STEEL IMPORTS
Dumping or Competition?

Robert W. Crandall

IN MARCH OF THIS YEAR, the United States Steel Corporation filed antidumping charges against steel producers in seven European countries. This action was based in part upon a provision in the 1974 amendments to U.S. trade law that offers protection from imports if they are sold at prices below the exporter's cost of production and if they "materially" injure domestic producers or their employees. The dumping charges were brought because U.S. Steel believed it was not getting sufficient protection against competition from an overbuilt world steel industry under the "trigger price" program established in early 1978.

U.S. Steel's complaint is important because it may test the willingness of the U.S. government to use the relatively new 1974 provision of the trade law. Given the appeal of such protection to "sick" industries or to all industries in a time of general economic recession, the outcome of this case may well set an important precedent. Automobile companies, facing problems of their own, must be looking eagerly towards the use of this statute to defend themselves against low-priced imports from Japan and Europe. And producers of paper, chemicals, electronics equipment, industrial machinery, and agricultural equipment are likely to do the same, should the world economy settle into a general recession this year or next. Now that the Europeans have followed our example by implementing a cost-of-production standard in their own antidumping laws, the stage seems ready for a new attempt at industrial cartelization in the developed world.

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The Steel Industry's Crisis

There is no doubt that the U.S. steel industry is in trouble. So are the steel industries of Europe and Japan. Part of the problem is a general condition of excess capacity brought about by slow recovery from the 1975 recession. At least as important, however, is the slowness with which the steel industries of Europe and, to a lesser extent, the United States have responded to changing competitive conditions. For about twenty years, steel investments have gravitated to the less-developed world and to Japan, where new plants are more economical than they are in Western Europe and the United States. But, in spite of the change in comparative advantage that occurred because of declining real materials and shipping costs, the Germans, French, Belgians, and British continued to expand—keeping inefficient facilities while building modern ones—and the U.S. companies have stubbornly tried to maintain even their smaller, poorly located plants. Had the firms of these countries acted differently, their problems would be far less severe today.

Even the Japanese are suffering. Their problem is not poorly conceived investments, but rather the protectionist policies of the West Europeans and the United States. Had Japan been able to export freely to these two key Western markets, its steel industry would be producing today at substantially more than its current 70 percent operating rate.

The excess world capacity in steel is concentrated principally in Japan and Western Europe. Between them, they had average excess capacity of approximately 80 million metric tons in 1978 and 1979—equal to about 15 percent of total capacity in the non-Communist world and reflecting an average capacity utilization of scarcely more than 70 percent. The United States, on the other hand, enjoyed fairly brisk demand in those two years, utilizing over 87 percent of its capacity. Part of the reason for this strength was the protection afforded our domestic producers through the trigger-price system for implementing U.S. trade laws.

The U.S. Import Problem. Throughout the 1960s, the importers' share of our domestic steel market rose slowly but steadily without any U.S. government response. By 1968, imports accounted for 17 percent of domestic steel consumption. In 1969, the government responded by inducing Japanese and European exporters to enter into "voluntary restraint" agreements. The growth of imports subsided a little through 1970, but resumed again in 1971 and 1972. In the next two years, these agreements were not generally binding, as exporters turned away from U.S. markets and U.S. price controls. Imports remained at 12 to 15 percent through the recession year of 1975 and the first year of recovery from the recession, 1976.

Then, in 1977, the U.S. steel industry once more began to complain about the damage imports were creating. The economic recovery had aborted, and world steel production had actually begun to decline. The large overhang of excess capacity caused export prices to crumble, with European firms starting the price-cutting and the Japanese following suit. Soon U.S. steel imports were rising substantially and, by summer, domestic steel producers were beginning to talk seriously about resorting to the Antidumping Act of 1921 as amended by the Trade Act of 1974. This amendment makes it unlawful for foreigners to "dump" products in the United States at prices that are below the cost of production, even if export prices are no lower than home prices.

At first, the Carter administration invited the companies to file their antidumping suits. After all, it wished to enforce "the law." Unfortunately, as its trade negotiators subsequently explained, such suits could well lead to very high dumping margins being assessed on European steel exported to this country and, therefore, to a sharp reduction in U.S. steel imports from Europe. The administration, then in the midst of the Multilateral Trade Negotiations (the Tokyo Round or MTN), warned that any sudden lurch towards denying Europe access to the U.S. market for a major industrial commodity might scuttle these talks altogether. More important, the administration feared the inflationary impact of a major increase in imported steel prices caused by the imposition of dumping margins.

