerable length of time to find new employment (and they may suffer permanent loss of value of industry-specific skills), and some of the capital of an industry that has shrunk because of import competition might be usable only by that industry and not transferable to another industry.

6. See Congressional Budget Office, *Antidumping Action in the United States and Around the World: An Analysis of International Data* (June 1998), and *Antidumping Action in the United States and Around the World: An Update* (June 2001).

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and steel products. Other industries receiving significant protection are chemicals and pharmaceuticals with 55 orders and agriculture, forest, and processed food products with 32 orders.[7]

CDSOA allows firms that have filed or supported successful petitions for relief under the AD/CVD laws to receive distributions of the revenues each year from the resulting duties. CBO projects that federal receipts of antidumping and countervailing duties will total $2.35 billion from 2005 through 2009 and $3.85 billion from 2005 through 2014 (see Table 1). In line with AD/CVD receipts but lagged by one year, CBO projects that distributions under CDSOA will total $2.35 billion from 2005 through 2009 and $3.85 billion from 2005 through 2014.[8]

Table 1.
Projections of AD/CVD Receipts and CDSOA Distributions
(Millions of Dollars)

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2005-2009	2005-2014
Receipts	300	1,150	300	300	300	300	300	300	300	300	300	2,350	3,850
CDSOA Distributions													
Budget authority	300	1,150	300	300	300	300	300	300	300	300	300	2,350	3,850
Outlays	300	300	1,150	300	300	300	300	300	300	300	300	2,350	3,850

Source: Congressional Budget Office.

7. These numbers are based on the classifications in a listing of orders on the Web site of the U.S. International Trade Commission, except that orders relating to ball bearings and spherical plain bearings are excluded from the total for other iron and steel products.

8. There is a lag of one fiscal year between the receipt of antidumping and countervailing duties and their distribution under CDSOA. Hence, outlays lag receipts by one year. Budget authority is considered to occur when the receipts occur. CBO's projections of CDSOA distributions differ from those in the President's budget. CBO projects distributions that are somewhat larger and at later dates than those projected by the Office of Management and Budget.

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The Effects of CDSOA

The Continued Dumping and Subsidy Offset Act of 2000 can be expected to result in more antidumping and countervailing-duty petitions and more support for those petitions by import-competing industries. That, in turn, would lead to the initiation of more AD/CVD cases, the imposition of more duties, and greater consequent harm to the economy as a whole.

Encouragement of More Antidumping Cases

CDSOA encourages more firms to file or support antidumping cases. The linkage of payments to support for a case is a direct incentive. The Uruguay Round agreement requires that AD/CVD administrative authorities verify that an application for initiation of an investigation is supported by at least 50 percent of the industry (as measured by production) that expresses an opinion and at least 25 percent of the total industry. This requirement is intended to deter the initiation of frivolous cases, which are very expensive for the foreign firms under investigation. CDSOA, by making distribution of duty revenues contingent on whether a firm supported the AD/CVD case in question, makes it more likely that 50 percent of the firms expressing an opinion and 25 percent of the total industry will support an application for initiation of an investigation, thereby causing more cases to be initiated.

Encouragement of Inefficient Production

Domestic firms that have ceased producing a good since an AD/CVD protection was granted in the past might resume production to receive the distribution.[9] A firm can receive distributions of duties only if it is in business producing the good in question in the United States. The fact that the company ceased production after the duty was imposed suggests that it was not as competitive a producer as the other firms in the market. A firm that returns to production, therefore, may inefficiently employ capital, labor, land, and other resources that would be more productively employed in producing other goods or services.

Firms that have not ceased production are encouraged by the distributions to increase their output beyond the levels signaled by market incentives. CDSOA stipulates that "[t]he distributions shall be made on a pro rata basis based on new and remaining qualifying expenditures," where qualifying expenditures consist of expenditures on manufacturing facilities; equipment; research and development; personnel training; acquisition of technology; health care benefits to employees

9. That has happened in at least one case. See Neil King Jr., "Trade Imbalance: Why Uncle Sam Wrote a Big Check to a Sparkler Maker—A New Dumping Law Sends Tariff Proceeds to Firms that Filed the Complaint—Break with International Law," *Wall Street Journal*, December 5, 2002.

