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Burning Rubber:

Proposed Duties on Chinese Tires Whiff of Senseless Protectionism

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Introduction

Although the stew that is the U.S.-China trade relationship has the potential to reach a full boil, it has been on a low simmer since before the start of the financial crisis and subsequent global economic slowdown. Despite pork bans, poultry bans, a steady stream of antidumping and countervailing duty investigations, dispute settlement judgments from the World Trade Organization, accusations of currency manipulation, admonitions regarding China's dependence on export-led growth, and China's concerns about the impact of profligate U.S. government spending on its U.S. debt holdings, the relationship has held up fairly well.

But that could all change quickly. By September 17 President Obama is required to render a decision in a potentially combustible case concerning automobile tire imports from China. Pursuant to a petition filed by the United Steelworkers of America under Section 421 of the Trade Act of 1974—known colloquially as the “China-Specific Safeguard”—the U.S. International Trade Commission has already recommended that Obama impose duties of 55 percent on imports of consumer tires from China. Under the law, the president can adopt, modify, or reject that recommendation.

Although this may sound like just another day in Washington, Obama's decision will be consequential. It will help clarify his administration's heretofore opaque trade-policy objectives. It will set the tone for U.S.-China trade relations for the foreseeable future. And it will affect broader international trade relations, for better or for worse, as America honors or disavows its pledge to the Group of 20 nations to avoid new protectionist measures.

Under the statute, the president has discretion to deny import “relief” if he determines that such restrictions would have an adverse impact on the U.S. economy that is clearly greater than its benefits, or if he determines that such relief would cause serious harm to the national security of the United States. The first condition is met overwhelmingly.

And, for good measure, there is a very strong argument that the second is met, too.

But at the end of the day the president is a politician, who is presumed to owe Big Labor for his election last November. Will the president do what is overwhelmingly in the best interest of the country? Or will he do what he thinks is best for himself politically? This paper provides some law and case background and then summarizes why the president should reject the recommendations of the USITC and deny import restrictions altogether.

The Section 421 Statute and a Brief History

Section 421 of the Trade Act of 1974, as amended, is a special statute that applies only to imports from China. It became U.S. law as a condition of China's accession to the World Trade Organization in 2001. The provision aimed to assuage fears about Chinese competition by establishing a special “safeguard” to deal with increased imports from China for the first 12 years after China's entry into the WTO.¹ The law will expire at the end of 2013.

The broader U.S. “safeguard” law, Section 201 of the Trade Act of 1974, authorizes the imposition of temporary trade barriers against increased imports that are a “substantial cause” of “serious injury” to American producers. The China-specific safeguard of Section 421, by contrast, sets a lower threshold for imposing trade restrictions. Specifically, the statute provides:

If a product of the People's Republic of China is being imported into the United States in such increased quantities or under such conditions as to cause or threaten to cause market disruption to the domestic producers of a like or directly competitive product, the President shall, in accordance with the provisions of this section, proclaim increased duties or other import restrictions with respect to such

product, to the extent and for such period as the President considers necessary to prevent or remedy the market disruption.²

Under the statute, “market disruption” exists “whenever imports of an article like or directly competitive with an article produced by a domestic industry are increasing rapidly, either absolutely or relatively, so as to be a significant cause of material injury, or threat of material injury, to the domestic industry.”³ And the term “significant cause” refers to “a cause which contributes significantly to the material injury of the domestic industry, but need not be equal to or greater than any other cause.”⁴

If the ITC renders an affirmative finding (which is decided by majority vote) or if there is an even split among commissioners, the affirming commissioners must submit recommendations for relief to the president and the U.S. Trade Representative within 20 days of the determination. The USTR then has 55 days to advise the president about the ITC’s findings—a period during which it must hold hearings on the matter and solicit views from importers, exporters, and other interested parties. It is also authorized to pursue negotiations to address the underlying market disruption with the Chinese government during this period.

Unless an agreeable settlement is reached, the president must announce import relief by the 150th day after the petition’s filing unless he determines that “provision of such relief is not in the national economic interest of the United States or, in extraordinary cases, that the taking of action . . . would cause serious harm to the national security of the United States.”⁵ If the president chooses to grant import relief, it must become effective within 15 days of his decision.