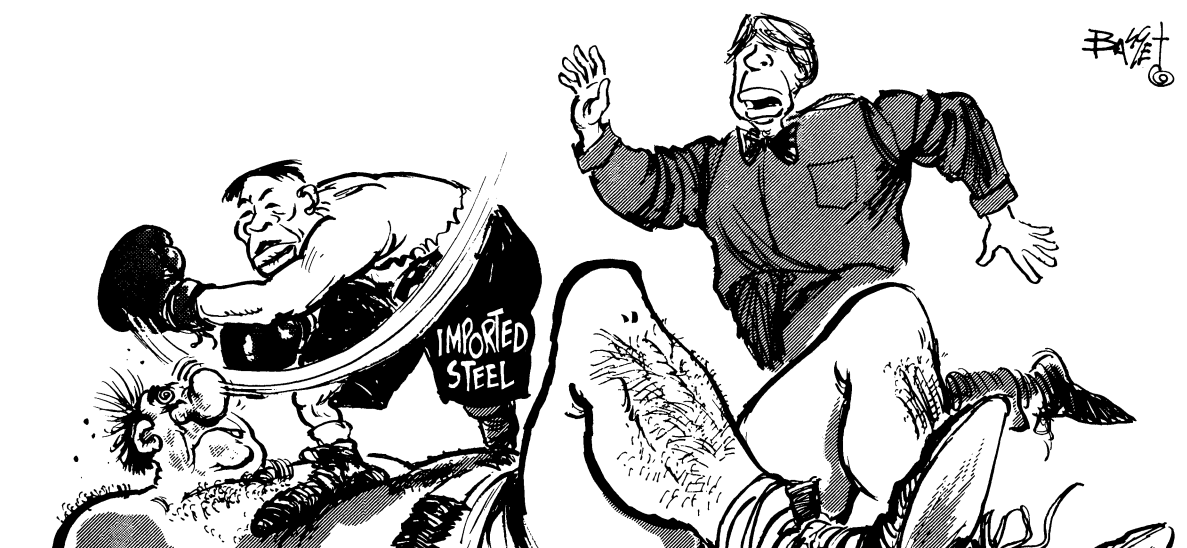
By late 1977, a task force assembled by Undersecretary of the Treasury Anthony Solomon had prepared for President Carter a series of recommendations carefully crafted to induce domestic steel producers to withdraw or "suspend" their antidumping suits. By this time also, U.S. Steel had filed a massive suit against the Japanese, while National Steel and Armco had filed suits against the Europeans; other suits were in preparation. Solomon's plan was a system of trigger prices to serve as minimum import-price screens for enforcing the Antidumping Act as amended in 1974. These trigger prices were to be based on Japanese costs of production (plus freight to the United States). As long as the prices importers paid were no less than the trigger prices, no anti-dumping investigations would be launched. Exporters, such as Canadian and Mexican firms, who could show that their costs were sufficiently low to justify selling at prices below the trigger levels, could do so. But all others would have to stay at or above these levels.

The U.S. industry accepted the trigger-price system as part of a larger package that included some loan guarantees from the Economic Development Administration, an attempt by the Environmental Protection Agency at more rational enforcement of environmental laws, and a promise from the Department of the Treasury to reexamine the allowed rate of depreciation of steel assets for tax purposes. The industry knew that the trigger prices would be below unit costs of production for many European firms, but apparently concluded that the other elements of the Solomon plan warranted this concession. It must also have been a welcome change to have the federal government offer its cooperation in solving the industry's problems after fifteen years of jawboning or formal price controls.

Japanese costs were chosen by Solomon as the basis for the trigger prices because Japan was known to have the lowest-cost producers in the world. In effect, Solomon was challenging the U.S. firms to prove their repeated claim that they could compete in the U.S. market with anyone if only the terms of competition were "fair." Had the firms pursued their antidumping cases against the Europeans, they might have gained more protection, but they would have had to forgo the opportunity to gain the cooperation of the industry. Moreover, who could measure Japanese costs anyway (a point we will return to later)? Certainly, the industry must have believed that it could induce Treasury bureaucrats to raise these prices over time to acceptable levels.

