United States General Accounting Office 131921

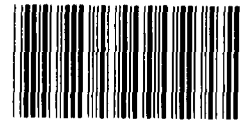
GAO

Report to the Chairman, Subcommittee on International Trade, Committee on Finance, United States Senate

December 1986

INTERNATIONAL TRADE

Trade Law Remedies Under Floating Exchange Rates



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United States
General Accounting Office
Washington, D.C. 20548

National Security and
International Affairs Division

B-224929

December 16, 1986

The Honorable John C. Danforth
Chairman, Subcommittee on
International Trade
Committee on Finance
United States Senate

Dear Mr. Chairman:

This report responds to your request of January 28, 1986, that we examine the compatibility of the floating exchange rate regime with the principles of the international trading system and U.S. trade laws. Specifically, you requested that we determine (1) how exchange rate fluctuations can affect import relief granted under section 201 of the Trade Act of 1974, as amended, (2) whether exchange rate changes alter the findings reached and the protection provided under the antidumping and countervailing duty laws, and (3) whether General Agreement on Tariffs and Trade goals, principles, and remedies are compatible with a system of floating exchange rates. We have reviewed the literature on this topic, discussed the issues with government and private sector experts, and analyzed selected trade cases to illustrate the consequences of exchange rate movements for trade law remedies.

We found that exchange rates will influence the effectiveness of tariffs in protecting domestic industries. If the dollar were to appreciate relative to other currencies after imposition of a tariff, for example, the effective protection would be diminished. This does not cause substantive problems for the antidumping and countervailing duty provisions. These provisions are intended to offset unfair price advantages that subsidized or dumped imports may enjoy over domestic products. In general, the provisions are applicable when the imports have caused injury to the domestic industry. Countervailing duties are imposed to offset the effects of foreign government subsidies and antidumping duties to offset dumping, which is the sale of imports at prices below their fair value. Although industries that have received relief from dumped or subsidized imports could still be injured by imports if the dollar appreciated after the appropriate duty was imposed, the unique disadvantage that industries face from dumping or subsidies remains offset by the imposed duty.

We also found that when exchange rate changes impair the ability of tariffs to protect industries that have obtained relief under the safeguard or escape clause provisions of section 201, they create substantive problems in achieving the law's objectives. Section 201 is expressly intended as a device to temporarily remedy or prevent injury from imports, allowing the domestic industry an opportunity to adjust to the import competition. Tariffs and quantitative restrictions on imports can be imposed to protect the domestic industry. Quotas or other quantitative restrictions on imports will provide a level of protection that is not as directly affected by exchange rate changes as tariffs would be. The greater certainty of protection provided by quantitative restrictions in the face of exchange rate or other changes may help explain their frequent use in section 201 and other safeguard actions.

Quantitative restrictions on imports do impose considerable economic costs on the country seeking to limit imports. A desire to provide a set level of protection while avoiding or minimizing these costs has led to proposals that import licenses be auctioned in section 201 cases. Section 1102 of the Trade Agreements Act of 1979 authorizes the President to auction import licenses to administer relief granted under section 201.

While experience with auctioned import licenses does not provide a sufficient basis for advocating widespread use, we believe that their potential advantages relative to the known disadvantages of current measures warrant their consideration. Therefore, we recommend that the Secretary of the Treasury direct the Department to experiment with auctions of import licenses in selected cases and evaluate their effectiveness, administrative feasibility, and potential for wider application.

While quantitative restrictions offer the advantage of greater assurance of protection in safeguard actions, the General Agreement on Tariffs and Trade favors tariff protection since tariffs create less trade distortion, are less burdensome, and are generally a less ambiguous or hidden form of protection. Efforts to negotiate an agreement governing international use of these safeguard actions will have to balance these competing interests. We recommend that the U.S. Trade Representative, in negotiations with other nations on a safeguards code, explore the feasibility of including auctioned import rights to administer quantitative restrictions as an option for nations to implement safeguard actions.

Our analysis did not reveal a need for legislative recommendations. We sought comments on this report from the U.S. Trade Representative; the

Departments of Commerce, State, and the Treasury; and the International Trade Commission. The Department of Commerce disagreed with our recommendation that import licenses be auctioned in selected cases brought under section 201, noting that the administration has opposed auctioning quota rights. Commerce asserted that the costs of auctioning far outweighed the benefits, that auctioning quotas would "raise questions regarding our GATT obligations", and that mandatory auctioning would make it more difficult to negotiate orderly marketing agreements under section 201. Commerce also stated that auctioning quotas would require a new administrative bureaucracy during a period of budgetary restraint.

We agree that auctioning could be challenged within the GATT dispute settlement process, but the outcome of such a challenge is uncertain because auctioned quotas could fall within the scope of actions allowed in Article XIX, Safeguards, of the GATT. We are recommending auctioning in selected cases on an experimental basis, rather than mandatory auctioning. We believe this might actually be an incentive for other nations to negotiate orderly marketing agreements in appropriate cases because such agreements would provide a surer outcome than open bidding.

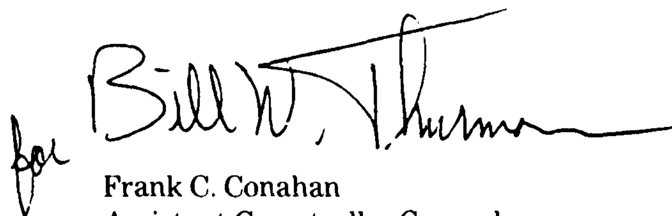
We question whether the potential creation of a new administrative system presents a significant obstacle to our recommendations. First, the auctioned quotas would be used in lieu of some other form of quantitative restraint, and we see no reason to expect that auctioned quotas would be a greater burden for the government to monitor and enforce. Second, if running an auction would cost more than allocating quota rights by administrative fiat or negotiations, these costs could be offset by auction revenues.

Based on other comments received from the Departments of Commerce and State and the International Trade Commission, we corrected or clarified statements in the report. The U.S. Trade Representative and the Department of the Treasury did not comment on the report.

Detailed information on these issues is presented in the appendices.

Copies of this report are being sent to the Secretary of the Treasury, the U.S. Trade Representative, various congressional committees, and other interested individuals. Copies will be made available to others upon request.

Sincerely yours,



Frank C. Conahan
Assistant Comptroller General

Contents

Letter		1
Appendix I Background		8
	U.S. Trade Laws	9
	General Agreement on Tariffs and Trade	11
	Objectives, Scope, and Methodology	11
Appendix II Section 201 Safeguard Actions		13
	Imports Versus Exchange Rates as a Substantial Cause of Injury	15
	Relief and Exchange Rates	16
	Conclusions	19
	Recommendation	20
	Agency Comments and Our Evaluation	20
Appendix III Antidumping and Countervailing Duties		22
	Antidumping Laws	23
	Countervailing Duties	27
	Injury Tests	28
	"Margin Analysis"	28
	Collection of Duties	31
	Effects of Exchange Rate Variations After a Final Decision	31
	Agency Comments and Our Evaluation	32
Appendix IV Exchange Rate Movements and GATT Effectiveness		33
	GATT Goals, Principles, and Remedies	34
	Floating Exchange Rates and International Trade	37
	Conclusion	38
	Recommendation	38
	Agency Comments and Our Evaluation	38
Appendix V Comments From the Department of Commerce		39

Appendix VI Comments From the Department of State 40

Appendix VII Related GAO Reports 43

Abbreviations

AD	Antidumping
CVD	Countervailing duty
EC	European Community
GAO	General Accounting Office
GATT	General Agreement on Tariffs and Trade
IMF	International Monetary Fund
ITC	International Trade Commission

Background

Since 1973, the United States and most industrialized Western countries have had a system of floating exchange rates for their currencies. This period of floating rates followed the breakdown of the Bretton Woods fixed exchange rate system, which had prevailed since 1944.

Under the Bretton Woods system, nations pegged their currencies to the U.S. dollar, largely because of the overwhelming economic strength of the United States in the years immediately following World War II. The dollar, in turn, was pegged to gold. Nations adjusted these rates, or parities, in response to changes in economic conditions, such as persistent balance-of-payments deficits or surpluses. In many cases, however, these changes were politically costly for nations that had to devalue their currencies, inducing strong resistance to changing the parities.

The Bretton Woods system collapsed in 1973 despite efforts to sustain it. By the early 1970's, an overvalued dollar and large dollar outflows had strained the Bretton Woods system to the breaking point. Underlying these immediate and visible problems were (1) disparities in national economic policies despite the greater economic interdependence of nations and (2) the reluctance of countries with undervalued currencies to revalue their currencies and ease the strain on the system. The move to floating rates in 1973 was widely regarded as a temporary phenomenon, but oil price shocks, worldwide inflation, and sharply increased international capital flows prevented a return to fixed rates.

By the late 1970's, floating rates were no longer thought of as being temporary. Although exchange rates currently float according to market conditions, government actions can strongly influence exchange rates. The role of governments in controlling exchange rate movements, however, varies over time and among nations; for instance, some nations frequently try to manage exchange rates. The United States, however, generally does not try to set the dollar at a specific value through a deliberate policy. In addition, nations sometimes coordinate their efforts to manage exchange rates. In September 1985, finance ministers and central bankers of the Group of 5 nations (France, Japan, West Germany, the United Kingdom, and the United States) agreed to coordinate actions to accelerate the dollar's decline. Plans to manage floating exchange rates through coordination of economic policies also were announced during the May 1986 Economic Summit in Tokyo. The long-term effects of such plans on exchange rates are unclear and the effectiveness of actions directed solely at exchange rate targets remains controversial. Many analysts believe that targets, whether formally or

informally set, cannot be met without changing underlying economic policies.