It is also important to appreciate what Section 421 is not. It is not an “unfair trade” statute. Unlike the antidumping and countervailing duty laws, a Section 421 case does not include allegations of prices at less than fair value or prices that benefit from countervailable government subsidies. The evidentiary threshold is much lower. All that is alleged—and all that has to be established—in a 421 petition is that imports from China are increasing in such a manner as to be a cause of market disruption (or threat thereof) to the domestic industry.

Section 421 is not intended to remedy any wrongdoing on the part of Chinese exporters, but is intended rather to give U.S. producers the opportunity to holler “time out!” as they catch their breath, assess prospects, and attempt to adjust to a new level of competition. Of course there are huge costs to this kind of intervention in the marketplace, thus the president is granted discretion, under the law, to deny relief if he determines that the costs to the broader economy clearly exceed any benefits to the petitioning industry. While such discretion provides some comfort that the law’s relaxed evidentiary standards won’t be routinely abused by domestic interests seeking to stifle competition, there are no guarantees that the president’s discretion will be based exclusively on considerations of the national economic interest. If there were, it would be nearly impossible to conjure a scenario in which the concentrated, temporary benefits to a specific industry receiving protection were not overwhelmed by the costs of that protection

on the broader economy. Political considerations always influence decisions that lead to protection.

During the Bush administration (the first administration under which the law was in effect), there were six Section 421 cases filed by domestic parties, and in four of those the ITC found market disruption and recommended import restrictions. In each of those four cases, President Bush exercised his discretion to deny relief. Thus, trade restrictions have never been imposed under this statute.

Some Specifics of the Tires Case

The tires case is noteworthy in several respects, starting with the fact that it is the first Section 421 case initiated during the Obama administration. Petitioners came to regard the law as a dead letter under President Bush, but have been anxious to test its viability under a new president, who promised last year to decide Section 421 cases “on their merits, not on the basis of an ideological rejection of import relief like that of the current administration.”⁶

The petition in the tires case was filed by the United Steel, Paper and Forestry, Rubber, Manufacturing, Energy, Allied Industrial and Service Workers International Union—the United Steel Workers, for short—on behalf of workers in the U.S. tire industry. However, the USW represents workers accounting for only 47 percent of U.S. tire production capacity, so most workers in the industry are not officially supporting the petition.⁷ Furthermore, this is the first 421 case that does not have a domestic producer as the petitioner. Out of the 10 firms determined to comprise the entire domestic tire industry, none supports the union’s petition for import restraints. Thus, this case, initiated on behalf of no producers and less than half of the industry’s workers, and given the acrimony it has engendered within the U.S. tire-supply chain, is probably not the kind of case that President Obama idealized when he promised to decide these issues “on their merits.”

In reaching its affirmative conclusion of market disruption in June 2009, the USITC cited the 215-percent increase in the volume of tire imports from China between 2004 and 2008 as a cause of material injury to the domestic industry. The conclusion of material injury was based on evidence of declining industry capacity, production, shipments, employment, wages, and financial results.⁸

The argument put forward by respondents in the case (i.e., various producers, exporters, and importers) during the ITC proceeding, which was ultimately rejected in the majority’s determination, is that tire production is stratified among three quality “tiers,” and that competition across tiers is mitigated. Most of the increase in imports from China was of the lowest tier, while most of the tires produced in the United States are of the top two tiers.

Furthermore, 7 of the 10 U.S. tire producers also manufacture tires in China, as well as in other countries.⁹ And of those 7 firms, 4—Goodyear, Michelin, Cooper, and Bridgestone—account for almost 90 percent of U.S. production. Thus, the change in composition of domestic and imported tires in the U.S. market is a function of the decisions of these U.S. producers. And it was a deliberate decision of U.S. producers to reduce production of Tier-3 tires—the lowest-

end, lowest-profit-margin tires—at their U.S. plants, and increase sourcing of that tier in China and elsewhere, where lower production costs enable the realization of some profit, which in turn helps support continued production of Tier-1 and Tier-2 tires in the United States. Thus, the declining employment, production, capacity, and shipments are all attributable to intentional, conscious planning on the part of profit-maximizing firms.

For a law that is characterized by its champions as a tool to support our producers vis-à-vis Chinese producers and to ensure a level playing field, this test case for Obama pits American workers against American producers, and American workers against American workers. By going after Chinese producers, petitioners ensnare their own employers, as well as fellow American workers, organized or otherwise. Although the lightning rod is China (with all of the negative perceptions that have been cultivated about its trade practices), this case has little to do with China per se, and everything to do with organized labor begrudging U.S. producers for pursuing profit-maximizing strategies in a globalized world. In seeking sanctions, petitioners are asking Obama to indict globalization.