Whatever their reason, the industry leaders accepted Solomon's plan and cooperated for two years. In 1978 and 1979, trade was guided by U.S. trigger prices and European "reference" and "guidance" prices. Export prices rose sharply, in large part because of the depreciation of the dollar, and even the Japanese learned that profits are possible at only 70 percent capacity utilization. Indeed, both the Japanese and Europeans became staunch supporters of the trigger-price system.

A New Round of Antidumping Suits. Although the 1978–1979 trigger prices helped raise world export prices, domestic steel prices, and industry profits, they could not do the impossible. The U.S. steel industry will continue to be much less profitable than average manufacturing until it has adjusted fully to the new world competitive reality. And the major producer, U.S. Steel, will continue to have serious problems. All but a small share of the rise in imports since 1960 has come at its expense. Moreover, while Inland, National, and Bethlehem all have at least one relatively modern plant specializing in carbon sheet steels, U.S. Steel has none. Its plants are older and badly located, and what should be its best plant, the one at Gary (In-



"No more cheap shots!"

diana), apparently does not enjoy satisfactory labor relations. Thus the largest firm in the industry earns very low profits, even in a strong market protected by trigger prices.

After unsuccessfully trying to persuade the Carter administration either to impose some form of quota or to raise trigger prices sharply (particularly for European exports), U.S. Steel played its trump card in March 1980. It filed dumping charges against seven European countries, arguing that it had been injured in at least five product markets. The administration reacted by dropping the trigger-price system, which had of course been seen as an alternative to antidumping suits. The U.S. industry was not to be allowed to have its cake and eat it too. Once it chose the contentious route of litigation, it lost the protection of trigger prices.

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With its antidumping suit, U.S. Steel has begun what could become a trade war by insisting that its desperate condition demands protection from unfairly priced foreign steel. It asks only for "fair" trade. But is steel just the first in a procession of declining U.S. industries to develop an interest in the equity of the world economic order? With automobiles waiting in the wings, it is useful to examine the laws that U.S. Steel has begun to exploit.

Trade Policy and Antidumping

The steel industry is among the first industries to benefit from the 1974 Trade Act amendments to the Antidumping Act. These amendments altered in a fundamental way the definition of dumping and the degree of import protection afforded domestic industries that are subject to strong cyclical influences or are suffering from persistent excess capacity. The steel industry meets both qualifications.

"Fair" Trade. Presumably, the purpose of an antidumping statute is to prevent "unfair competition" in our markets. This concept of fairness is rarely defined with precision, nor can it be defined in a convincing manner. Traditionally, dumping was defined as a sale in export markets at a price below the domestic price. For instance, if European chemicals were sold in U.S. markets more cheaply than at home (Europe), they were "dumped." Essentially, that is the definition of dumping used in the Antidumping Act. Fair value is home-market value. But is this "fair" in all circumstances?

Assume that the European chemical industry is a tight cartel that sells its products in European markets at prices far above costs. Would it be "fair" to our consumers for Washington to forbid sales in our market below these monopoly prices (plus freight)? If the cartel members wished to sell at prices above their incremental costs in our markets, and if they could compete with our producers at such prices, should we not let them do so? Undoubtedly, the cartel could only be effective if Europe erected high trade barriers against our chemical companies' products, but these barriers would hurt their consumers, not ours. Surely, the fact that Europe protected its industry would not mean that we should deny our consumers the benefit of competition from foreign and domestic sources alike. Why, in other words, is it "fair" to penalize ourselves for the "unfair" prices charged in other countries?

Obviously, the process of negotiating trade policy is not so simple. We need to exploit our comparative advantage, and we need to use the threat of denying imports of one commodity in order to induce countries to lower their trade barriers against our exports of another. This is the reality of trade negotiations, but it should not be explained as the search for the "fair price." Such a concept belongs in medieval philosophy books, not economic policy statements.

A New Definition of "Fairness." Unfortunately, dumping has taken on a different meaning since 1974. The Trade Act amendments make the definition of "fair value" a price that is above the "cost of production." If home-market sales are made at prices below cost (that is, if firms are losing money at home), they must sell at *higher* prices abroad. Fair value in these cases is defined as costs (including overhead costs of at least 10 percent of direct costs) plus an 8 percent profit margin. Presumably, cost refers to unit or average cost, a magnitude that rises when sales fall and falls when sales rise. Therefore, when market prices decline as a country or the world slips into recession, our trade laws require exporters to raise their prices if their exports are deemed to injure U.S. firms or their employees. The deeper the recession, the larger the required price increases. As export prices rise, sales decline, causing exporters to raise prices once again in order to be "fair." In short, we require exporters to exacerbate a recession by further reducing output—hardly a sensible economic policy.