U.S. Trade Laws

At the time of the switch to floating exchange rates, it does not appear that anyone seriously questioned the consistency of floating rates with U.S. trade laws. The implications of floating exchange rates were not clear at the time, and the need to find a substitute for the failing Bretton Woods system meant that the new exchange rate regime was not "designed," as the Bretton Woods system had been.

Although exchange rates and trade laws are related issues, they are frequently addressed through separate mechanisms. Exchange rate issues are generally addressed as macroeconomic policy issues, while trade laws focus on and affect specific industries that are injured by imports.

The strength of the U.S. dollar in the early and mid-1980s brought to the forefront the relationship between exchange rates and trade laws. The strength of the dollar is generally thought to have contributed to the record U.S. trade deficits by making exports more expensive and imports less expensive. Many U.S. industries, such as the steel industry, suffered sharp financial losses because of increased competition from imports. These industries sought relief through a variety of U.S. trade laws, including the countervailing duty (CVD) and antidumping (AD) laws and section 201 of the Trade Act of 1974, as amended. In many other cases, industries did not receive relief through formal statutory processes but instead were able to persuade the government to provide relief through informal channels. The voluntary restraint agreement on Japanese automobiles is an example.

When most U.S. trade laws were written, the United States was on a fixed exchange rate system. The Antidumping Act of 1921 and the Tariff Act of 1930, which together provide the basis for the AD and CVD laws, were passed when the United States and most other nations of the world were on the gold standard. Similarly, the origins of section 201 can be traced to the era before floating exchange rates were firmly in place.

The CVD and AD laws were written to provide U.S. industry with an opportunity to compete against imports without interference from unfair foreign competition. These laws have been amended several times since exchange rates have been allowed to float, but the changes have been made primarily to conform the U.S. statutes to the international

agreements made during the Kennedy and Tokyo Rounds of trade negotiations and to increase administrative efficiency. None of the amendments appears to have been motivated by the switch to floating exchange rates.

The relationship of exchange rates and the trading system changed when the Bretton Woods system collapsed, but the extent of that change was not as revolutionary as it might seem. Even under the "fixed" rate system of Bretton Woods, exchange rates did change. The dollar was rarely devalued against gold, but the value of other currencies against the dollar did fluctuate. The changes in the parities established under Bretton Woods were less frequent, but often more dramatic, than the day-to-day changes in market-determined exchange rates. Thus, even under fixed exchange rates, the level of protection provided by tariffs was influenced by changes in exchange rates.

Floating exchange rates, however, have increased the burden on the CVD and AD laws to help U.S. industries maintain or regain their competitiveness. For example, a U.S. industry competing effectively with subsidized or dumped imports might be forced to seek relief if the dollar appreciates. Moreover, a decline in the value of the dollar could also cause a U.S. industry to seek relief from dumped imports if competing foreign exporters did not adjust their prices.

A strong dollar can also induce more U.S. industries to seek relief from fairly traded imports by using section 201. Under this section, industries may seek temporary relief in the form of quotas, orderly marketing agreements, tariffs, tariff-quotas, and/or assistance in industrial adjustment to relieve them from injury caused by imports. Section 201 does not require a demonstration that the imports have been unfairly traded. The purpose of section 201 is to ensure that individual industries do not bear an unequal burden of adjusting to trade liberalization in an open trading system and that protected industries have a period to adjust to import competition by either lowering costs or exiting the industry in an orderly manner. If the relief granted under section 201 is diminished by subsequent exchange rate movements, however, it is questionable whether the relief will accomplish the goals of the law. In particular, tariffs imposed under section 201 may become much less effective relief measures if the dollar appreciates after the tariff is imposed. The level of protection provided by a quota would be unaffected by any subsequent appreciation of the dollar, although such an increase would make foreign firms more profitable. In the long run, this could endanger U.S. industry efforts to adjust and become more competitive. Conversely, a

depreciation of the dollar following imposition of a tariff could engender greater levels of protection than anticipated. Again, the protection of a quota would be unchanged.

General Agreement on Tariffs and Trade

International trade among market economies and some centrally planned economies is governed by a variety of international agreements and rules, the most important being the General Agreement on Tariffs and Trade (GATT). The GATT is both an institution and a system of principles specifying the rights and obligations of member nations. It is based on the principle that economic factors, such as differences in prices, product quality, or costs of production among nations, should determine trade patterns rather than government intervention. As an institution, the GATT provides an international forum for discussing trade practices and for resolving disputes that arise among member nations. In practice, there are many exceptions to or deviations from GATT principles and rules, some of which have explicit GATT approval.

When the GATT was established in 1947, exchange rates were fixed under the Bretton Woods system. Under GATT auspices, seven rounds of multilateral trade negotiations have taken place that have reduced tariff rates and established procedures for dealing with unfair trade practices. The U.S. AD and CVD laws and section 201 conform with the GATT codes or agreements reached during the negotiations. At the Tokyo Round of negotiations, in 1979, floating exchange rates had already been adopted, but the issue does not appear to have played a prominent role in those negotiations.

Objectives, Scope, and Methodology

The Chairman of the Subcommittee on International Trade, Senate Committee on Finance, requested that we examine the compatibility of the floating exchange rate system with the principles of the trading system and of U.S. trade laws. Specifically, we were requested to determine (1) how exchange rate fluctuations can affect relief granted under section 201 of the Trade Act of 1974, as amended, (2) whether exchange rate changes alter the findings reached and the protection provided under the CVD and AD laws, and (3) whether GATT goals, principles, and remedies are compatible with a system of floating exchange rates. We were also asked to provide recommendations for legislation dealing with either U.S. trade laws or negotiating authority for a new round of multilateral trade negotiations. Our analysis did not reveal a need for legislative recommendations.

We spoke with officials of the Office of the U.S. Trade Representative; the Departments of Commerce, the Treasury, and State; the International Trade Commission (ITC); and the Customs Service about their procedures for carrying out the provisions of the CVD and AD laws and section 201 and about U.S. rights and obligations under the GATT and other international agreements. In addition, we discussed the issues in this report with private-sector officials and researchers. These officials and researchers were selected to indicate the range of opinions and options rather than to develop a sample to statistically measure prevailing views of the effects of floating exchange rates on U.S. laws and international accords. We reviewed studies by multinational organizations, government agencies, and private researchers analyzing U.S. trade laws and international trade rules. We also analyzed selected cases brought under the AD and CVD laws and section 201 to illustrate how Commerce and ITC include exchange rates in their determinations. Finally, this report builds on our previous reports that examine the relevance of GATT, both as an institution and a system of rules, international agreements on subsidies and government procurement, U.S. trade law, and the floating exchange rate system. (See app. VII for a listing of relevant GAO reports.) Our review was conducted in Washington, D.C., between January 1986 and May 1986 in accordance with generally accepted government auditing standards.

We sought comments on a draft of this report from the Office of the U.S. Trade Representative; the Departments of Commerce, the Treasury, and State; the International Trade Commission; and the U.S. Customs Service. We received formal comments from the Departments of Commerce and State and staff comments from ITC. We also informally discussed the draft report with an official of the Office of the U.S. Trade Representative. Agency comments are included as appendices V and VI.

Section 201 Safeguard Actions

Sections 201 et seq. of the Trade Act of 1974, as amended, provide temporary relief from import competition for industries injured by fairly-traded imports to allow them to adjust to the imports. Section 201, commonly called the "escape clause," is based on the recognition that, while the benefits of trade liberalization and an open trading system are spread across the entire economy, the costs may be disproportionately borne by particular industries. By permitting safeguard actions, i.e., measures providing temporary relief from import competition, the escape clause is intended to relieve this unequal burden and provide industries with a period during which they may adjust to import competition. Section 201 is not limited to cases in which imports are unfairly traded. Section 201 is consistent with GATT Article XIX, which defines permissible import relief options, but is more liberal for domestic industries because it does not require that the injury be attributable to a trade liberalization or concession negotiated under the GATT.

The ITC is charged with determining whether an article is "being imported in such increased quantities as to be a substantial cause of serious injury" or a threat of serious injury to a competing domestic industry in section 201 cases. The statute defines "substantial cause" as a "cause which is important and not less than any other cause." In determining whether an industry is seriously injured or threatened with serious injury, the ITC considers relevant economic indicators, including

"...the significant idling of productive facilities in the industry, the inability of a significant number of firms to operate at a reasonable level of profit, and a significant unemployment or underemployment within the industry."[1]

Similar variables may indicate threat of serious injury:

"... a decline in sales, a higher and growing inventory, and a downward trend in production, profits, or employment (or increasing underemployment)."[2]

If the ITC determines that a domestic industry is being seriously injured or is threatened with serious injury by imports, it recommends to the President the relief necessary to prevent or remedy injury, such as tariffs or quantitative restrictions on imports. If it finds that adjustment assistance would be effective, ITC may recommend such assistance. Based on a consideration of the ITC recommendation, the needs of the industry, and national economic interests, the President decides what

[1] 19 U.S.C. 2251 (b)(2)(A).

