Report on Unfair Trade Policies and Practices

By Mitsuo Matsushita

In June 1991, the Fair Trade Center, an independent institution in Japan, made public a report analyzing trade policies and practices in the United States, the European Community and Canada. The *Journal* provides its readers with this summary of the report with a comment from Mitsuo Matsushita, a professor at Tokyo University, who had been leading the study.

The Report on Unfair Trade Policies and Practices, a summary of which follows, was carried out in order to analyze which of the trade policies and practices of the major trading nations have the potential to act as unfair impediments to free trade. It is hoped that the material we have compiled will assist the countries concerned in their efforts to promote economic growth through freer trade.

Surveys on "unfair" trade practices have been conducted by various governments and organizations: "National Trade Estimate Report" (the United States Trade Representative); "Report on United States Trade Barriers and Unfair Practices" (the Commission of the European Communities); "Trade Policy Review" (European Parliament); and the "Trade Policy Review" (GATT). No small number of surveys on trade barriers, by Japanese and foreign organizations, have focused on Japan.

What makes a trade policy or practice unfair?

One thing that will not be found in all of these reports is a common definition of unfairness, and sometimes the criteria for judging unfairness are not consistent within one report. Some employ consistency with the GATT and other international conventions. Others regard any practice or policy that differs significantly from those employed in their own country as unfair or undesirable. This report examines the major trading countries' trade policies and practices in relation to international agreements such as GATT and the Paris Convention, as well as generally accepted principles of international law and the comity of nations.

While GATT remains the basic set of rules concerning international trade, we must not overlook the fact that GATT is by no means comprehensive. It does not, for instance, contain an adequate set of rules for the so-called new areas, including intellectual property, trade in services and trade-related investment measures. The problems that now affect these new areas were not completely foreseen at the time GATT was established. But even in the more traditional areas–agriculture is a case in point–the problem-solving capacities of GATT have been limited. The objectives of the Uruguay Round negotiations are to lay down international rules, including those on new areas, thereby expanding the coverage of GATT rules and enhancing the ability of GATT to resolve disputes.

Despite its imperfections, GATT continues to provide the fundamental principles for today's world trade order. If a trade policy or practice of one of the major trading nations is in violation of, or inconsistent with, GATT, it could impede the expansion of world trade as a whole. In this report, we have attempted to identify, examine and assess those policies and practices whose consistency with GATT or other accepted international rules is questionable, and to offer recommendations on how these policies might be modified. In other words, the purpose of this report is not to make an exhaustive list of trade barriers of the major trading economies, but rather hopefully to present a generally acceptable concept of "fairness" in international trade.

We have decided not to include policies and practices concerning agricultural trade. Fundamental reforms in agricultural trade are being attempted in the Uruguay Round. Governments are now prepared to make changes in long-standing policies and practices as soon as the round is successfully concluded. Consequently, the present policies and practices appear likely to change in a radical manner in the near future. For this reason, we have concluded that it would be more appropriate to look at agricultural trade policies and practices at a later date.

This survey focuses on the United States, the European Community and Canada, which, together with Japan, comprise the "Quad" countries. The importance of these four can be illustrated by the fact that, in 1989, they accounted for two-thirds of total world trade. The report identifies trade policies and practices of the U.S. and the EC that are questionable under GATT and, accordingly, to varying degrees undermine the multilateral efforts to promote global free trade. None of the trade policies and practices employed by Canada at present appear to be having a serious effect on the economic relationship between Canada and Japan.

Identifying problems

It should be noted that trade policies and practices of the U.S. are in many cases highly laudable. For example, U.S. trade laws are generally characterized by a high degree of transparency and predictability as well as procedural due process. In this regard, the United States is appropriately held up as a model of trade policy administration in accordance with the rule of law. At the same time, all eyes are also turned, with high expectations from the standpoint of harmonization of trade systems, on the EC, which is in the middle of the historic achievement of making comprehensive and well-organized common trade policies and practices through the unification of the European market. It should also be borne in mind that some problems which are pointed out with respect to the U.S. and the EC may be also found in the policies and practices of other countries.

Japanese trade barriers are not included within the scope of this report, but we do not mean to imply that Japanese practices present no impediments to trade or that Japan's policies and practices are always more "correct" than those of its trading partners. As a country having one of the world's largest GNPs and a responsibility to promote global free trade, it goes without saying that Japan should take the initiative in addressing its own problems, if any, promptly without waiting for them to be pointed out by other nations.

