Developing a Trade Policy Based on Rules: The Japanese Experience (2)

by Sakamoto Yoshihiro

Dumping Claims: First Semiconductor Disputes

I would like to begin by discussing the first semiconductor dispute between Japan and the United States, which began as a dumping claim in the mid-1980s.

According to WTO rules, anti-dumping (AD) duties can be levied only after clear evidence of dumping has been established and it has been categorically proven that the alleged dumping offense has caused real injury to a domestic industry. After —and only after — a dumping claim has been verified through an investigation by the appropriate agency of the country where the damaged industry is located can further actions, in the form of AD duties, be initiated.

Looking at the number of dumping investigation cases in recent years, it is interesting to note that while the total number of dumping investigation cases doubled from the 1970s to the first half of the 1980s — there was only a slight increase in the latter half of the 1980s. In the 1990s, however, we are seeing another upward trend. Also, while in the past, the initiation of AD measures was seen primarily in the United States, the EU, Canada and Australia, in recent years we are seeing a marked increase by developing countries such as Brazil, Korea and South Africa. (Chart 1)

The number of instance in which dumping duties have been levied on imports from Japan — including price undertakings — showed a marked increases in the 1980s, but gradually decreased in the 1990s. However, duties levied by developing countries have been increasing over recent years.

In my opinion, the increasing trend toward the initiation of AD measures reflects several factors: One, AD measures have become an increasingly important policy tool in an environment characterized by accelerated globalization and intense international price competition; and two, AD measures have become a more important part of the process through which developing countries are incorporated into the international economic system as the result of their having achieved a certain level of economic development.

This is not to minimize the need for rules-based corrective measures when dumping has in fact caused injury to an importing country's domestic industry. Such activities will hinder the normal flow of trade and must be rectified.

However, if AD measures are abused as a means to camouflage the implementation of protective trade policies in cases where "genuine dumping" does not clearly exist, serious problems will come to the surface. Additionally, since AD measures are only admitted as an exception to most-favored-nation treatment, the initiation of such measures should be implemented only with the strictest caution.

Looking at the actual initiation of AD measures over the years, there have been cases in which a price comparison between domestic prices and export prices could be called unfair. Other cases have shown low-pricing strategies, which have been traditionally admitted as a normal business practice, to be judged as dumping. While such instances may be more appropriately called "artificial or disguised dumping" they were, nevertheless, unfairly subjected to dumping duties. In my view, as these were not genuine dumping cases, they should not be subjected to dumping sanctions.

Another typical example of unfair treatment is the calculation method that seeks to amortize the investment costs of a facility into domestic prices in an inappropriate manner. It is customary for capital-intensive industries such as iron and steel to establish prices under the assumption that investment costs will be recovered on a long-term basis. Nevertheless, officials who are engaged in dumping investigations might perceive that sales have been made below actual cost on the basis of limiting their evaluation to production volumes over the short period of time while the investigations are made. This neglects a recognized business practice, and increases the risk that these acts will be recognized as real dumping, when in reality, they are actually a camouflaged, "pseudo" type of dumping. The actual recovery of costs must be considered over an appropriate time frame, so that inves-

Chart 1: Recent Trends in Anti-dumping Cases Involving Japan

	1969 – 74	1975 – 79	1980 – 84	1985 – 89	1990 – 94	1996 – 97
Total number of Investigations	225	453	712	689	969	430
Number of cases resulting in imposition of sanctions on Japan (Figures in parentheses: developing countries)	–	–	46(0)	44(1)	38(9)	11(6)

tigators do not inaccurately amortize investment costs into production costs at a higher rate than is justified.

Next there is the problem that is called "level of trade." This refers to the need to make price comparisons between domestic and export prices at the same level and stage of a business transaction. Otherwise, serious problems can result. For example, regulatory authorities in the EC used to allow marketers to set their export prices after deducting, not only the direct and indirect sales expenses borne by their overseas associate firms, but also the profits earned by such firms. This was the case even though when establishing domestic prices they were only allowed to deduct direct sales expenses. As a result, this situation artificially indicated an appearance of dumping, as domestic prices were set at a higher level. The GATT panel decided, however, that this EC practice violated the WTO Agreement and recommended that the EC make appropriate adjustments. The EC has since made the necessary statutory amendments to address the GATT recommendations.