Nor does the 8 percent profit margin make economic sense. Japanese firms are often highly leveraged, employing one dollar of equity for every three or four dollars of debt. Since interest costs are included in the cost of production, to insist that these firms charge prices that yield them an 8 percent profit margin could in effect require them to earn 40 percent on equity or more if their products are to be priced "fairly." This would probably limit Japanese exports to the United States to the marketing of chain letters since the Japanese could not sell steel, automobiles, or electronics at prices that returned such high profits.

Imagine how the 1974 Trade Act definition of "fair value" would work if applied to our domestic economy. In 1979, Ford, Chrysler, and U.S. Steel lost money on domestic sales. If they continue to sell autos or steel, they are engaging in "unfair" competition because, under the Trade Act, prices below cost are unfair.

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Thus, in the name of "fairness," we would have to order each of these companies to suspend its domestic sales immediately or to raise its prices to a level sufficient to cover costs. If these price increases resulted in substantial losses in market share to their rivals—General Motors or Bethlehem Steel—there might be no price at which these companies could make a profit. Indeed, if there were such a price, they would have found it. (One presumes that they do not wish to show negative profits.)

It would be obvious folly to say that Chrysler has been engaging in unfair competition because it has been losing money. It would be similarly absurd to say that steel producers in Germany, Japan, or France have been behaving unfairly because they find the world steel market so weak that they have to offer prices below their full unit costs in order to make a sale. What could their motive be for cutting prices in this manner other than an attempt to use their resources most efficiently and fully during the downturn? The answer from proponents of antidumping policy is that these motives are (1) predation or (2) subsidization of employment. Each deserves careful scrutiny.

(1) *Predation.* Predation consists of an attempt to drive out competition by sales below costs, with the ultimate intention of recouping the losses through the monopoly profits that will then become possible. Surely, no one believes that the owners of the mini-mills in the Brescia region of Italy or the smallish mills in northern France and Belgium are trying to monopolize the world's steel industry by slashing prices in a recession. How could they satisfy this monopoly demand from their inefficient little plants? Nor can one seriously believe that even British Steel or Nippon Steel could monopolize the U.S. steel market. There are so many established steel producers in the world and so many new and aspiring entrants that monopolization would simply be impossible. Predation has rarely worked, even in insular nineteenth-century America. How could it work in the worldwide steel, textile, or automobile markets of today? The monopoly profits that one might gain from predation would be so uncertain and so distant that the rational firm would hardly view the immediate cost—in the form of negative profits—worth the prospect of future gain. Moreover, the chance that the importing country might tax away the future gains through a variety of policies would have to make the game even riskier.

The proponent of the predation argument has a very heavy burden of proof to bear. How many firms have been able to achieve a monopoly in the United States through aggressive predation? How many exporters enjoy this monopoly position? The OPEC cartel is often offered as a prototype, but it is hardly a useful example from which to generalize. The concentration of oil reserves in a small number of countries and the urgency of the need to consume oil combine to make OPEC quite effective. Steel, textiles, shoes, television receivers, and automobiles have neither of these attributes. They can be produced in a number of locations, and we can adjust rather easily to a temporary curtailment in the supply of each of them. The mere suggestion of the possibility of a steel cartel involving South Korea, India, Japan, Germany, Taiwan, Italy, the United Kingdom, France, Australia, Venezuela, Mexico, and Canada seems absurd. This is particularly true in light of the fact that reductions in supply from these countries would probably encourage increases in supply from South Africa, Brazil, Indonesia, Romania, Poland, and Turkey. The number of players is large and growing.

(2) *Subsidization of employment.* Obviously, the motive for reducing prices is to increase sales, output, and employment. This is how competitive firms respond to a reduction in demand. In fact, it is how monopolists respond as well. To suppose that the proper response to a reduction in demand is an increase in price to cover the higher fixed costs per unit of sales is to be rather myopic. In an industry characterized by such behavior, the underutilization of resources would increase, reducing incomes further and adding to unemployment problems in other industries. The anti-inflationary force of an economic contraction would be lost, and inflation would accelerate. While one cannot argue that price reductions are a general cure for recession, clearly price *increases* are counterproductive. It does not make sense to encourage further idling of resources as a response to slack in the economy.