It is sometimes pointed out that certain problems, particularly those relevant to Japan, cannot be effectively solved by international rules. The important point here is, first of all, to identify problems objectively without having an unnecessary exchange of reproaches, and then to try to find the appropriate solutions through bilateral and multilateral efforts. Various approaches could be taken, including coordination of policies and harmonization of systems.

The reason why this report does not attempt to examine and assess Japanese policies and practices is simply because Japanese trade barriers have already been dealt with, quite extensively, by the U.S. "National Trade Estimate" and other reports circulated both at home and abroad, and little can be expected in the way of additional contributions.

The decade of the 1980s saw world trade expand by 50%, from $2 trillion to $3 trillion. Japanese imports and exports with the U.S., the EC and Canada grew at rates exceeding the average−150%, 250%, 100% respectively. The growth rates of Japanese trade with the EC and the U.S. were even higher than the EC-U.S. growth rate of 100%. In the same 10 years, an important shift took place as Japan's imports started to grow at a faster rate than its exports.

For the development of free trade

As this report notes, however, when viewed more generally it is clear that trade with Japan, which has sustained higher rates of growth than the world average, has been a driving force behind the expansion of world trade, and has made a vital contribution to economic growth of not only the Quad countries, but other developed and developing countries as well. From time to time, Japan has been involved in trade friction. In one sense, the trade friction in which Japan has been involved can be seen as a sign of the deepening interdependence between the economies of Japan and other nations.

The purpose of this report is not to intensify mutual criticism by Japan and its trading partners of one another's trade policies and practices. It is, rather, to serve as an aid to mutual efforts to overcome the problems that challenge each country, so that world trade can enjoy further development in the years to come.

We understand that Japanese perspectives concerning the trade barriers that exist in the other major developed nations have not been publicized widely either in Japan or abroad. This report seeks to fill this void in the public discourse on unfair trade policies and practices, thereby contributing to mutual efforts to expand free trade.

Again, I would like to emphasize that the report uses the rules of GATT and other international conventions as our yardstick, in the belief that resolving problems based on these has proved to be an effective process for reducing barriers and increasing economic growth in the world economy and for overcoming protectionism and political difficulties in the countries concerned.

Finally, I wish to note that this report was prepared by the Fair Trade Center, an independent private research institution. Every effort has been made to approach the trade policies and practices of the U.S., the EC and Canada from a scholarly, neutral standpoint.

Summary of the Report

United States

In many respects, the trade policies and practices of the U.S. are highly laudable, and the United States has appropriately been held up as a model of trade policy administration under the rule of law. However, U.S. trade policies and practices have departed from GATT rules with increasing frequency in recent years. These developments are highly regrettable, particularly because of the signal to the many nations around the world that look to the United States for leadership on trade as well as other issues.

1. Unilateral measures

The movement of U.S. trade policy away from multilateralism and toward unilateralism has become of great concern to its trading partners. Many of the unilateral actions which the U.S. has taken are associated with Section 301 of the Trade Act of 1974 and related provisions−"Super 301," "Special 301," the telecommunications provisions of the 1988 Trade Act, and the sanctions provisions of the Federal Buy American Act.

Under these provisions, the United States has increasingly engaged in the following unilateral actions:

- Using the threat of unilateral sanctions to coerce other countries into changing practices which the United States unilaterally has determined to be inconsistent with international obligations (without recourse to international dispute settlement procedures).
- Using the threat of sanctions to coerce other countries into changing practices which admittedly are not covered by international obligations, but which the United States unilaterally has determined to be "unfair."
- Imposing unilateral sanctions without authorization from GATT.

Although it is often pointed out that these actions were developed from a domestic perspective, these unilateral measures have significantly undermined multilateral efforts to resolve disputes and to conclude new trade liberalizing agreements. Moreover, where the U.S. sanctions withdraw GATT concessions without authorization, these actions themselves constitute violations of Articles I, II and/or XI of GATT.

2. Intellectual property

Protection of intellectual property has become increasingly important to international trade. In certain respects, U.S.

policies and practices concerning intellectual property discriminate against foreign inventions, and pose other barriers that many believe to be inconsistent with international rules.