Photo: Kyodo News

Semiconductor negotiation between the U.S. Semiconductor Industry Association and the Japanese Electronic Industries Association in 1987

Another important problem is the well-known issue of "forward pricing." This is a price-setting policy that sets an initial price at an intentionally low level in the expectation that increased volumes, technological advances and a firm's experience will allow sharp cost reductions in the future. This is a common practice in fields such as high-technology, where dramatic increases in productivity are realized as firms become more proficient in production of a specific product. In the United States in particular, many technology-oriented exporters — and domestic manufacturers as well — employ a strategy that seeks to gain market share in order to develop the large economies of scale needed to compete on a global basis, as well as to ensure their long-term profitability. Investigations, however, which base their cost criteria on extremely high constructed prices (artificially computed costs) at the initial stage of production without considering the practice of forward pricing, will tend to view these initial prices as being below the cost of production. This will lead them to recognize extremely high dumping margins.

The 1986 determination by the United States government, which alleged that Japanese firms were dumping semiconductors in the U.S. market is a typical example of the problems that can arise from "forward pricing."

Semiconductor manufacturers experience rapid declines in their production costs. These declines can exceed 80% in the first year and range up to 90% or more — over two to three years. It is therefore customary that they establish prices at a significantly lower level than their average cost at the start-up of sales, on the assumption that prices will fall sharply over a short period of time. The United States, however, maintained that Japanese firms were dumping — on the grounds that Japanese sales in the U.S. were price below their actual cost.

This first semiconductor dispute between Japan and the U.S. government was settled by a Suspension Agreement (price undertaking) as well as the First Semiconductor Arrangement in 1986. This First Semiconductor Arrangement was intended to promote cooperation between Japanese and U.S. industry. Since most of you are familiar with the history of this issue — which led to an initiation of Section 301 measures by the United States in 1987 — I will not dwell on this topic. Afterwards, the Japanese Government participated in the Uruguay Round negotiations with the perception that AD measures had not been initiated in a way that adequately addressed the important issue of "forward pricing." In the new AD Agreement established through the Uruguay Round negotiations, provisions concerning forwarding pricing techniques were introduced that stipulate the cost adjustment method to be used at a start-up stage. (Chart 2) These new provisions clearly state that the judgment of whether sales are made below cost shall be made by reflecting sharp cost reductions during the target period for investigations. The rules themselves have now been clearly defined to ensure that these normal business practices will be reflected in judgments concerning dumping applications.

It should be noted that AD measures are, in principle, exceptional measures and a clear deviation from the accepted principle of most-favored-nation treatment. Since it is directly related to the most essential strategy of price setting for a firm, the utmost caution should be given to initiating AD measures. Based on these concerns, the rules and regulations relating to issues such as forward pricing and price comparisons based on

Chart 2: Points of New Provisions Related to Forward Pricing

[New provisions related to forward pricing]

2.2.1 Sales of the like product in the domestic market of the exporting country or sales to a third country at prices below per-unit (fixed and variable) costs of production plus administrative, selling and general costs may be treated as not being in the ordinary course of trade by reason of price and may be disregarded in determining normal value only if the authorities*1 determine that such sales are made within an extended period of time*2 in substantial quantities*3 and are at prices which do not provide for the recovery of all costs within a reasonable period of time. If prices which are below per-unit costs at the time of sale are above weighted average per-unit costs for the period of investigation, such prices shall be considered to provide for recovery of costs within a reasonable period of time.

Notes:

*1 When in this Agreement the term "authorities" is used, it shall be interpreted as meaning authorities at an appropriate senior level.

*2 The extended period of time should normally be one year but shall in no case be less than six months.

