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**Working Group on the Interaction
between Trade and Competition Policy**

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The Impact of Trade Policy on Competition

I. INTRODUCTION

Both trade law, which regulates trade policy, and competition law, which regulates competition policy, have, despite some different perspectives, a common core objective: to maximize economic welfare by improving the efficiency with which resources are allocated. However, as we have pointed out in previous meetings, we notice that these two laws have complementary effects, as well as contradictory effects. As long as this Working Group deals with the interaction between trade and competition policy, it should address the contradictory effects of trade and competition policy, especially the anti-competitive effects caused by trade measures on market competition. The objective should be to introduce a pro-competitive view into trade measures. We would, therefore, like to explain the contradictory effects of trade measures more concretely, and then discuss the anti-competitive view of anti-dumping.

Some trade laws such as the Anti-dumping Agreement and the Safeguards Agreement of the WTO justify government measures to protect domestic firms from allegedly unfair pricing and a sharp increase in imports. Since trade-restrictive border measures are generally prohibited, these trade measures are recognized as temporary exceptions from the principles of free trade. Since these laws are not concerned with effect on competition, they are often used as justification for imposing economically inefficient trade measures, and their inadequate (e.g., prolonged and/or frequent) application results in the protection of an inefficient domestic industry. We discuss below some cases in which either a national competition authority or a party recognized that in applying (or even considering) trade measures, especially anti-dumping measures, the resulting measures were anti-competitive.

Dynamic Random Access Memory Semiconductors (DRAMs) of 256 Kilobits and Above from Japan (1986)

The US Department of Commerce (DOC) self-initiated this anti-dumping investigation. The US Federal Trade Commission (FTC) submitted a report to the DOC stating that the home market of Japan was competitive and not susceptible to predatory practices. It further stated that prices charged by Japanese producers would permit the recovery of all costs within a reasonable period of time in the

normal course of trade. These points were not accepted by trade authorities, however, and the investigation was concluded with price undertakings.

Truck Trailer Axle and Brake Assemblies and Parts from Hungary (1982)

The US Department of Justice (DOJ) submitted a statement to the US International Trade Commission asserting that the US market was highly concentrated, with a single company in a dominant position. The DOJ contended that competition in the domestic market would deteriorate if anti-dumping duties were imposed, eliminating imports. Finally, in exchange for certain promises made by the exporter, the dumping investigation was halted.

Glycine from Japan (1985)

A major European Community user and the two Japanese producers argued that an anti-dumping duty on glycine from Japan would enable the largest Community producer either to raise its prices of glycine unreasonably in a market with essentially only three suppliers or to undercut Japanese prices so severely that the Japanese product would disappear from the market. This concern did not deter imposition of anti-dumping measures.

When a firm or small group of firms possesses "market power" in a domestic market, anti-dumping measures can be used by the firm or firms (and its government) as a strategic tool to restrain or eliminate competition in the market. Two examples of such anti-competitive behaviour have been provided: one is to use anti-dumping measures as a tool to facilitate cooperative price setting by domestic and foreign firms; the other is to use anti-dumping measures in order to exclude competitors and monopolize the domestic market.

II. ANTI-DUMPING LAW AND COMPETITION LAW

(1) Objective of Anti-Dumping Law and Competition Law

Both competition law and anti-dumping law are concerned with predatory pricing. While competition law seeks to eliminate predatory pricing in domestic trade, anti-dumping law addresses such pricing in international trade.¹ However, despite the identical objective of these two laws, they protect different objects, with anti-dumping law protecting competitors while competition law protects competition. Consequently, they are implemented in significantly different ways, leading to unnecessarily stronger protection for companies against foreign competitors than against domestic competitors.

(2) Differences in Predatory Pricing between the US Competition Law and the US Anti-Dumping Law

Predatory Pricing under the US Competition Law

Section 2 of the Sherman Act regulates predatory pricing in the US. Under the US Competition Law, illegal predatory pricing is defined as pricing below the costs appropriately measured and with intention to eliminate competitors, or with the "specific intent" to monopolize.² A landmark US Supreme Court decision on predatory pricing was made in Zenith vs. Matsushita. The

¹ Robert A. Lipstein (1997). "Using Antitrust Principles to Reform Antidumping Law". In *Global Competition Policy*, ed. by Edward M. Graham and J. David Richardson. Washington: Institute for International Economics.

² Eleanor M. Fox (1997). "US and EU Competition Law: A Comparison". In *Global Competition Policy*. Washington: IIE.