[2] 19 U.S.C. 2251 (b)(2)(B).

relief, if any, to provide. The President may decide not to provide relief or to grant relief in a manner other than that recommended by the ITC.[3] The relief ordered by the President may include negotiating orderly marketing agreements with the exporting nation. The President may also direct the Secretaries of Commerce and Labor to give expedited consideration to petitions for adjustment assistance filed by the industry or its workers; this expedited aid may supplement or replace other forms of relief.

In many cases, industries that receive relief from imports do so outside the normal procedures set in the law, such as the Japanese voluntary restraint agreement providing quantitative limits on automobile exports to the United States. This relief has often gone to declining industries whose size, regional importance, or products have been so significant that departure from normal procedures was deemed necessary. Quantitative restrictions have been used much more often than tariff increases in recent years to provide such relief.

In section 201 cases, the prime consideration is not whether imports are unfairly traded but whether increasing imports are causing the requisite harm. The purpose of the "serious injury" standard is to ensure that the law is not used to protect every industry that competes against imports. The ITC must weigh causes of injury and find that the increased imports are at least as important as any other cause of the injury. The law, however, does not specifically define what other causes should be examined. The ITC is instructed to consider all relevant economic factors in determining whether imports have caused serious injury to the domestic industry, including an increase in imports (either actual or relative to domestic production) and a decline in the proportion of the domestic market supplied by domestic producers.

ITC commissioners differ over what constitutes a cause of injury. For example, prior to 1983, several commissioners considered an economic recession as a causal factor that could outweigh the impact of increased imports.[4] In more recent cases, however, most commissioners have

[3]When the President does not implement the ITC recommendations, he must report his reasons for the decision to the Congress.

[4]See Certain Motor Vehicles and Certain Chassis and Bodies Therefor, USITC Pub. 1110 (1980), in which the ITC denied the automobile industry's request for relief.

rejected the argument that a recession is a single cause, citing the multitude of interrelated factors associated with a decline in consumption caused by a recession.[5]

Imports Versus Exchange Rates as a Substantial Cause of Injury

Section 201 does not explicitly address exchange rate changes and their subsequent role in determining the cause of injury and commissioners have never totally agreed on the proper treatment. However, the ITC has never found that an exchange rate movement, as opposed to the imports themselves, was the substantial cause of injury.[6]

Several options are available to the ITC in weighing the effect of sharp exchange rate movements on injury determinations in section 201 cases.[7] To date, the commissioners as a whole have not embraced any one of these alternatives. First, an exchange rate change could be treated as a factor that merely explains the increase in imports; it would not be considered as a separate cause of injury and could not be used to deny relief to an industry. A majority of the commissioners have often followed this approach.

Second, an exchange rate change could be treated as a separate and distinct cause of injury to be weighed against imports in determining whether imports were a substantial cause of the injury. Under this line of reasoning, if the appreciation of the dollar led to the increase in imports, the appreciation of the dollar would be the actual source of injury to the domestic industry rather than the imports. Under this option, relief could be denied to the domestic industry on the grounds that the exchange rate change caused more injury than imports and that section 201 is an inadequate vehicle for relief from the injury attributable to macroeconomic variables, including exchange rates. As previously noted, the ITC has never taken this position with respect to exchange rates. Some commissioners believe that their responsibility is

[5]See for example, Heavyweight Motorcycles and Engines and Power Train Assemblies Therefor, USITC Pub. 1342 (1983). In Stainless Steel and Alloy Tool Steel, USITC Pub. 1377 (1983), the ITC cited other causes, such as technological change, product substitution, or interest rate changes as possible causes of a decline in consumer demand.

[6]Individual commissioners, however, have cited the effects of sharp exchange rate movements as an overriding cause of injury in specific cases. In particular, see Commissioner Stern's comments in Stainless Steel and Alloy Tool Steel and Commissioner Alberger's comments in Bolts, Nuts and Screws.

[7]The Federal Trade Commission outlined some suggestions to the ITC in Prehearing Brief by the Federal Trade Commission: Carbon and Certain Alloy Steel Products, (Investigation No. TA-201-51), May 1984.

not to determine why imports are increasing but rather to determine if imports are increasing, if the domestic industry is seriously injured, and if increased imports are the substantial cause of the serious injury. They may argue that section 201 is not the best tool to correct distortions brought about by currency fluctuations, but frequently see it as being one of the few tools available under the law to help industries injured by imports.[8]

Third, a flexible approach could be adopted whereby the cause of the exchange rate fluctuation would determine whether it would be treated as a substantial cause; if the cause is attributable to foreign factors (i.e., the foreign currencies of exporters depreciated relative to the currencies of most countries, including the United States) then the exchange rate change would not be considered a separate cause of injury. However, if the cause of the exchange rate movement was due to U.S. factors (i.e., the dollar appreciated relative to most foreign currencies) then the exchange rate change would be considered a separate cause of injury. A problem with this approach is the inherent difficulty of attributing exchange rate fluctuations to specific causes.

Relief and Exchange Rates

In addition to the relief granted in the forms of quantitative restrictions or tariffs, certain industries have received relief outside the normal channels of section 201 relief, such as the Japanese automobile voluntary restraint agreement (VRA) and the VRAs with the major carbon steel producers.[9] (Both industries had petitioned for relief under section 201.) The Japanese auto VRA, in fact, came after the ITC denied the domestic industry's request for relief.

Industries seeking relief generally prefer quota relief to tariffs, because quotas provide more certain protection against additional import penetration. If tariff relief is granted, foreign producers and/or importers could lower their prices and absorb some or all of the increased duty themselves to ensure that sales are not lost. As long as a quota is restrictive or binding (in the sense that imports would be higher if the quota did not exist), exporters have little incentive to lower their prices and U.S. producers face less price competition. A quota restricts the supply

[8]See, for example, the opinion of Commissioner Eckes in Nonrubber Footwear, USITC Pub. 1717 (1985), pp. 135-50.

[9]See GAO report, Current Issues in U.S. Participation in the Multilateral Trading System (NSIAD-85-118, Sept. 23, 1985) and Hufbauer, Gary C. and Howard Rosen, Trade Policy for Troubled Industries (Washington, D.C.: Institute for International Economics, 1986).

of imports so that foreign producers and their U.S. dealers can earn higher profits because of the artificial scarcity. U.S. consumers, however, generally suffer from this lack of price competition; for example, under the Japanese auto VRA, the price of a Japanese auto is estimated to have increased by approximately $1,000 above what it would have been if the VRA did not exist. According to one estimate, Japanese manufacturers and their U.S. dealers received at least $2 billion a year from these higher prices.[10]

An additional reason that injured industries prefer to receive import relief in the form of quotas is to protect themselves from changes in exchange rates. The dollar could become stronger after relief is granted, which would lower the effective protection provided by the tariff increase. Quotas, on the other hand, provide a constant level of protection that cannot be offset by movements in exchange rates. If a quota is imposed and the dollar subsequently strengthens, for instance, imports will be unable to capture a larger share of the U.S. market. (Exporters, however, may enjoy greater profits.) Thus, a quota, assuming it is binding, will protect a U.S. industry from an increase in the value of the dollar. If the dollar weakens after a quota is imposed, import prices may rise, just as they would if the quota was not in place. Import prices eventually could increase enough that reduced U.S. demand for the imported products falls below the quota limit, so it no longer limits imports.

On the other hand, a fixed tariff cannot fully protect a U.S. industry from a stronger dollar. If the dollar strengthened after a tariff was imposed, the level of protection would decrease. If the dollar appreciation were equal to the tariff, the protection provided by the tariff increase could be completely offset by the exchange rate change. The U.S. industry would be in better shape than if it had received no relief, but it would remain in a weak competitive position relative to competing imports. If the dollar weakened after a tariff was imposed, however, exporters might raise their prices, which could improve the competitiveness of the U.S. industry even more than provided for by the tariff increase.

To avoid reductions in effective protection, tariffs imposed under section 201 could be indexed for changes in exchange rates; this could pose severe administrative and policy problems. Because section 201 cases

[10]ITC, A Review of Recent Developments in the U.S. Automobile Industry, Including an Assessment of the Japanese Voluntary Restraint Agreements (USITC Pub. 1648 (1985)) and Robert Crandall, "Import Quotas and the Automobile Industry: The Costs of Protectionism," The Brookings Review, Summer 1984.

examine imports from all countries, any indexing scheme would have to involve the currencies of all countries that export the product to the United States. If the United States were to index the relief for changes against each individual currency, that scheme might be challenged as a violation of the GATT principle of nondiscrimination, under which a nation may not be favored with a lower tariff than others. Relief, therefore, would have to be indexed for changes in the value of a basket of currencies. Determining what weights each currency would receive in the basket, how often the weights should change, and how the relief should be changed in response to exchange rate changes would make the job of equitably indexing relief extremely difficult.