*3 Sales below per-unit costs are made in substantial quantities when the authorities establish that the weighted average selling price of the transactions under consideration for the determination of the normal value is below the weighted average per-unit costs or that the volume of sales below per-unit costs represents not less than 20% of the volume sold in transactions under consideration for the determination of the normal value.

[Points]

1. "Not being in the ordinary course of trade by reason of price" shall be defined as follows:
Sales at prices below per-unit costs of production plus administrative, selling and general costs shall meet all the conditions stated hereunder:

(1) Such sales are made over a long period and in substantial quantities.
  a. Long period = Normally one year but in no case less than six months.
  b. Substantial quantities = In case quantities come under either of the following two categories:
    (i) (weighted average selling price) $<$ (weighted average per-unit cost)
    (ii) (volume of sales below cost) $\geqq$ (volume of sales) x 20%

(2) Prices are such that all costs cannot be recovered within a reasonable period of time.

(3) Even if (per-unit costs at the time of sale) $>$ prices, if price $<$ (weighted average per-unit costs), such prices shall be considered to provide for recovery of costs within a reasonable period of time.

2. Transactions that are not in the carried out ordinary course of trade may be disregarded in determining normal value.

weighted averages have been strengthened and improved.

To clarify investigation proceedings, quantitative criteria to apply for AD duties have been identified. In addition, it was agreed that AD measures are no longer applied in cases where an investigation determines that only slight dumping margins or marginal imports have been in effect.

Furthermore, to avoid the continuation of dumping duties after the settlement of a dumping claim, a sunset clause has been legislated. It states that AD duties shall, in principle, cease automatically five years after the imposition of dumping duties has begun.

As I mentioned earlier, although the regulations that surround AD measures have been strengthened to avoid their being abused for protectionist purposes, it is generally recognized that many additional improvements need to be made. Pressing issues include "circumvention rules" and other issues that will help us to cope with the

2.2.1.1 For the purpose of paragraph 2, costs shall normally be calculated on the basis of records kept by the exporter or producer under investigation provided that such records are in accordance with the generally accepted accounting principles of the exporting country and reasonably reflect the costs associated with the production and sale of the product under consideration. Authorities shall consider all available evidence on the proper allocation of costs, including that which is made available by the exporter or producer in the course of the investigation provided that such allocations have been historically utilized by the exporter or producer in particular in relation to establishing appropriate amortization and depreciation periods and allowances for capital expenditures and other development costs. Unless already reflected in the cost allocations under this sub-paragraph, costs shall be adjusted appropriately for those non-recurring items of cost which benefit future and/or current production, or for circumstances in which costs during the period of investigation are affected by start-up operations*4.

Note:

*4 The adjustment made for start-up operations shall reflect the costs at the end of the start-up period or, if that period extends beyond the period of investigation, the most recent costs which can reasonably be taken into account by the authorities during the investigation.

[Outline of Articles and Points for Revision]

I. Outline

Methods for calculation of costs are defined as follows:

1. Costs shall normally be calculated on the basis of records kept by the exporter or producer (Under the condition that such records are in accordance with the generally accepted accounting principles of the exporting country and reasonably reflect the costs associated with production)
2. Costs shall be properly allocated (Under the condition that such allocations have been historically utilized by the exporter or producer).
3. Costs shall be adjusted appropriately for:
   1) Non-recurring items of cost
   2) Start-up operations

   The adjustment made for start-up operations shall reflect:
   a. Costs at the end of the start-up period or
   b. (If that period extends beyond the period) The most recent costs which can reasonably be taken into account by the authorities during the investigation.

II. Points for Revision: All are newly established rules.

accelerated trend toward economic globalization.

Before moving on, these is one point I would like to emphasize. Governments should not — and must not, under any circumstances attempt to hide real dumping behind a curtain. It is necessary that we all bravely deal with and acknowledge protectionist practices, respecting enforcement measures such as AD measures, so long as they are initiated in full consideration of WTO rules. However, if dumping should really be perpetuated by an exporting country, domestic industries within an importing country will naturally be injured. It is perfectly appropriate to levy dumping duties under those circumstances. JJTI

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