Court concluded that a low price alone is not enough to support a finding of predatory pricing, but that a low price is only illegal if it can be shown that there is a dangerous probability that such pricing would permit the elimination of competitors thereby allowing the predator to raise prices later and recoup the original losses from low pricing.³

Predatory Pricing under the US Anti-Dumping Law

The 1916 US Anti-Dumping Law states that "dumping", which is importing and selling the goods within the US at a price substantially less than normal price or value in the principal markets of the producing country, is unlawful if this dumping is done with the intent of destroying or injuring an industry in the US, or of preventing the establishment of an industry in the US, or of restraining or monopolizing any part of trade and commerce in the US. Under the 1916 law, anti-dumping measures would only be applied in the case where dumping is done with the predatory intent (equivalent to the "monopolistic intent" in section 2 of the Sherman Act which regulates domestic competition). However, since it was found to be virtually impossible to prove this "predatory intent", the new law, the Anti-Dumping Law of 1921, required only international price discrimination and "injury" to a domestic industry for the imposition of anti-dumping measures.⁴ Anti-dumping rules of the WTO basically have the same framework as the 1921 law.

Inconsistency between Competition Law and Anti-Dumping Law

10. Consequently, though both competition law and anti-dumping law were supposed to deal with predatory pricing, the result of enforcing these two laws differs significantly. Under competition law, which regulates predatory pricing in domestic trade, low price sales are basically illegal in the case of pricing below marginal costs and with predatory intent. It must be shown that there is a probability that, through predatory pricing, competition will be eliminated and the predator will subsequently be able to realize monopoly prices and profits. In contrast, anti-dumping law requires only the existence of a difference between prices in the domestic market and those in the exporting country, and injury to a domestic industry. "Predatory intent" and "probability for monopolistic profits" are not required to be proved.⁵ This difference in standard is significant in that positive finding regarding the existence of predatory pricing is exceptional under the US Competition Law but the norm under the US Anti-Dumping Law. The US has a different standard for predatory pricing: a very rigorous standard for domestic competitors and a very relaxed standard for foreign exporters. In addition, it should be noted that the unilateral procedure under anti-dumping law, where anti-dumping authorities fulfill the roles of both a prosecutor and a judge, makes it easy for domestic industries to obtain protection from foreign competitors. Instead, domestic competition law is implemented through judicial or semi-judicial procedures.

Problem in Measuring Costs

Measuring costs to determine the existence of predatory pricing also gives rise to serious problems. Average "variable cost" is normally the standard for determining whether a price is

³ Tadatoshi Homma (1994). "Uruguay Round changed the international trade" Tokyo: Chuo Keizai Sha.

⁴ Kazumasa Iwata (1997). "Competition Policy and Unfair Trade Measures". In *Trade and Tariffs*. Tokyo: Japan Tariff Association.

⁵ The Congressional Budget Office of the US said in its report of "Antidumping Action in the United States and Around the World: An Analysis of International Data, 1998" that "(t)he vast majority of cases in which antidumping duties are imposed do not involve predatory pricing" and that "(i)n cases where predatory pricing is not an issue, however, imports priced below cost or their foreign price are generally beneficial to the economy".

predatory and to prove the existence of predatory intent under the US Competition Law⁶ (while marginal cost is theoretically a more appropriate standard, the difficulty in measuring marginal cost forces average variable cost to be used⁷). Under anti-dumping law, sales price in the market of the exporting country, export price to the third country, or constructed value based on fully allocated costs (i.e., variable cost, fixed cost and profits) is used to determine dumping. Therefore, international predatory pricing or dumping can be found in instances where there would be no support for a claim of predatory pricing under domestic competition. Fully distributed costs are always higher, and usually substantially higher than variable costs. In addition, constructed value involves the danger of creating or enlarging dumping margins intentionally since the investigating agency has a significant margin of discretion in calculating the constructed value. (See Annex 1)

(3) Justification for the Broad Application of Anti-Dumping Law

Price Discrimination

Though anti-dumping law seeks to prohibit predatory pricing and uses price discrimination as well as injury to a domestic industry as the criterion for the imposition of anti-dumping measures, price discrimination itself is not generally unlawful from the perspective of competition policy.⁸ Indeed, it is not irrational for prices in one market to be below prices in the another market. For example, in a case where the brand name is less popular on one market than on another, sales prices in the latter market would be expected to be lower than in the former as sellers try to increase competitiveness by offering more attractive prices to offset a weak brand image. Another example would be the price difference resulting from the existence of active competitors. Sellers may offer lower prices in one market to match prices of their competitors, while setting higher prices in another less competitive market.