Another alternative is needed to provide protection that, like quotas, will not be changed as exchange rates or other factors vary but that lessens or avoids the greater economic distortions and other drawbacks of an allocated quota, such as the potential for foreign firms to earn higher profits from the restriction. Several analysts have suggested that quantitative restrictions imposed under section 201 be implemented through the auction of import licenses, selling the right to import a specified amount. Section 1102 of the Trade Agreements Act of 1979 authorizes the President to auction import licenses in order to "provide for more efficient and fair administration of quantitative restrictions and import licenses used to administer them."[11]

By auctioning the import licenses, the U.S. government, rather than foreign producers, could capture the excess profits created by the supply restriction of the quota. The price paid for the auctioned import license would decrease these potential profits. Under some proposals, the auction revenues would fund industrial adjustment plans, so the auction revenues would be an explicit component of the safeguard action remedy. Furthermore, opening the auction to all potential bidders could provide greater opportunities for new foreign suppliers to try to enter the U.S. market than would be the case if a quota were allocated administratively, which could favor historic suppliers. If new suppliers are more efficient than the historic suppliers and their bids for import licenses reflect their cost advantages, auctioned quotas would distort trade less than administratively allocated quotas.

Although the proposals to auction import licenses have some attractive features, auctioning would be inappropriate in some cases. For instance, a large number of products are traded under specific multilateral and

[11]Senate Report No. 249, 96th Congress, 1st Sess. (1979), p. 258.

bilateral agreements, such as the Multi-Fiber Arrangement that governs trade in textiles. It would be difficult to devise an administrative program for auctioning quotas that would cover all these agreements and their provisions. Auctioning also would not be appropriate if there are few potential bidders. Section 1102 stipulates that the President must insure against a relatively small number of large importers gaining an "inequitable" share of the imports through the auction. This could be accomplished by setting aside a share of the available licenses for small importers, for example. If a small number of suppliers dominate the market, however, there may not be a feasible way to prevent their gaining a dominant share of the import licenses.

In addition, there are concerns that an auctioned quota for safeguard actions may be subject to challenge as being inconsistent with U.S. obligations under the GATT. If the price paid for the license were viewed as a trade barrier above and beyond the quota itself, the auctioned quota would constitute a greater interference in trade, potentially violating Article VIII or the Licensing Code. The counterargument is that an auction would fall within the latitude that governments are allowed to "prevent or remedy" serious injury to domestic industry through safeguard actions under GATT Article XIX. This issue has not been addressed explicitly in the GATT dispute resolution process or in the GATT Licensing Code, according to officials in the Office of the U.S. Trade Representative, so the potential severity of the issue is hard to determine. Potential administrative costs and problems and the questions regarding the compatibility of auctioning with U.S. obligations under GATT have led the administration to oppose auctioning quotas.

Australia and New Zealand have auctioned quotas. The quotas were imposed for a wider range of objectives than safeguard actions; therefore, their experience may not be indicative of the potential effectiveness and administrative feasibility in the United States. Both nations encountered some administrative problems in their systems.

Conclusions

Experience with auctioned quota rights to administer safeguard actions has not been sufficiently extensive to assess the severity of these problems or to determine whether those buying quotas would seek out lower-cost producers. We believe, however, that the potential advantages of auctioned quotas, relative to the known disadvantages of tariffs or allocated quotas, could be significant.

Recommendation

We recommend that the Secretary of the Treasury direct the Department to experiment with auctions in selected section 201 cases and evaluate their effectiveness, administrative feasibility, and potential for wider application. We believe the Department of the Treasury should have primary responsibility for these auctions, since it has experience in auctioning government securities and since the auction would be a source of government revenue. Treasury should coordinate its actions with other government agencies involved in section 201 cases.

Agency Comments and Our Evaluation

The Department of Commerce noted that the administration has not used the authority to auction import licenses because the "costs of auctioning quotas far outweighed the benefits." Commerce argued that auctioning quotas would "raise questions regarding our GATT obligations," that auction fees would be a "GATT-illegal" added layer of protection, and that "mandatory auctioning would make it more difficult to negotiate orderly marketing agreements under section 201 and could violate the GATT Licensing Code." Commerce also stated that "auctioning quotas would require the establishment of a new administrative bureaucracy during a period of budgetary restraint."

Although auctioning may be challenged within the GATT dispute settlement process as a violation of U.S. obligations, the outcome of such a challenge is uncertain. An auctioned quota clearly designed to "prevent or remedy" serious injury to a domestic industry could fall within the scope of actions allowed in Article XIX. Proposals to allocate auction revenues to fund industrial adjustment may have an advantage over proposals that do not similarly allocate revenues, since those revenues would be an explicit component of the remedy. The issue, however, has not been resolved within the GATT.

In response to comments, we did clarify the report to emphasize that auctioning should be used to allocate import licenses only in selected safeguard actions under section 201. Our recommendation does not envision mandatory auctioning, however. While mandatory quota auctions would remove any incentive for other nations to negotiate orderly marketing agreements (OMAs) with the United States, a demonstrated willingness to auction quotas might actually be an incentive for other nations to negotiate OMAs in cases where they are appropriate, since there would be a greater assurance of the outcome through negotiation than open bidding.

Finally, we question whether the potential creation of a new administrative system during a period of budgetary austerity presents a significant obstacle to our recommendation. First, if a quantitative restriction of any form is imposed, it must be monitored and enforced. The issue is whether an auctioned quota is a greater burden for the government to monitor and enforce than one that is administratively allocated, and we see no reason to expect any substantial difference. Second, if running an auction would cost more than allocating quota rights by administrative fiat or negotiations, these costs could be offset by the auction revenues.

In informal discussions concerning the draft report, an official of the Office of the U.S. Trade Representative also noted the potential for GATT challenges of auctioning. The official suggested changes to clarify this section of the report. The ITC did not formally comment on the report or recommendation but did suggest several changes and clarifications of a technical nature. We adopted most of these suggestions along with technical changes suggested by Commerce.

The Department of State noted that the Trade Policy Staff Committee examined the issue of auctioning and recommended that the Administration not auction quotas.[12] In drafting our report and recommendation, we had considered the final version of the Trade Policy Staff Committee's memorandum that State referenced in its comments as well as a subsequent letter on the subject to the Chairman of the Senate Finance Committee from the U.S. Trade Representative. The analysis in these documents is applicable in specific and limited circumstances. Our recommendation stated that auctioning would be inappropriate in cases affecting products traded under several specific multilateral and bilateral agreements, a stipulation that is consistent with the Trade Policy Staff Committee's analysis.

[12]This committee is an interagency group, comprised primarily of senior civil servants, that works to coordinate U.S. trade policy.

Antidumping and Countervailing Duties

U.S. antidumping laws (Title VII of the Tariff Act of 1930, as amended) are designed to prevent unfair foreign competition due to international price discrimination. AD duties may be imposed to offset the effects of imports into the U.S. market that are determined to be (1) priced below their fair value based on an affirmative finding by Commerce and (2) materially injuring a U.S. industry. The ITC is responsible for determining whether or not an industry has been materially injured.

The U.S. countervailing duty law (Title VII of the Tariff Act of 1930, as amended) provides for levying duties to offset foreign subsidies on products imported into the United States. A material injury test was added to the U.S. law in 1979 to align the law with U.S. obligations under the GATT Agreement on Subsidies and Countervailing Measures. Imports originating in a country under the Agreement are entitled to this injury test. Imports from other countries are generally subject to countervailing duties and no injury determination is made. (Duty-free imports from other countries are subject to an injury test.)

Exchange rate changes can be a key element in determining whether dumping has occurred. A depreciating dollar generally increases the likelihood that Commerce may find less than fair value sales (i.e., dumping) in dumping cases. As the dollar further depreciates against the currency of the country from which the product is imported, the likelihood of dumping and/or the level of any dumping margin (i.e., the amount of which the price charged is less than the "fair value," as defined) increases. As the dollar depreciates, the dollar price of an imported product should increase (assuming the foreign producer does not reduce the price charged in its home market). Thus, the U.S. price will be lower than the foreign price, potentially constituting dumping or sale at less than fair value in violation of U.S. trade law, until the U.S. price is changed.[1] Conversely, when the dollar appreciates, the fair value price of a product should fall, decreasing the likelihood of finding a dumping margin or the level of any dumping margin. Because of the importance of exchange rate changes in AD cases, Commerce has established a procedure to ensure that a foreign exporter is not unfairly affected by temporary exchange rate fluctuations. (See p. 25-27.)

[1]The economic rationale for an AD law that prohibits international price discrimination for any reason has long been questioned. Some recent investigations note that sales below fully allocated production costs may occur when businesses try to avoid varying their production in the face of uncertain demand.

In CVD cases, however, exchange rates generally are not an important factor. Commerce calculates the total value of the subsidies as a percentage of the total value of the sales benefiting from the subsidies to determine the subsidy rate. The value of both subsidies and total sales are generally expressed in the foreign currency.

Exchange rates also may influence the ITC's determination of whether or not imports have caused injury in AD and CVD cases. The standard of injury is lower in these cases than in section 201 cases; in CVD and AD cases the imports are unfairly traded, whereas in 201 cases the imports need not be unfairly traded. A strong U.S. dollar can result in lower prices for imports, causing the level of imports to increase. This increase in imports may cause material injury to U.S. industries that compete with imports, thus increasing the likelihood that the ITC will vote in favor of providing relief to a U.S. industry competing with dumped or subsidized imports. Conversely, by tending to raise the price of imports and thus reducing the demand for imports, a weak dollar generally reduces the likelihood that U.S. industries are being materially injured by dumped or subsidized imports. In sum, changes in the value of the dollar can have opposite effects on findings reached by Commerce and the ITC. Exchange rate changes producing a weaker dollar are more likely to lead to Commerce finding dumping margins in its investigations. In such cases, however, the weaker dollar may result in higher prices and reduced import levels of the products, making it less likely that the ITC would find injury.