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paid for by the employer; pension benefits to employees paid for by the employer; environmental equipment, training, or technology; acquisition of raw materials and other inputs; and working capital or other funds needed to maintain production. Many of these expenditures vary with the scale of production. The effect of CDSOA is to subsidize the perceived cost of production by domestic firms.

The typical firm increases its production until there is no further gain. To produce more would result in costs higher than revenues on the additional output. To produce less would mean foregone profits on the output not produced since the price is greater than the cost of that output. Under CDSOA, the firm sees a lower cost than the true cost to the economy of its output. As a result, the firm increases its output beyond the point where the unsubsidized cost to the firm—and thus to the economy—is balanced by the price. Since the price or value is less than the cost to the economy of that additional output, the economic welfare of the country is reduced.

If not all competing domestic firms receive the subsidy (because they did not support the AD/CVD petition), there is a detrimental impact on the composition of the industry. Any increased output by the subsidized firms may drive down the market price, leading unsubsidized firms to cut back their operations—a loss of unsubsidized production that met the market test. Thus, the overall net effect of the distributions mandated by CDSOA is to cause the firms receiving the distributions to produce output at greater cost than it is worth and to cause domestic firms that do not receive the distributions to restrict output that would be worth more than its cost of production. Consequently, U.S. gross domestic product and gross national product decline.

These effects are exacerbated by the fact that the revenues from duties imposed before CDSOA was enacted are likely to be distributed disproportionately to firms that are less efficient in the affected industries. CDSOA is retroactive in the sense that it applies to current receipts from duties imposed in cases filed, investigated, and adjudicated before CDSOA was enacted. Since the enactment of CDSOA, firms know that they must support an AD/CVD case if they are to receive distributions of the duty revenues resulting from the case. Before CDSOA, however, firms and industries that were efficient and profitable had less incentive to seek protection from foreign competition and pay the costs of filing an AD/CVD case. Such cases tended to be filed by firms and industries that were less efficient—the very firms that receive offset payments from duties put in place before CDSOA. As a result, the firms whose output is subsidized and thereby increased by CDSOA are disproportionately those that are less efficient than other firms in their industries, and the firms whose outputs decline because of the

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resulting fall in price are disproportionately the more efficient firms of their industries.

Retaliation by U.S. Trading Partners

As noted above, the WTO has ruled that CDSOA violates the Uruguay Round agreement. Therefore, U.S. trading partners will eventually be allowed to retaliate against U.S. exports if CDSOA is not repealed or modified (unless the United States succeeds in negotiating a settlement with the complaining countries, which undoubtedly would require trade concessions on the part of the United States). In late January of this year, the United States asked for a WTO arbitrator to settle a dispute over the extent of the retaliation that will be allowed. Retaliatory duties imposed against U.S. exporters will cause additional harm to the U.S. economy beyond that stemming directly from the distributions mandated by the law.

Discouragement of the Settling of Cases

AD/CVD cases are sometimes settled by suspension agreements—in which the foreign exporter(s) agree to limit their exports to the United States of the product in question, or perhaps to keep their sale price of the good above a certain level—in lieu of an investigation and imposition of duties. With CDSOA, U.S. firms have a strong incentive not to agree to such settlements because with an investigation and imposition of duties, they will receive distributions of the duty revenues in addition to protection from the foreign competition, whereas with a suspension agreement they would receive only the protection from competition. Whether this effect is good or bad for the U.S. economy is unclear. Antidumping duties often are so high that they effectively force the foreign firm(s) out of the U.S. market, whereas with suspension agreements they usually remain in the market, which is good for the economy. However, any restriction on trade results in so-called rents, which are the increase in the price of the import as seen by domestic purchasers (which includes any tariffs) multiplied by the quantity of the good still imported after the restriction is put in place. With duties, the rent goes to the U.S. government in the form of the duty revenues. With suspension agreements, the rent remains with the foreign producer in the form of higher prices for its goods.

Increased Transactions Costs

From the perspective of the whole economy, the resources necessary to pursue a successful antidumping or countervailing-duty petition—that is, the cost of lawyers, economists, and lobbyists—are transaction costs that add to the social cost of the laws. By increasing the incentives for firms to file and pursue

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antidumping petitions and by adding similar costs associated with implementing the distribution of duty revenues, CDSOA increases those social costs.

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