If exporters begin to slash prices to maintain production levels, they will place downward pressure on import-competing industries in the United States. The obvious response to this price pressure is for domestic firms to cut their prices to meet the competition. Our firms often complain that this downward price flexibility is disastrous because of the myopia in U.S. capital markets. I rather doubt that our investors are this short-sighted. If foreign firms, facing much less developed capital markets, can engage in price competition, our industrial giants should be able to respond without fearing that their bankers will call their loans. Not all exporters are owned or subsidized by their governments; many engage in price competition without assurances from government. For instance, the mini-mills in Brescia are reputed to be the most aggressive of competitors in this regard, and they are fiercely independent of their government.

In short, there is no good reason to restrict competitive pricing activities in world trade.

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Since we would not suspend the Sherman Act simply because an industry had excess capacity, we should not impede competitive forces simply because they originate outside our borders. Allowing flexible prices in import-competing industries will not risk sacrificing our markets to world monopolists, nor will it result in large increases in unemployment. Dumping does not cause us to lose employment and output, but the failure to meet foreign competition might have that result.

Unfortunately, our trade policy has set a poor example for other countries. If we want "fair" trade, why should others accept unfairness? In December 1979, the European Economic Community (EEC) adopted a dumping code similar to our own. Dumping may now be defined on either side of the Atlantic as sales below cost of production if these import sales "injure" domestic firms or their employees.

Not only is a cost-of-production standard for dumping bad economics, but it offers enormous opportunities for political abuse. Under U.S. law, the Department of Commerce must make final determinations on whether sales have been at less than "fair" value—that is, below home-market prices or domestic production costs. Under the 1979 statute that implements the MTN, the schedule for making such a determination has been accelerated. The Department of Commerce must now make its finding within 160 days of the filing of the complaint. Unfortunately, even if it were allowed six years, Commerce could not divine the level of production costs for steel, automobiles, motorcycles, tomatoes, or Polish golf carts. The final determination of cost will always depend upon unverifiable assumptions concerning capacity utilization, capital costs, input coefficients, transportation costs, services purchased from affiliated and unaffiliated companies, and even exchange rates.

At one point in the post-1974 history of trade policy, the Treasury Department (which had jurisdiction in these matters before Congress assigned the task to the Department of Commerce in 1979) decided to base its determination of the fair value of Polish golf carts exported to the United States on an estimate of what production costs would have been if the carts had been manufactured in Spain! (Spain had no golf cart industry.) This was required because one cannot assess foreign costs without a measure of the exchange rate, and Poland's exchange rate, like those of all nonmarket economies, does not reflect the relative value of its currency. All the more reason, one would think, for fashioning a dumping standard based on something other than production costs.

The decision to use a cost-of-production standard in dumping cases simply opens the field for arbitrary and capricious decisions. No one can make such calculations with any assurance of accuracy. As a result, political considerations, rather than financial or economic concerns, will dominate the decision calculus. Whatever the Department of Commerce's assessment of the "cost of production" of each steel product from the various European exporters, it is safe to say that no one could convincingly challenge it. Having made the initial calculation of trigger prices under the Carter administration, I speak from experience. Those trigger prices were based upon the best information available from the Japanese government and represented an honest effort to assess the full cost of production. Nevertheless, one firm tried to sue Treasury for overestimating the Japanese costs. The firm was rebuffed early, but that simply saved it legal fees. I could have engaged it for years in a senseless and fruitless debate over raw-steel to finished-steel yield ratios, the amount of contract labor employed in Japanese selling costs, the true capacity of Japanese mills, and the value of fringe benefits for Japanese steel workers. One cannot successfully challenge as capricious the execution of a policy that Congress requires to be based upon imprecise and often unmeasurable definitions of cost.

The Effects of Protecting Steel. It is important to stress that trigger prices by themselves were not responsible for increased imported and domestic prices. Prices would have risen in response to the dumping cases anyway. If anything, the trigger-price mechanism reduced the inflationary impact of the 1974 Trade Act upon steel prices because it allowed steel imports to continue to flow without sudden disruptions. Dumping cases would certainly have been more disruptive than the trigger-price mechanism, and domestic producers could have raised prices while the exporters were attempting to sort out our trade policy.