Antidumping Laws

Following a complaint that a foreign producer is dumping its products on U.S. markets, the Department of Commerce investigates whether imports are being sold, or are likely to be sold, in the United States at less than fair value. Sales at less than fair value generally occur whenever the price of merchandise exported to the United States is less than the price at which it is sold in the home market of the exporting country or is sold at a price that is below the cost of production. Following a Commerce finding that sales at less than fair value are occurring, the ITC determines whether a domestic industry is materially injured or threatened with material injury or whether the establishment of a domestic industry is materially retarded by reason of dumped imports.

In AD cases, Commerce generally examines imports that entered the United States in the 150 days before and 30 days after the first day of the month in which a petition is filed. To determine whether sales have been made at less than fair value during this 6-month period, Commerce

compares the U.S. price with fair value.[2] The home-market price is generally used as fair value unless the volume of sales in the home market is so small in relation to the quantity exported to countries other than the United States that it is inadequate to use as the basis for fair value.[3]

In most cases, Commerce compares a weighted average of home market prices over the entire 6-month investigatory period. When dealing with imports from a country with high inflation, however, Commerce will break down the 6-month investigatory period into individual months and will only compare prices of separate transactions that were contracted for and shipped in the same month.

In a normal proceeding, Commerce makes a preliminary dumping determination within 160 days after a petition is filed unless the investigation is terminated because the ITC finds no reasonable indication of injury. If Commerce determines that dumping has occurred, it will order (1) an importer to post a bond or cash deposit equal to the estimated dumping margin to secure the potential liability for duties and (2) liquidation to be suspended for all entries made on or after the date of the preliminary determination.[4]

Commerce normally makes a final dumping determination within 75 days of the preliminary determination. At this time, Commerce may also change its estimate of the dumping margin. Shortly after Commerce makes its final determination, the ITC makes its final injury determination. If the ITC votes that injury has occurred, Commerce publishes an order directing Customs to assess an AD duty equal to the estimated

[2]The U.S. price is the price of an import to the first unrelated customer in the United States. (Related parties would generally include subsidiaries, for instance.) If the foreign exporter is unrelated to the U.S. importer, the transaction price between them is used as the basis of comparison. If the exporter is related to the importer, the importer's price to an unrelated party is used. In both cases, prices are adjusted by removing all costs borne by the seller after the product leaves the gate of the foreign factory. Because exchange rates can change considerably between the time a product is sold for export and the time it is resold in the United States, the difference between the two prices could be considerable.

[3]Commerce generally requires that home-market sales amount to a minimum of 5 percent of a country's total foreign sales to nations other than the United States (i.e., third-country sales) before it will consider using the home-market price as fair value. When home-market sales are inadequate, third-country sales are used. If adequate information is not available for using either home-market or third-country sales, constructed values are used. In constructing values, Commerce includes such factors as the cost of materials and processing, overhead, profit, and packaging.

[4]Liquidation is defined as the final determination of duties owed on an entry. When liquidation of an imported good is suspended, imports of that good may still enter the country, but the determination of the duty that must ultimately be paid on the product is postponed until a later date. Prior to liquidation, preliminary duties are deposited or a bond is posted.

dumping margin. Liquidation, however, remains suspended until Commerce conducts an annual review so that the duty assessed will equal the actual dumping margin.

In the first annual review after an order is published, Commerce calculates the fair value of imports that entered the United States after the preliminary dumping determination and notifies Customs of its findings.[5] Customs then liquidates all suspended entries on an entry-by-entry basis.[6] This process of suspending liquidation, conducting an annual review, and duty assessment continues until the order is removed.

In an AD investigation, home-market prices are generally expressed in terms of the foreign currency while prices for exports to the United States are usually expressed in U.S. dollars. Thus, Commerce must make currency conversions before comparing prices. Commerce regulations strictly prescribe the exchange rate to be used for these conversions.[7]

In its calculations, the exchange rate Commerce uses to convert foreign prices or costs to dollars depends upon the method used to calculate the U.S. price. Where U.S. price is based upon transactions between an unrelated exporter and importer, Commerce generally uses the exchange rate in effect on the date the contract to sell to the United States is made. Commerce does not adjust its finding for exchange rate changes that occur between the date the contract is made and the date payment is due or the goods are shipped, because it assumes that companies allow for trend movements in the exchange rate in their pricing policies. Where the U.S. price is based upon transactions between related parties, Commerce generally uses the exchange rate in effect on the date the merchandise is resold to an unrelated party in the United States.

[5]The Trade and Tariff Act of 1984 requires an annual review of outstanding AD or CVD orders only if Commerce receives a request for such a review. Otherwise, liquidation is made annually, using the cash deposit or bonding amount posted when the goods entered the country. The previous law had required that the amount of any AD duty or CVD be reviewed at least once during each 12-month period following publication of a CVD or AD order. The change was made to eliminate the time and expense of conducting unnecessary review proceedings in which neither petitioner nor respondent had any interest.

[6]Although Commerce calculates fair value on a firm-by-firm basis, imports from the same foreign firm may have different dumping margins because their U.S. prices may be different. The average dumping margin for each firm is used as the estimated dumping margin until the next annual review.

[7]The regulations require that Commerce use the official exchange rate posted by the Secretary of Treasury on the date of sale. Treasury gets the exchange rate data from the Federal Reserve Bank of New York. The rate is posted on the first day of a quarter and on all days when the daily rate differs from the quarterly rate by more than 5 percent.

A decline in the value of the dollar not only raises the AD fair value but also decreases the return an exporter receives in its home-market currency for U.S. sales if dollar prices are unchanged. Thus, purely because of a decline in the value of the dollar, the exporter could wind up with dumping margins and sales below cost on its sales to the United States.

For example, between March 1985 and March 1986, the British pound rose in value from approximately $1.12 to $1.45. Thus, an import from Britain that had a fair value of $112 in March 1985 would have a fair value of $145 in March 1986, a 29-percent increase in a year. In this hypothetical case, the British exporter would have to raise its U.S. prices by 29 percent to maintain the original relationship between its U.S. and home-market prices to avoid creating a dumping margin. Business practices, such as published price lists and commitments to suppliers, however, can limit the ability of exporters to raise prices to accommodate exchange rate fluctuations.

Exporters that attempt to avoid dumping would have to reprice their products constantly in response to temporary fluctuations in the value of the dollar. To relieve exporters of this burden and to prevent temporary exchange rate fluctuations from causing the imposition of AD duties, the regulations allow Commerce to disregard a margin of dumping created solely by temporary fluctuations in the exchange rate of a particular foreign currency against the U.S. dollar. Commerce determines whether the fluctuations are "temporary" or "sustained."

Commerce has considerable discretion in determining if temporary exchange rate fluctuations exist and what period to use as a representative period if rates did fluctuate widely during the 6-month investigatory period. Commerce relies upon data trends and the expertise of its investigators to make the distinction in individual cases. Parties involved in AD proceedings have sometimes argued that exchange rates were fluctuating violently during the investigatory period and have requested that Commerce use exchange rates from an earlier, more stable period.[8] But only in one case has Commerce done so, Melamine in

[8]In one case, Pads for Woodwind Instrument Keys from Italy, an exporter argued that Commerce's use of the average quarterly exchange rate in its calculations caused less than fair value margins to appear. The exporter argued that had Commerce used daily exchange rates to calculate fair value instead of using daily rates only when they differed from the quarterly rate by more than 5 percent, no sales at less than fair value would have been found. Commerce argued that the use of the average exchange rate actually reduced the AD margins. The Court of International Trade reversed Commerce's finding and remanded the case back to it for administrative review, including recalculation of dumping margins using the more favorable exchange rates.

Crystal Form from the Netherlands, 45 Fed. Reg. 29619 (1980)[9]. In Melamine, Commerce used exchange rates from a previous period to calculate fair value because the exchange rate between the foreign currency and the dollar fluctuated violently during the period of investigation. This fluctuation alone caused U.S. prices to sometimes dip below fair value. In its analysis, Commerce used more stable exchange rates from the previous quarter and determined that dumping had not occurred.[10]

If a currency has been subject to significant depreciation over a long period of time, Commerce would not consider these fluctuations to be temporary nor would it use exchange rates from an earlier period in its calculations. Commerce assumes that a company reasonably can be expected to allow for steady exchange rate trends in its pricing policies.

Countervailing Duties

Procedurally, the CVD law is similar to the AD law. Commerce determines whether a subsidy exists and the margin of subsidy.[11] If an injury test is required, the ITC determines whether a domestic industry has been materially injured or is threatened with material injury or whether the establishment of a domestic industry has been materially retarded by reason of imports of such subsidized merchandise.

Subsidies are generally expressed in the home currency; sales prices can be expressed in the home currency, the purchasing country's currency, or a third country's currency. If the subsidies are expressed in a different currency from sales, Commerce must convert the values to a common currency. Commerce determines which currency to use based on the form in which it receives the information. It does not consider the date of sale in CVD cases, but rather it generally uses the average exchange rate for the year.

[9]A precedent had been established by the Department of Treasury (which administered the AD law prior to 1979) in Motorcycles from Japan (1978). In that case, exchange rates were lagged one quarter in calculating the fair market value of sales by one exporter. (See Federal Register, vol. 43, no. 203, Oct. 19, 1978, pp. 48754-5.)