Whom Will Protectionism Help, and How

Duties on imports of tires from China are more likely to lead to greater production in other developing countries than to greater production in the United States. U.S. producers have chosen to outsource production of their lower-tier tires to China because producing those tires in that location makes the most sense economically. But raising the costs of producing in China by imposing trade restrictions would not make U.S. production more attractive. It would not bring back U.S. jobs. It would make Indonesian or Mexican or Brazilian production more attractive, and would likely divert jobs from China to those countries.

According to data compiled by the ITC staff, the average unit price (based on the customs value) of a tire imported from China in 2008 was \$38.98.¹⁰ A 55-percent tariff would drive up the unit value to \$60.42. But, in 2008, U.S. producers sold 159 million tires, valued at \$11 billion, for an average price of \$68.60.¹¹ Factoring in mark-up of the Chinese price, it is reasonable to conclude that prices of American- and Chinese-produced tires might retail for about the same price. But that outcome is highly unlikely to be incentive enough for globalized tire producers to divert production from China to the United States. Instead, producers are much more likely to shift production to Mexico, Brazil, or Indonesia, where the unit prices in 2008 (based on customs value) were \$56.26, \$48.93, and \$32.10, respectively.¹²

Furthermore, the ITC's recommended remedy would be in place for three years. The statute expires in four years. What kinds of changes should be expected during the interim that would make the United States a more cost-effective place to produce Tier-3 tires, or any tires for that matter? There are no changes—short of technological advances that raise productivity and reduce the demand for labor—that could make the United States a better place to produce tires. But this case is about jobs and nothing else, so even that outcome wouldn't satisfy petitioners. Three years of "relief"

will do nothing but perhaps defer the day of reckoning, while imposing heavy costs on the rest of the economy, taxing our relationship with China, and further sully America's international standing.

Adverse Economic Impact Is Clearly Greater Than any Benefits

Formal economic models, testimony, anecdotes from representatives of industries in the tire-supply chain, and common sense analysis all reveal an excessive cost burden on the economy from the proposed remedy of 55-percent duties in year one; 45-percent duties in year two, and; 35-percent duties in year three.

In their dissenting opinion, ITC Vice Chairman Daniel R. Pearson and Commissioner Deanna Tanner Okun concluded:

[W]e find that imposing a trade-restrictive quota or tariff on the subject imports will be far more likely to cause market disruption than to alleviate it for domestic producers who have already undertaken significant strategic adjustments to adapt to a changing global market.¹³

Indeed, economist Thomas Prusa estimates that "the tire manufacturing industry will experience little to no job creation as a result of the tariff. Under the best-case scenario more than a dozen jobs will be lost for every job protected." Prusa estimates a net loss of at least 25,000 U.S. jobs if the recommended tariff is imposed. Under the best case, Prusa finds that higher prices and other inefficiencies stemming from the proposed remedies would sap U.S. consumers of \$600 to \$700 million per year, translating to an annual cost of \$300,000 for every job "protected" in the tire industry.¹⁴

According to a statement of the U.S. Tire Industry Association, which represents all segments of the tire industry, including those that manufacture, repair, recycle, sell, service, or use new or retreaded tires, and also those suppliers or individuals who furnish equipment, material, or services to the industry:

Our members, by directly importing or contracting with suppliers, are meeting the demands of a segment of the tire consumer market for lower-cost tires. No manufacturing uptick would satisfy this product segment, but instead could create a need for product allocation, resulting in shortages and outages. In the best of times, such occurrences are troubling, but in today's climate, this could inflict severe financial harm on many retailers and on the motor-ing public.¹⁵

Consumer groups and other organizations have also expressed safety concerns about the impact of higher-priced tires on increasingly-pinched consumers. The likelihood that an increasing number of consumers will forego the replacement of old and worn-out tires presents a whole new category of risk and costs that are difficult to quantify economically.

If President Obama imposes trade restrictions in this case—regardless of whether those restrictions are as severe as the ITC’s recommendation or if they are milder—the United States will have blatantly violated its commitment to the G-20 earlier this year to avoid new invocations of protectionism. That would be a colossal mistake that simultaneously undermines U.S. credibility on trade and invites other governments to indulge their own protectionist lobbies. The consequences for world trade could be severe. There should be no doubt that the demonstration effect would not only influence other governments toward intervention, but would also encourage other U.S. interests to pursue their own protection under Section 421.