By my estimates, the Carter administration's antidumping trade policy—which took the form of trigger prices—raised U.S. steel import prices by about 10 percent and domestic steel prices by about 1 percent through 1979. A sharp rise in import prices would have occurred anyway given the decline in the value of the dollar. Given a 16 percent share of imports, the total effect was to increase steel prices in the United States by about 2.4 percent. At an average price for carbon steel of $420 per ton and total consumption of 104.5 million tons, the total cost to American consumers was about $1 billion. At most, the total effect upon the domestic price level in 1978–1979 was 0.1 percentage points. It would appear that Solomon's trigger prices moderated the potentially inflationary effects that the full prosecution of dumping suits might have produced.

That is at best a rough estimate. Trying to determine what import prices would have been in a hypothetical world of laissez faire is not easy, given our willingness to use a variety of policies to avoid free trade. Nor should one be deceived by the small size of the total effect upon the price level. Steel import protection is only one example of an unfortunate trend. Textiles, shoes, televisions sets, meat, and even nails are protected in a similar manner. The sum of the price effects from all such policies could well have accounted for a large part of the recent acceleration in the inflation rate.

How much protection has been afforded steel workers? As in most cases of trade protection, only a small part of the immediate benefits go to labor. I estimate the maximum increase in jobs for domestic steelworkers because of trade protection at 12,000. These workers, if laid off, would generally find employment elsewhere, but their real incomes would decline as they turned to less remunerative jobs. Even if this caused them to lose $5,000 a year for the rest of their lives, the value of saving those 12,000 jobs would be only $60 million a year to those steel workers—a far cry from the $1 billion in annual costs to consumers. Of course, trade barriers may relieve some of the pressure on the United Steel Workers Union to accept slower wage increases in future years.

How much trade protection would be required to "get the industry moving again?" My calculations suggest that a 9 percent increase in the relative price of steel might be sufficient, meaning that consumers would have to pay nearly $4 billion a year in order to make new investments in steel plants look profitable. These new investments might employ 36,000 new people at most. The annual subsidy would thus be about $110,000 per new job created—a rather expensive way to expand employment.

Is trade protection required to "save" the U.S. steel industry? It is frequently assumed in popular discussions that the industry will either collapse or prosper, depending on the direction of government policy. In fact, it will do neither. With protection, U.S. steel firms

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might maintain their 82 to 85 percent share of the domestic market for the next decade or so, but at a very low profit rate. Without it, some marginal plants would close and the remaining more efficient plants would be worth less on the stock market. At worst, the U.S. industry might lose another 15 million tons of raw steel capacity. Even the American Iron and Steel Institute in its most gloomy mood cannot see more than 25 million tons of raw steel capacity (about 16 percent of the industry total) being lost in the next ten years in a world without protection of domestic steel. While I think this estimate is much too pessimistic, it would still leave us with 130 million tons of capacity—far more than we need to see ourselves through a national security crisis. The gradual loss in jobs over the next ten years would be about the same as what would result from a doubling of the industry's recent productivity growth rate. We would not react with horror if the industry were able to achieve 3 percent productivity growth. Why should we fear the loss of the same number of steel-making jobs as a result of gradual attrition in an overbuilt industry?

A Concluding Assessment

There can be no doubt about what trigger prices, antidumping suits, and European reference prices have been designed to accomplish. The steel industries of North America, Western Europe, and Japan were aggressively competing for market shares after the 1975 recession. To put a stop to this painful exercise in price competition, U.S. producers reached for the new U.S. trade law. At the same time, the EEC began to intervene in pricing decisions in its market, while Japan played the role of cooperative trading partner by "voluntarily" reducing its exports to both markets. The 1978 and 1979 results were so reassuring to the world's steel producers that they are now seeking to formalize their insulation from competition through an OECD "Steel Committee."

As I noted at the outset, however, the beleaguered steel industry's attempt to raise its prices by these extra-market means is merely the first example of how industrialists can use the 1974 trade law to obtain relief from competition. As we experience yet another recession, the danger exists that European and U.S. firms will seize the opportunity to have their governments substitute an artificial concept of "fair prices" for market-determined prices. If steel is any precedent, this will be followed by an attempt to formalize "fairness" in a cartel-like group, meeting under government auspices in Geneva or Paris. While we might not like the cruel choices that market forces demand, I doubt that those of us who buy the final products affected by the world industrial cartels will agree that the result is "fair trade." ■