[10]Following an appeal by the U.S. melamine industry, the Court of International Trade ruled that Commerce did not have the discretion to use exchange rates from a previous period. This finding, however, was overturned by a Federal Circuit court that ruled in favor of the Commerce determination.

[11]Subsidies can be divided into two categories: export subsidies and domestic subsidies. To determine export subsidy levels, Commerce divides the total value of export subsidies by the total value of the exports that received the subsidies. To determine domestic subsidy levels, Commerce divides the total value of domestic subsidies by the total value of sales that received the subsidies.

Injury Tests

In CVD and AD cases, the ITC determines if a U.S. industry is materially injured or threatened with such injury and whether the dumped or subsidized imports are a contributing cause. The ITC uses essentially the same procedure for handling either a CVD or AD case.

A preliminary injury determination is required within 45 days after the date the petition is filed with Commerce. If the ITC does not find injury, the case is immediately terminated. If injury is found, the ITC begins a final injury investigation after Commerce makes its preliminary dumping or subsidy determination. A final ITC determination is required 45 days after a final Commerce finding.

In CVD and AD cases, the domestic industry must provide proof of a significant downturn in sales, market share, prices, profits, capacity utilization, or other industry measures. Downturns in all these factors need not be present for the ITC to find injury; the ITC uses its discretion in weighing these factors in determining whether injury is occurring. The causal link between the injury and dumped or subsidized imports also requires the ITC to consider import volumes and lost domestic sales.

ITC members use different interpretations of existing statutes in determining causation. The ITC, as a body, handles decisions on a case-by-case basis, with the only indication of historical continuity being the rationale used by individual commissioners in deciding cases. As a result, ITC decisions on injury shift with prevailing majority views on congressional intent and required statutory criteria. This has caused at least one commissioner to argue that the ITC is enforcing trade law by administrative fiat rather than by statutory guidance, including substituting its own injury tests in place of statutory requirements. (See the opinion of Commissioner Eckes in Brazilian Ethanol, March 1986.)

Exchange rates, by themselves, have never been cited by the majority as the primary factor in reaching a negative injury determination. However, some commissioners have cited sharp exchange rate movements as important causal factors in dissenting opinions. Respondents, furthermore, regularly raise exchange rate movements as a factor for the ITC to consider in attempts to prove that imports have not caused injury.

"Margin Analysis"

Commissioners have also divided on whether the size of the dumping or subsidy margin should be considered, particularly in relation to the price differences between imports and domestic products. No definitive

court ruling exists on the matter, and the ITC commissioners appear to be split about considering this factor in determining injury.

The ITC is required to determine injury and the causes of that injury "by reason of imports of that merchandise or by reason of sales (or likelihood of sales) of that merchandise for importation." A strict reading of the statute implies that the dumped or subsidized imports themselves must be found to be a contributing cause of the material injury being suffered by the domestic industry. At the same time, the law does not specifically forbid the ITC from considering factors other than imports in determining the causes of injury.

Some commissioners have used what is commonly termed as "margin analysis" in their efforts to determine causes of injury. This analysis compares the dumping margin or net subsidy with the average margin of underselling (the difference between prices of domestic and imported products). These commissioners have been reluctant to find injury if the margin of underselling is substantially larger than the dumping margin or subsidy. If commissioners use margin analysis, exchange rate changes could cause a case to be dismissed because these changes could lead to large margins of underselling. Other factors that may affect the margin of underselling include differences in foreign and domestic costs.

Margin analysis has been used sporadically over the years. The size of the dumping margin or subsidy was an important factor in ITC decisions from 1969 through 1980. The ITC reached negative determinations when the subsidy or AD margin accounted for only a small fraction of the margin of underselling. (For examples, see Welded Stainless Steel Pipe and Tube from Japan, USITC Pub. 899 (1978) and Silicon Metal from Canada, USITC Pub. 954 (1979).)

Since 1982, however, a majority of the commissioners has determined the injury question on the basis of whether the dumped or subsidized imports have caused material injury; they have not examined the relationship between injury and the dumping margin or subsidy in their causation analysis. Although some commissioners have argued against the exclusion of such factors as margin differentials and fluctuating exchange rates, the present commissioners appear divided on the issue. Exchange rates, if examined, are commonly viewed as an explanatory factor for the volume of imports. (For example, see Pads for Woodwind Instrument Keys from Italy, (1984); Certain Red Raspberries from Canada, (1985); and Oil Country Tubular Goods from Brazil, Korea, and Spain, (1985).)

Although margin analysis has been adopted in various ITC decisions, the majority of commissioners has never used exchange rate fluctuations as grounds for a negative injury determination. Recently, however, some commissioners have noted exchange rate changes in their consideration of the causal linkage between material injury and the dumped or subsidized imports. (For examples, see Steel Wire Rope from the Republic of Korea, (1982); Carton-Closing Staples and Nonautomatic Carton-Closing Staple Machines from Sweden, (1983); and Certain Fresh Potatoes from Canada, (1983).)

In 1981, the ITC's General Counsel advised the commissioners that reliance on margin analysis was inconsistent with the AD and CVD laws. The General Counsel argued that Congress intended the ITC to determine whether the dumped or subsidized imports caused the injury, regardless of the subsidy or AD margin, not whether the subsidy or dumping margin caused the injury. This position has been embraced rather consistently by a majority of the commissioners since 1982. However, proponents of margin analysis point to several legislative history references that seem to indicate that Congress intended for the ITC to consider the causes of injury on the basis of factors in addition to imports themselves. For example, in the Senate Report accompanying the Trade Agreements Act of 1979, the Senate directs the ITC to consider "how the effects of the net bounty or grant relates to the injury, if any, to the domestic industry."[12]

The scope of factors legally addressable by the ITC in determining cause in injury determinations has been examined in only one court decision — Maine Potato Council vs. U.S.[13] The judge ruled that the ITC is not compelled to take into account the effect of a large dumping margin to reach an affirmative injury determination. The opinion, however, does not state that the ITC cannot use margin analysis in reaching determinations.

Arguments exist for and against using margin analysis in determining injury. One side argues that it is questionable public policy for the ITC to find injury in cases where the subsidy or dumping margin is insignificant in comparison to the margin of underselling or where exchange rate movements contribute significantly to the margin of underselling found for the period. Proponents of this view believe that imposing duties in

[12]Senate Report No 249, 96th Congress, 1st Sess. (1979) p. 85; also, the same language for dumping is found on p. 74, note 20.

[13]Court of International Trade, June 27, 1985, Slip Op. 85-67.

these circumstances would not benefit U.S. industries because significant underselling will continue to occur. In addition, the duty may be viewed as a burden on fair and open trade because the protection being granted to the domestic industry is of no practical use.

The opposing viewpoint argues that U.S. trade laws are used to remedy unfair trade practices by foreign producers. The size of the calculated dumping margin or net subsidy should not matter in injury determinations. Furthermore, tracing the effect of subsidies or dumping margins on imports is extremely difficult. To assume that such effects can be traced exclusively to pricing behavior is also questionable. For example, a subsidy may not necessarily be used to lower the price of a product; it may be used to improve plant equipment or to lower credit terms in the home market if U.S. and foreign prices change.

A final problem with using margin analysis is that a judicial reversal of margins determined by Commerce could require a new ITC injury determination if the ITC decision was based on a comparison of the Commerce margins to the margin of underselling. In addition, the actual duty assessed after the annual review process is completed may be quite different from the estimate produced by Commerce during the investigation.

Collection of Duties

Customs collects the AD and CVD duties after being notified by Commerce of the amount of estimated duty that should be collected on affected imports. This duty is generally expressed on an ad valorem basis and is based on the c.i.f. price of imports (the cost of the product and the insurance and freight costs of shipping). In a few cases, Customs uses constructed values as the basis for the duty. If the price is expressed in a foreign currency, Customs uses the exchange rate on the date of export to convert the price into dollars. No adjustments are made for fluctuations in exchange rates occurring after that date. Customs gets its exchange rate data from the same source as Commerce, the official exchange rate posted by the Department of the Treasury.

Effects of Exchange Rate Variations After a Final Decision

Although an appreciating dollar that occurs after an AD or CVD is imposed may permit importers to lower prices so that imports are less expensive than domestic products even after paying the duty, the argument to prevent this is not the same as the argument to prevent a lower level of protection under section 201. In section 201 cases, a finding of

injury by the ITC and a decision by the President to grant protection represents a choice to temporarily prevent any further import injury to the domestic industry, without any charge that unfairly traded imports have caused the injury. When duties are imposed to offset unfair foreign subsidies or dumping practices, however, the decision to impose the duty is far less sweeping. It is an attempt to remove the unfair advantage that has injured a particular industry or to "level the playing field." It is not a decision that the injured industry ought to receive blanket protection from import competition. AD and CVDs are designed only to offset the unfair foreign practice. If AD or CVD protection is modified or indexed in some manner to compensate for exchange rate variations, a protected domestic industry will have an advantage over other U.S. industries in competing with foreign industry.

Agency Comments and Our Evaluation

The Department of Commerce provided technical comments correcting or clarifying matters discussed in a draft of this appendix. The ITC provided similar corrections and clarifications. All such technical comments have been incorporated as appropriate.

The Department of State believed that the report "devotes too much space to speculation on issues such as 'margin analysis,' a methodology favored by some ITC commissioners," and urged that it be deleted. After considering State's comments, we decided to retain this discussion, including the arguments favoring and opposing margin analysis, because it is the most prominent alternative approach in the ITC injury determination.