The fact that President Bush rejected the ITC’s recommendations to impose restrictions four times reinforces the perspective held by the Chinese government that the imposition of trade restrictions under Section 421 is firmly a matter of presidential discretion. Unlike antidumping or countervailing duties, which run on statutory autopilot without requiring the president’s attention or consent, Section 421 explicitly requires the attention and participation of the U.S. president. In other words, although there are over 90 outstanding U.S. antidumping and countervailing duty orders against various Chinese products, none of them is considered to reflect the direct wishes of the U.S. president, and thus none of them rise to the level of a potentially explosive trade dispute.

Technically, if the United States imposes restrictions under Section 421, the Chinese are not entitled to formally retaliate. But that’s cold comfort when it’s quite obvious that trade restraints under Section 421 will no doubt be considered by the Chinese to be a directive of the U.S. president, and thus the offense taken and the consequences wrought could be profound. U.S. industries across the manufacturing spectrum have written to President Obama, urging him not to impose restraints in this case for fear that they will bear the brunt of the costs through lost export sales. This is a real possibility.

As to the question of national security, the prospect of a spiraling trade war with China, if duties are levied and retaliation ensues, will strain the commercial ties that have been successfully cultivated over the past few decades and will increase the risk that China becomes less helpful on crucial matters of U.S. foreign and security policy.

Conclusion

Through the first eight months of his tenure, the president has avoided making any decisions of consequence on matters of trade policy. While his actions have not been conclusively protectionist, his tepid rhetorical endorsements of trade and his conditional repudiations of protectionism have sown doubts at home and abroad about the direction of U.S. trade policy. A decision to reject trade restraints in the tires case would be reassuring to a world that is struggling to grow out of recession.

The stakes appear to be much higher for Obama than they were for Bush. The unions feel that they have earned the president’s support and are more emboldened in their position now than in the past. Bush didn’t win the near-unanimous support of organized labor leaders in his elections, as Obama did. Nor did Bush promise to get tough on Chinese trade practices, as Obama did. Instead, Bush set the precedent of denying relief—and he did it four times.

The USITC’s recommendation of a 55-percent tariff is a remedy far more restrictive than the quota sought by the USW. The president, then, may be tempted to offer what he might think is a compromise solution, of lower duties or a tariff-rate quota. But the costs of any protectionism at this time and under these circumstances could unleash a protectionist backlash in the United States and around the world. It would be far less costly for the president to reject trade restraints altogether and to capitalize on his earned credibility by moving the trade agenda forward.

Notes

1. Daniel Ikenson, “Bull in a China Shop: Assessing the First Section 421 Trade Case,” *Cato Free Trade Bulletin* no. 2, January 1, 2003, p.1.
2. 19 U.S.C. § 2451(a).
3. 19 U.S.C. § 2451(c)(1).
4. 19 U.S.C. § 2451(c)(2).
5. 19 U.S.C. § 2451(k)(1). Note that in cases in which the ITC is evenly split, the president has complete discretion about whether or not to accept the affirming commissioners’ recommendations for relief.
6. Barack Obama (letter to Cass Johnson, President of the National Council of Textile Organizations, October 24, 2008), <http://www.ncto.org/newsroom/pr20081029.pdf>.
7. U.S. International Trade Commission, *Certain Passenger Vehicle and Light Truck Tires from China, Investigations No. TA-421-7*, Publication 4085, July 2009, p. I-14.
8. For a full discussion of the statutory questions of increasing imports, material injury, and causation, see USITC, *Certain Passenger Vehicle and Light Truck Tires from China*, pp. 11–29.
9. Those companies are Toyo, Yokohama, Pirelli, Michelin, Goodyear, Cooper, and Bridgestone. USITC, p. IV-3.
10. USITC, Table IV-4, p. IV-10.
11. *Ibid.*, Table III-5, p. III-13.
12. *Ibid.*, Table II-1, p. II-4.
13. *Ibid.*, p.45.
14. Thomas J. Prusa, “Estimated Economic Effects of the Proposed Import Tariff on Passenger Vehicle and Light Truck Tires from China,” American Coalition for Free Trade in Tires (submission to the International Trade Commission, July 26, 2009).
15. Tire Industry Association (position statement, June 17, 2009), http://www.tireindustry.org/pdf/news_archives/press_release061709.pdf.