Price Discrimination Under the US Competition Law

Price discrimination is regulated under the Robinson-Patman Act in the US. Section 2 of this law states that price discrimination is unlawful if it has a distorting effect on competition. Specifically, price discrimination has been found to have a distorting effect on competition only if "the effect of such discrimination may be substantially to lessen competition or tend to create a monopoly, in any line of commerce, or to injure, destroy, or prevent competition". The most important thing to note is that this law concerns not price discrimination itself, but the distortion of market competition caused by price discrimination. In fact, the US Supreme Court said that the distortion of market competition by price discrimination, which is illegal under competition law, should be judged by the existence of predatory intent in section 2 of the Sherman Act (Brook Group Ltd. vs. Brown & Williamson Tobacco Corp. 1993). Therefore, price discrimination itself is not unlawful in the US. Similarly, EU considers that price discrimination can be caused naturally by such factors as the difference of

⁶ There is some difference in the decisions by the US courts regarding the requirements of marginal cost and predatory intent. For example, some decisions state that sales below marginal cost mean the existence of predatory intent while other decisions maintain that prices can be below marginal cost even without predatory intent.

⁷ Eleanor M. Fox and Robert Pitofsky (1997). "United States" In *Global Competition Policy*. Washington: IIE.

⁸ According to the economic theory, price discrimination for each customer enables the transfer of consumer surplus to producer surplus and causes a decrease in consumer surplus (first-degree price discrimination). In this case, price discrimination does not cause any loss in economic efficiency since net surplus in a whole economy remains the same as before, with an increase in producer surplus offsetting a decrease in consumer surplus. Therefore, competition law is not concerned with price discrimination itself because its objective is the protection of economic welfare in an entire economy.

demand elasticity and geographic conditions and that prices are naturally different in each market. Therefore, price discrimination itself is generally not against competition law in the EU.⁹

Injury to Domestic Industries

Another criterion for imposing anti-dumping duties is injury to domestic industries caused by price discrimination. However, it should be noted that normal price discrimination which is not predatory pricing can cause a significant reduction in sales, or injury, as a result of domestic competition between companies, and that competition law does not regard such competition as illegal. Thus, anti-dumping measures in such cases merely protect domestic industries from normal foreign competition, resulting in a restriction in competition in the importing country.¹⁰ It goes without saying that the protection of domestic industries should be achieved basically by tariffs, and that temporary protection should be provided by safeguard measures, which are the only measures allowed under the WTO for the protection of domestic industries. In fact, anti-dumping measures can exclude low price sales from the importing country, even when exporters do not have the possibility of acquiring monopoly power and of raising the prices of their products above competitive prices later.¹¹

Anti-Dumping Measures Based on the Protected Home Market in the Exporting Country

Attempts are often made to justify anti-dumping measures on the grounds that the exporter enjoys a protected home market. However, it is clear that anti-dumping measures do not solve the problem of market protection. Economics indicate that it is irrational for private companies to sell their products below cost in foreign markets without the prospect for future predation profits, regardless of the existence of monopoly profits in their closed domestic market. When companies make monopoly profits in their home market, they will normally prefer keeping them rather than merely losing them in the export market through below-cost sales.¹²

(4) Introduction of A Competition Promoting Perspective into Anti-Dumping Law

Since there is significant doubt about the economic validity of the criteria for imposing anti-dumping measures, the possible action of reforms that will theoretically come out of the above discussion would be to improve the criteria by introducing the perspective of competition policy.

More specifically, first, the price standard for imposing anti-dumping measures would need to be average variable costs as in the case of predatory pricing under competition law. That is to say, the standard would be whether the export price is below average variable cost.¹³

⁹ Under the Japanese competition law, price discrimination is illegal if an entrepreneur unfairly discriminates between regions or trade partners through offering different prices. "Unfair" means pricing with intent to distort market competition by eliminating competitors aggressively or forcing competitors into a significantly disadvantageous position and then distorting market competition. (Joji Atsuya (1997). "Primer of Act Concerning Prohibition of Private Monopoly and Maintenance of Fair Trade". Tokyo: Nihon Keizai Shimbunsha.)

¹⁰ The CBO's report pointed out that anti-dumping measures are substitutes for other trade barriers to protect domestic industries.

¹¹ Eleanor M. Fox and Robert Pitofsky (1997). "United States". In *Global Competition Policy*. Washington: IIE.

¹² This is consistent with the Chicago's school view.

¹³ Even an high ex-official of the US government admitted that marginal cost is desirable to use in assessing exports for anti-dumping measures. (Kenneth Flamm (1996). "Mismanaged Trade: Strategic Policy and the Semiconductor Industry". Washington: Brookings Institution.)

Second, before imposition of anti-dumping measures, the authorities would need to be required to prove the existence of predatory intention and the probability of future success in predation as is required under the US domestic competition laws.