Exchange Rate Movements and GATT Effectiveness

When the GATT was negotiated in 1947, exchange rates were firmly governed by the Bretton Woods agreement of 1944 that established fixed exchange rates under the surveillance of the International Monetary Fund (IMF). Under the Bretton Woods agreement, nations pegged the value of their currencies to the dollar, which was the central currency in the system. The value of a currency against the dollar could be changed if large trade imbalances or capital flows dictated a need for change. Nations with balance of payments deficits, however, were reluctant to devalue their currencies because the devaluation generally resulted in increased domestic prices. Yet because surplus nations faced little pressure to revalue their currencies, deficit nations bore much of the adjustment burden. This asymmetry helped to weaken the Bretton Woods system.

From their beginnings, the GATT and the IMF have had separate roles, although they have maintained official ties to coordinate their activities. Article XV of the General Agreement, which deals with coordination of IMF and GATT policies that affect trade, stresses the obligation of contracting parties to "consult fully" with the IMF in addressing problems related to exchange rates. The original GATT negotiators were afraid that countries would deliberately devalue their currencies to encourage exports and restrict imports and thus undercut the operation of the system envisioned at Bretton Woods.

Under the Bretton Woods agreement, the GATT seldom addressed exchange rate issues; the IMF and other international organizations maintained clear control of surveillance of exchange rate policies. For its part, the GATT operated as an international forum to resolve disputes involving tariffs, nontariff barriers to trade, and other specific trade issues. The switch to floating exchange rates has not changed the GATT's role. For example, during the Tokyo Round negotiations in the late 1970's, which were conducted after the current floating exchange rate system was created, exchange rates apparently were not topics of discussion. When the floating exchange rate regime emerged in the early 1970's, the effects that floating rates would have on trade law were not known.

The IMF has not been the only multilateral forum addressing international monetary arrangements or maintaining surveillance of exchange rate policies since the breakup of Bretton Woods. Major industrial nations, including the United States, have relied on other multilateral arrangements, such as the Group of 5 (G-5) or the Group of 10, to

address exchange rate issues[1]. For example, in September 1985, the G-5 financial ministers and central bankers agreed to coordinate intervention in exchange markets to lower the value of the dollar. Similarly, in November 1978, the finance ministries and central banks of West Germany, Japan, Switzerland, and the United States arranged the "dollar rescue package" to address the problems of the then chronically weak dollar.

GATT Goals, Principles, and Remedies

The primary goal of the GATT is to reduce barriers to trade so that all nations may enjoy the benefits of access to larger markets, for both buying and selling goods and services. The GATT has had much success in some areas, such as reducing tariff levels; however, it has been unable to prevent the increased prominence of nontariff barriers to trade, such as quotas or export subsidies.[2]

Forces beyond GATT's influence make its mission difficult; for example, even if all trade barriers were eliminated, exchange rate movements would still be affected by capital flows, influencing trade patterns in ways not directly related to underlying cost and production advantages. The GATT would find it difficult to address this problem. Although one goal of the IMF is to maintain a stable exchange rate system to facilitate trade flows, IMF agreements necessarily address all factors included in international balance of payments, including capital flows. Trade deficits will not necessarily motivate an IMF agreement. Furthermore, persistent international disagreement over exchange rate policies may make countries less willing to make concessions during trade negotiations.

U.S. trade policy and international trading rules have only limited power and scope in determining trade patterns. Although there are major exceptions, international trading rules seek to prevent governments from interfering with international trade by prohibiting or discouraging specific practices, such as export subsidies, that would distort trade in particular products. However, these rules are not intended to address general economic conditions or macroeconomic variables, including exchange rates and national fiscal and monetary policies, that can greatly influence trade flows.

[1]Canada, Italy, Sweden, Switzerland, Belgium, and the Netherlands, together with the G-5 nations, form the Group of 10 (actually 11). Neither group is an international institution in the same way as the IMF or GATT with a full-time staff and headquarters. Ad hoc working groups perform the work of the Groups.

[2]See our Sept. 23, 1985, report, Current Issues in U.S. Participation in the Multilateral Trading System (NSIAD-85-118).

Despite these inherent limitations in its scope, the GATT system retains basic features that serve U.S. interests in a world of floating exchange rates. The principle of nondiscrimination, a central premise of the GATT system embodied in the most-favored-nation clause of Article I, is not adversely affected by changes in exchange rates. This clause states that a contracting party may not grant special trading privileges to another country but must grant other countries equal treatment. The goal of the nondiscrimination principle is to assure nations that if they allow all imports to compete equally in their home markets, their exports will receive similar equal treatment in other countries.[3] Floating exchange rates do not conflict with this principle.

A second basic principle of the GATT system calls for nations to avoid using nontariff measures to accomplish their trade policy objectives. The rationale for this principle is to ensure that the extent of protection is clear and that some price competition remains possible. As noted earlier, the uncertainty of floating exchange rates provides an incentive to rely on import quotas and equivalent measures, such as VRAs, to provide temporary protection to an industry injured by imports. However, the value of this principle is not affected by a regime of floating exchange rates. Nontariff measures, such as domestic subsidies or certain product standards, are politically and technically more difficult to counter than tariffs because these practices may arguably have aims other than those related to trade.

Many of the codes negotiated under GATT auspices during multilateral trade negotiations serve U.S. interests regardless of the exchange rate regime.[4] For example, the GATT Government Procurement Agreement sought to limit the use of discriminatory procurement practices among signatories. Although the Agreement has not had the commercial benefits that were originally expected,[5] there is no reason to believe that exchange rates have caused less opening up of procurement to foreign competition than anticipated. Likewise, the Standards Code was established to prevent governments from using unreasonable product standards to limit imports; such practices would be undesirable under any exchange rate regime. Negotiations toward an agreement governing

[3]The most-favored-nation nondiscrimination principle allows exceptions, most notably for customs unions or free trade areas.

[4]These codes, such as the Subsidies Code, interpret relevant articles of the original General Agreement.

[5]See our July 16, 1984, report, The International Agreement on Government Procurement: An Assessment of its Commercial Value and U.S. Government Implementation (NSIAD-84-117).

international use of safeguard actions (such as section 201) were not concluded during the Tokyo round of multilateral trade negotiations and are expected to continue during the next round.

GATT and multilateral trade negotiation codes do not adequately cover all areas of trade, primarily because the GATT contracting parties often disagree on how or when GATT principles should be applied.[6] Such disagreements frequently reflect different national approaches to handling domestic objectives. Countries often pursue drastically different domestic economic policies that may impede the functioning of the GATT system and may lead other countries to do the same. Similarly, the GATT dispute resolution process is often criticized as a slow and cumbersome process that lacks any ability to enforce decisions. For example, although the GATT found that European Community (EC) preferential import duties on citrus fruits and juices violated GATT rules, the EC blocked adoption of the panel's finding and refused to negotiate a resolution. The United States responded by imposing a retaliatory tariff on EC pasta products.[7] Similarly lengthy proceedings have occurred in a case involving EC subsidies for wheat. (Miller's National Federation v. EC, filed Nov. 24, 1975, was still pending as of June 10, 1986.)

Contracting parties envision only a limited role for the GATT in international financial relations and exchange rate surveillance policies or in coordinating international macroeconomic policies, for which other international forums exert greater authority.

The GATT and the IMF Articles of Agreement provide for an exception to exchange regulations in cases of balance-of-payments difficulties. The exception was written into the GATT on behalf of countries that were struggling with significant currency and balance-of-payments problems in the aftermath of World War II. It allows countries having such problems to adopt currency restrictions on a temporary basis until they can get their economies into line with IMF guidelines. Nations may also withdraw trade concessions made in negotiations or may impose quantitative restrictions under the balance-of-payments clause. In recent years, the

[6]For many reasons, the GATT and the multilateral trade negotiation system have not established a clear and unambiguous set of rules for agricultural trade. No GATT agreement governs the growing trade in services. Trade in many sectors, such as steel and textiles, is conducted under restrictive agreements where the GATT influence has been less effective.

[7]Florida Citrus Commission (FCC) et al. v. EC. The FCC filed its petition under section 301 of the Trade Act of 1974, as amended, on Nov. 12, 1976. During the Tokyo Round, U.S. negotiators sought a resolution without success. After several delays, a panel was formed and reported its findings on Feb. 1, 1985; the retaliatory tariff on pasta was imposed on Nov. 1, 1985.

exception has been used primarily by less developed countries. Beyond this, however, exchange rate issues do not appear to have played a prominent role in GATT deliberations or in the ensuing trade rounds.

Floating Exchange Rates and International Trade

At the time of the switch to floating rates, it does not appear that anyone seriously questioned their compatibility with the GATT system of trade rules. In fact, many argued that removing the obligation of nations to adhere to exchange rate and balance-of-payments targets would enable them to conduct economic policies that would expand international trade. It was argued that flexible exchange rates would allow countries to conduct independent monetary and fiscal policies designed to promote full employment and price stability in their domestic economies and, thus, preserve national autonomy.

Today, few would argue that floating exchange rates have had all the benefits that had been expected at their onset.[8] Floating exchange rates have permitted large current account surpluses and deficits despite expectations that they would lead to improved balance of payments. Erratic exchange rate fluctuations occurring in recent years have contributed to the instability of many trade-related industries. In addition, many less developed countries are in desperate straits because of their international debt problems, which were exacerbated by the strong dollar and high interest rates of the early 1980's.