Under the U.S. first-to-invent system, the first person to invent a particular technology is entitled to patent protection. For a U.S. invention, the relevant date for determining priority is the date of invention. For foreign inventions, however, the U.S. system uses the date of patent application in a foreign country as a substitute for the date of invention.

In addition, the U.S. patent system continues to follow the first-to-invent principle, rather than the first-to-file principle which is applied by virtually every other country. The first-to-invent system yields results that are inherently unstable and unpredictable, since the rights of a patent holder may be undermined at any time by someone who challenges their rights based on a claim of prior invention. The peculiarities of the U.S. system needlessly disadvantage foreign applicants who are unlikely to be familiar with the unique system.

Finally, a GATT panel has found that Section 337 of the Tariff Act of 1930 violates Article III of GATT by providing greater intellectual property protection for U.S. products than that which is available for imports. The U.S., however, has failed to implement this decision.

3. Antidumping

Increasingly there is a perception that the U.S. antidumping law is a major unfair impediment to trade with the United States. Although, in many respects, the U.S. antidumping law is the model of a transparent, rule-based system that affords procedural due process, in practice the U.S. law operates in a highly restrictive manner that is inconsistent with the GATT Antidumping (AD) Code. Most importantly, the rules applied by the Department of Commerce (DOC) in calculating dumping margins are significantly slanted against foreign exporters, and therefore do not provide the fair comparison required by the code.

The following are examples of the type of unfairness and bias that currently exist in the operation of the U.S. antidumping law:

- Dumping is defined as sales in the U.S. at prices below the foreign market value (generally, the home-market sale price). Yet, under current U.S. practice, dumping margins may be found even when prices are exactly the same in both markets, as a result of the U.S. practices of comparing an average home-market price to individual U.S. sales prices, making asymmetrical adjustments for selling expenses, and not fully taking exchange rate fluctuations into account.
- Rules requiring that home-market sales found to be at below-cost prices be disregarded are applied rigidly, without regard for commercially reasonable selling practices. As a result, pricing practices that are commonly followed in the U.S. and foreign countries (such as forward pricing in the case of new products, or level pricing in the case of fluctuating costs) may be unfairly penalized.
- In calculating construed value (which is used to represent home-market prices in certain situations), U.S. law mandates the assumption that the producer earned at least an 8% profit. This practice is contrary to the AD Code, which requires that a "reasonable" profit be used in such circumstances, and has been characterized by the predecessor of the International Trade Commission as "arbitrary" and "unreasonable."
- The DOC does not follow the "standing" requirement for petitioners mandated by the AD Code and the U.S. antidumping statute. Although this practice has been specifically held to be inconsistent with the AD Code by a GATT panel, the United States is blocking adoption of the report, instead of complying with the panel's conclusions.
- The U.S. practice in defining what products are subject to an antidumping order has been inconsistent, and has resulted in antidumping duties being imposed on products that were never investigated and never found to have been dumped. The anticircumvention provision is one of these examples.
- The U.S. procedures for the revocation of antidumping duties do not function well. Some antidumping duties last more than 20 years due to the absence of a "Sunset Clause." This U.S. practice is being challenged as a violation of the AD Code.

As a result of these biases and other practices, the U.S. antidumping law now seems to be moving more and more toward becoming an illegitimate safeguards mechanism that operates without satisfying the international rules for safeguards measures. These developments threaten to tarnish the image of the United States as a fair trading nation, and to undermine the confidence of other developed and developing countries in rules and legal process as reliable tools for administering trade policy.

4. Other trade barriers

1) Customs classification

In some cases, the U.S. customs authorities have arbitrarily reclassified products into a category with a higher rate of duty. In the case of multipurpose vehicles, the Customs Service change of classification resulted in a rise of duty from 2.5% to 25% *ad valorem*. The matter was referred to the multilateral Harmonized System (HS) Committee for dispute settlement. The committee found the U.S. reclassification to be improper. Nevertheless, the United States has refused to change its reclassificaiton.

2) Standards

The United States has failed to adopt international standards, thus creating unnecessary barriers to international trade and reducing global economic efficiency. Of an estimated 89,000 standards currently in force in the U.S., only 46 conform with ISO (International Organization for Standardization) standards. This failure violates the spirit–if not the letter–of the GATT Standards Code, which requires the adoption of international standards except where such standards would be "inappropriate."