These two requirements will certainly prevent the anti-dumping measures from being abused and from causing anti-competitive results.

III. CONCLUSION

Anti-dumping law, which, like competition law, was originally intended to prevent predatory pricing, have now been utilized much more frequently than competition law, with the effect of protecting domestic industries and restricting competition. A number of economists also point out that some trade measures such as anti-dumping and countervailing duties, which are legitimate under the current trade law, have anti-competitive effects. Therefore, this Working Group, as well as any future working group or negotiation group that might develop from it, should cover the effects of trade law on competition, as well as those of competition law on trade, in order to address these problems.

Finally, we would like to suggest some issues for further study. Although our explanation above has clearly demonstrated a need for the reform in anti-dumping law from the perspective of competition law, study on the following issues would further clarify the problems and give a better indication of necessary changes to the current anti-dumping law:

- (a) study on anti-dumping cases from the perspective of competition law;
- (b) case study of competition and anti-dumping rules in regional agreements;
- (c) further analysis of the key vocabulary and concepts in trade and competition law.

ANNEX 1

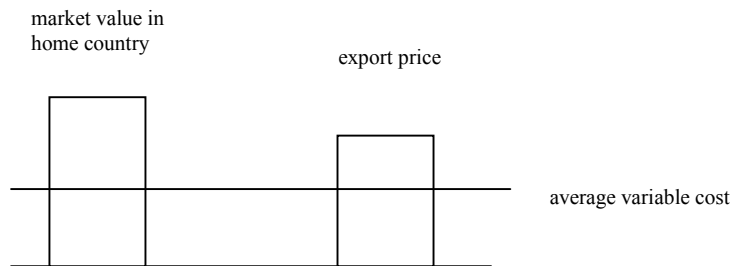
Difference in Price Comparison Between Anti-Dumping Law and Competition Law

- Price discrimination itself is not against the US Competition Law. Competition Law concerns the distorting effects on market competition caused by price discrimination. (More concretely, predation by price discrimination.)

In proving predatory pricing, the criterion is whether sales price is lower than average variable cost, which is a substitute for marginal cost.

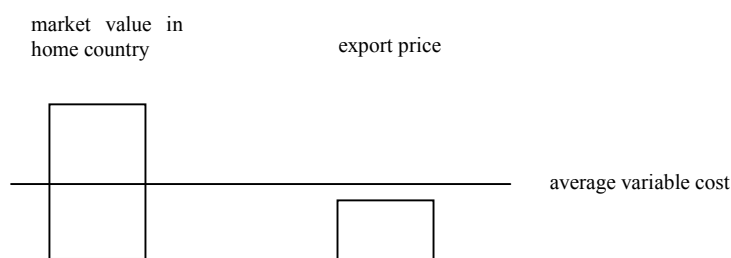
- Under anti-dumping law, anti-dumping measures will be applied if the export price is lower than the market price in the home country.

(Case 1: Export price is higher than average variable cost.)



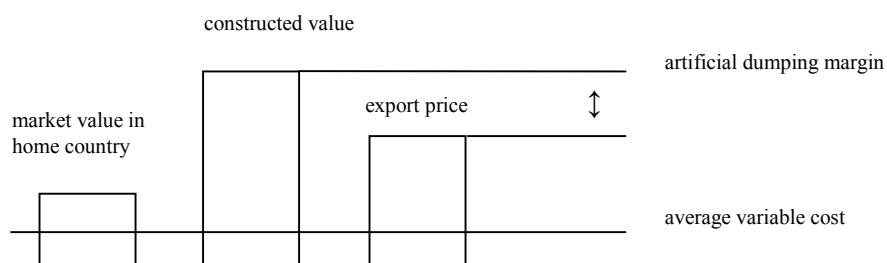
- Competition Law: this case is hardly to be proved as predatory pricing because export price is higher than average variable cost.
- Anti-Dumping Law: if a domestic industry is injured, anti-dumping measures are applied in this case because of the difference between export price and domestic price.

(Case 2: Export price is lower than average variable cost.)



- Competition Law: though export price is lower than average variable cost, the probability for future predation is necessary to be proved for predatory pricing.
- Anti-Dumping Law: if domestic industries are injured, anti-dumping measures will be applied.

(Case 3: Domestic price is lower than export price, but constructed value is higher than export price. All of these are higher than average variable cost.)



- Competition Law: this case is not predatory pricing because export price is higher than average variable cost.
- Anti-Dumping Law: if domestic industries are injured, anti-dumping measures will be applied because of the difference between export price and domestic price (constructed value).