Although conceding the shortcomings of the floating system, other analysts point out that proposed alternative systems, such as target zones, contain their own flaws and weaknesses. According to one observer, after exchange rates started floating:

> "Subsequent events have provided ample reason for extreme modesty on the part of prognosticators in both camps. Market-determined exchange rates have exhibited instability beyond the fondest nightmares of fixed-rates fanatics, yet trade and investment flows seem relatively unaffected by these changes."[9]

The resilience of aggregate trade and investment flows despite exchange rate variations has been observed in a wide range of studies. In 1984, for instance, the IMF found that exchange rate variations had not lessened trade. Researchers on the GATT Secretariat staff reached similar

[8]These issues are discussed in our report, Floating Exchange Rates in an Interdependent World: No Simple Solutions to the Problems, (NSIAD-84-68) Apr. 20, 1984.

[9]Rachel McCulloch, "Unexpected real consequences of floating exchange rates," Princeton Essays in International Finance, No. 153, (Princeton, N.J., 1983); p. 6.

conclusions in earlier research.[10] Again, these studies examined aggregate trade and investment flows, not trade in specific items; their conclusions do not imply that exchange rate movements cannot or have not harmed individual industries or firms.

Conclusion

As our earlier discussion of section 201 noted, tariffs can be less effective methods of protecting industries in Article XIX safeguard actions than quantitative restrictions if exchange rates change. If current efforts to lessen exchange rate misalignments are unsuccessful, the impetus for quantitative restrictions will increase and conflict with the GATT principles favoring tariffs as the preferred form of relief will continue. This conflict will exacerbate the difficulty of negotiating a safeguards code that remains consistent with the GATT goal of minimizing trade distortions. An auctioned quota might be a less disruptive way to protect industries than administratively allocated quotas in safeguard actions.

Recommendation

We recommend that the U.S. Trade Representative, in negotiations with other nations on a safeguards code, explore the feasibility of including auction import rights to administer quantitative restrictions as an option for nations to implement safeguard actions.

Agency Comments and Our Evaluation

While not directed specifically at this recommendation, the Department of Commerce's comments in opposition to auctioning quotas under section 201 are relevant here. These comments and our evaluation of them are discussed in appendix II; the Department's comments are contained in appendix V.

[10]Richard Blackhurst and Jan Tumlir, Trade Relations Under Flexible Exchange Rates, (Geneva, Switzerland: General Agreement on Tariffs and Trade, Studies in International Trade No. 8); Sept. 1980.

Comments From the Department of Commerce

UNITED STATES DEPARTMENT OF COMMERCE
The Under Secretary for International Trade
Washington D.C. 20230

September 9, 1986

Dear Mr. Peach:

Thank you for the opportunity to comment on your draft report, "International Trade: Trade Law Remedies Under Floating Exchange Rates."

One recommendation included in the report is that greater consideration be given to auctioning import quotas under section 201. As you are aware, section 1102 of the Trade Agreements Act of 1979 gives the Administration the authority to auction import licenses. This authority has not been used because the costs of auctioning quotas far outweighed the benefits.

Auctioning of quotas would raise serious questions regarding our GATT obligations. Article VIII of the GATT requires that import fees be limited to the approximate cost of services rendered and prohibits imposition of fees as a taxation of imports for fiscal purposes or for protection to domestic products. Auction fees would be an additional layer of protection which could be a GATT-illegal impairment of tariff bindings and result in the payment of more tariff compensation.

Moreover, mandatory auctioning would make it more difficult to negotiate orderly marketing agreements under section 201 and could violate the GATT Licensing Code. Finally, auctioning quotas would require the establishment of a new administrative bureaucracy during a period of budgetary restraint.

Beyond this specific issue, however, we found the report to provide a thorough analysis of the topic, and we commend your efforts. Our technical comments are of a limited nature, correcting or clarifying certain statements. These are enclosed.

Sincerely,

Bruce Smart

Enclosure

Mr. J. Dexter Peach
Director
Resources, Community, and Economic
Development Division
United States General Accounting Office
Washington, D.C. 20548

Comments From the Department of State

United States Department of State

Comptroller

Washington, D.C. 20520

August 27, 1986

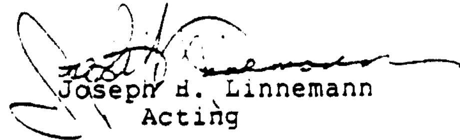
Dear Frank:

I am replying to your letter of July 29, 1986, to the Secretary which forwarded copies of the draft report entitled "International Trade: Trade Law Remedies Under Floating Exchange Rates" (Code 483425).

The enclosed comments on this report were prepared in the Bureau of Economic and Business Affairs.

We appreciate having had the opportunity to review and comment on the draft report.

Sincerely,



Joseph H. Linnemann
Acting

Enclosure:
As stated.

Mr. Frank C. Conahan,
Director,
National Security and
International Affairs Division,
U.S. General Accounting Office,
Washington, D.C. 20548

GAO DRAFT REPORT: INTERNATIONAL TRADE - LAWS AND REMEDIES UNDER FLOATING EXCHANGE RATES

This memorandum provides comments on the subject report. Attached is an annotated version of the report. The comments of the Bureau of Economic Affairs on this draft GAO report cover the following areas:

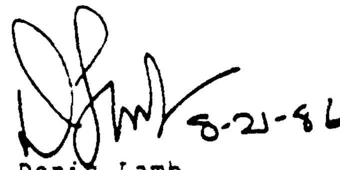
Structure of the Report: The covering letter needs to state clearly the findings of the study on the four questions posed in the request. Likewise, the conclusions should be briefly described in Appendix 1, Background.

The International Monetary System: The report is lacking in its description of the differences between the Bretton Woods system and the current exchange rate regime. The report's analysis of the impact of changes in the international monetary system on trade and capital flows, and on current account balances is incomplete. Attention is focussed exclusively on trade flows as determinants of current accounts. Consideration needs to be given to the role of capital flows and to developments of the past 15 years which would have occurred under any exchange rate regime.

Appendix 2 - Section 201 Safeguard Actions - We agree with the conclusion in the report that floating exchange rates may, in the short run reduce the ability of tariffs to protect industries that have obtained relief under Section 201. For this reason, injured industries often prefer to receive import relief in the form of quotas to protect themselves from exchange rate fluctuations. For a variety of reasons, however, quotas are a less than optimal form of relief in escape clause actions. The GAO study recommends therefore, that the administration consider avoiding some of the drawbacks of an allocated quota system by using its existing statutory authority to auction quotas on an experimental basis. The report states on page 19 that the U.S. Trade Representative opposes auctioning of quotas. It would be more correct to say that the Trade Policy Staff Committee, a working level interagency group, chaired by USTR examined the issue in June, 1985 and recommended that the Administration not use its legislative authority under Section 1102 of the Trade Agreements Act of 1979 to auction quotas. Attached is a copy of the conclusions of the TPSC. The Department of Treasury, in order to implement the recommendation in the draft GAO report, would have to reopen the question of quota auctioning in the TPSC and seek the mandate of that group. We do not believe that Treasury could implement an experimental scheme without TPSC authorization.

Appendix 3 - Antidumping and Countervailing Duties - This annex presents a generally clear view of the possible effects of exchange rate fluctuation on unfair trade cases. We defer to the Department of Commerce and the ITC on descriptions in the draft report of the specific procedures followed by the two agencies. We have two general comments. First, we found it hard to follow some of the examples of the effects of floating exchange rates on dumping margins because the draft report jumps somewhat inconsistently from dollar denomination of trade to home currency denomination. Second, we believe that the report devotes too much space to speculation on issues such as "margin analysis", a methodology favored by some ITC commissioners. If it were clear that considerations of margin analysis played a consistently definitive role in ITC injury determinations in trade cases, such discussion might be relevant. We question whether this is so.

GENERAL COMMENTS: We agree with the recommendation in the report that new legislation is not required to address the issue of floating exchange rates and their effect on trade law remedies. It appears that the regulations adopted by the Commerce Department to implement antidumping legislation allow that agency to disregard margins of dumping created solely by temporary fluctuations in the exchange rate of a particular foreign currency against the U.S. dollar.



Denis Lamb
Acting Assistant Secretary
Bureau of Economic and Business Affairs

Related GAO Reports

The Difficulty of Quantifying Non-Tariff Measures Affecting Trade (GAO/NSIAD-85-133), October 30, 1985

Current Issues in U.S. Participation in the Multilateral Trading System (GAO/NSIAD-85-118), October 23, 1985

Foreign Industrial Targeting — U.S. Trade Law Remedies (GAO/NSIAD-85-77), May 23, 1985

The International Agreement on Government Procurement: An Assessment of Its Commercial Value and U.S. Government Implementation (GAO/NSIAD-85-117), July 16, 1984

Judicial Review of Antidumping and Countervailing Decisions (GAO/NSIAD-84-129), June 24, 1984

Administration of Suspension Agreements by the Department of Commerce (GAO/NSIAD-84-125), June 15, 1984

Floating Exchange Rates in An Interdependent World: No Simple Solutions (GAO/NSIAD-84-68), April 20, 1984

Benefits of International Agreement on Trade-Distorting Subsidies Not Yet Realized (GAO/NSIAD-83-10), August 15, 1983

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