In addition, congressional proposals to require improvements in automobile fuel efficiency by a fixed percentage would unfairly penalize Japanese imports, which already have higher fuel efficiency than domestic products. Such discriminatory measures might violate Article III of GATT and Article 2.1 of the GATT Standards Code, which provide that internal regulations shall not be adopted with a view to creating obstacles to international trade.

3) Investment regulations

The Exon-Florio amendment has the

potential to act as a barrier to international investment, thus creating uncertainty. Current proposals to expand the authority of the amendment to include the power to block transactions for purely economic reasons would greatly exacerbate this uncertainty.

4) Discriminatory tax treatment

The Revenue Reconciliation Act of 1989 may increase discriminatory burdens on the affiliates of foreign companies, which could be interpreted as a violation of Article III of GATT and Article 7 (3) of the Japan-U.S. Income Tax Treaty.

5) Government procurement

The U.S. has a large body of laws and regulations designed to give preference to American products in government procurement, taking advantage of loopholes in GATT rules and its Government Procurement Code. Although these practices may not necessarily violate international rules, they undermine the principles of free trade that underlie the GATT system, and obstruct opportunities for mutually advantageous trade.

6) Extraterritorial application of antitrust

The U.S. Department of Justice is reportedly preparing new rules that would authorize action, under the antitrust laws, against acts that restrict the export opportunities of U.S. companies. Such rules would expand the extraterritorial reach of the U.S. antitrust laws well beyond current norms of national jurisdiction, and could have a substantial distorting effect on trade.

7) Compulsion of "voluntary" restraints

Japan has been forced to enter into a number of "voluntary" export restraints, as a last resort in order to avoid unilateral import restrictions by the U.S. The threatened restrictions that have given rise to these restraints are often inconsistent with GATT. These measures should be terminated, along with the U.S. measures which have given rise to them.

European Community

With full integration approaching, the EC has gradually amended many trade-distorting practices to make them part of comprehensive and well-organized trade policies and regulations. However, Japanese imports are still subject to unfair barriers as a result of biased antidumping regulations, quantitative restrictions, the arbitrary manipulation of rules of origin and discriminatory standards.

1. Antidumping

EC antidumping rules have some provisions such as "lesser duty" or "sunset," that can be model practices for other countries in fully realizing provisions of the AD Code. In recent years, however, EC antidumping measures have grown increasingly trade restrictive. The following are some examples of EC practices that unfairly distort trade:

- The AD Code provides that investigations "shall normally be initiated upon a written request by or on behalf the industry affected," and that such a request must be supported by "sufficient evidence." In practice, however, the EC has often initiated investigations where the petition did not establish a *prima facie* case of dumping and injury, thus needlessly imposing a substantial burden on respondents.
- Dumping is defined as sales in the export market (i.e. the EC) at prices below normal value (generally, the home-market sales price). Yet, under EC practice, dumping margins may be found even when prices are exactly the same in both markets, as a result of such practices as comparing an average home-market price to individual export sales prices and making asymmetrical adjustments for selling expenses.
- The AD Code provides that, in calculating construed value, the authorities shall include "a reasonable amount" from profit, which "shall not exceed the profit normally realized" in the domestic market. The EC, however, often arbitrarily applies an unusually high profit margin, thereby artificially creating or inflating dumping margins.
- Other unfair practices in the EC's administration of the antidumping law include the following:

– finding injury without any examination of whether there is a causal link between dumped imports and injury;

– the use of an unreasonably high profit in determining the "target price" for calculating injury margins;

– the application of the maximum duty rate to all new entrants;

– the expansion of the scope of an existing order to cover new products, without undertaking new investigations of dumping and injury with respect to those products;

– the deduction of antidumping duties as an adjustment to the sales price, thus effectively double-counting the dumping margins;

– the use of anticircumvention rules which have been found by a GATT panel to be inconsistent with GATT, and failure to comply fully with the panel recommendations.

The cumulative effect of these biased practices is to make the EC antidumping regulations an unfair barrier to trade.

2. Rules of origin

The EC has shown a disturbing inclination to manipulate rules of origin in order to restrict imports. For example, in the context of antidumping measures, the EC has employed origin rules to extend the coverage of antidumping duties to products manufactured in the EC or in third countries using imported parts. Similarly, EC countries have used rules of origin to expand the scope of products manufactured in a third country toward quantitative restrictions applicable to Japan. Rules of origin may also be used to expand restrictions to the areas of safeguards, government procurement and foreign investment.

3. Quantitative restrictions

Quantitative restrictions are generally prohibited by Article XI of GATT. Moreover, Article XIII provides that, where quantitative restrictions are permitted, they may not be applied in a discriminatory fashion. However, EC member states currently impose discriminatory quantitative restrictions against 62 Japanese products. France also maintains an effective quota, by means of administra-

tive guidance, that restricts Japanese automobiles to 3% of the domestic market.

4. Other trade barriers

1) Tariff classifications

From time to time, customs authorities in Europe arbitrarily change the tariff classification applicable to a certain product from one with a lower rate of duty to another classification that is subject to a higher rate. For example, the EC customs authorities sought to change the classification of mechanical assemblies for videocassette recorders from videocassette recorder parts, with a tariff rate of 5.8%, to finished videocassette recorders, which are subject to a 14% tariff. This change was found to be improper by the HS Committee in April 1989. Nevertheless, the EC still has not complied with this decision.

2) Unilateral measures

The so-called New Commercial Policy Instrument of the EC does not contain any provision that would be inconsistent with international obligations or procedures. However, in trade conflicts with the U.S., the EC has shown a readiness to impose unilateral sanctions against another country under the general trade authority vested in the commission. In addition, the EC has adopted a directive authorizing unilateral retaliatory action against other countries that do not permit effective market access or national treatment to EC financial institutions.

3) Intellectual property

The EC fails to give patent protection to biotechnology inventions, creating unreasonable trade and investment risks for Japanese and other foreign companies.

4) Standards

While improvements are expected with the approach of integration in 1992, the disharmony among the standards and technical regulations of different EC member states causes inefficiencies and unnecessary barriers to trade. In addition, foreign firms are often placed at a significant commercial disadvantage by their exclusion from standard-setting committees, since the members of such committees get an early start at developing products that conform to new technical standards.

The following are some examples of specific standards practices of EC countries which restrict Japanese trade:

- Italy requires that certification numbers be indicated on each product sold, but the rules regarding the procedures and time required for the issuance of certifications are not clear. As a result, imports are subject to delays and unexpected cost increases.
- Spain conducts strict inspections of imports to verify compliance with safety standards. However, no such inspections are conducted on domestic goods.
- Portuguese customs authorities require original documents (or authenticated copies) of certificates of compliance with safety standards, creating significant burdens on importers.
- The Netherlands requires exporters from Japan, Taiwan and some communist countries to obtain import licenses from the authorities, causing unreasonable expenses and delays.

5) Government procurement

Public procurement practices in the EC continue to result in far fewer purchases of foreign goods than any of the other Quad countries. GATT statistics show that only 0.7% of government procurement in the EC is of foreign products. By contrast, 15% of Japanese government procurement is of foreign products, compared with 8% for the U.S. and 6% for Canada.

The EC is also beginning to move toward the principle of "reciprocity" in public procurement, by extending access to government procurement markets only to the extent to which the EC unilaterally determines that the country of the firm in question provides the same opportunities to EC firms.

Canada

In contrast with the U.S. and the EC, Canada has only a relatively small number of trade policies and practices that impede trade with Japan. Several policies, however, have the potential for developing into unfair obstacles to international trade. It is expected that the government of Canada will continue to enforce these policies and practices in a GATT-consistent manner.

1. Intellectual property

Canada's Patent Act provides advantageous treatment for pharmaceuticals invented within Canada compared with those invented in other countries, because the latter are subject to compulsory licenses under conditions that are more strict than those applicable to Canadian inventions.

2. Government procurement

On both the federal and provincial levels, Canadian businesses enjoy preferential treatment in government procurement in Canada.

Canada has replaced the Foreign Investment Review Act, which had been found to be inconsistent with GATT, with a new statute that does not require advance approval for foreign investment. However, even under the new law, in some cases prospective investors have been required to enter into "undertakings."

In some Canadian provinces, public ("Crown") corporations require construction bids to include commitments to invest in assembly operations in the province concerned or to purchase local goods.

3. Unilateral measures

Canadian law authorizes the government to impose trade restrictions in response to the unfair trade practices of its trading partners. However, in practice, this authority has not been used to restrict imports from Japan.

4. Antidumping

Canada has an antidumping law which, in theory, is generally similar to the antidumping laws of the United States. But Japanese trade has been little affected by this law in recent years.