**Global Economy**

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**Assignment #2**

**Instructions:**

• You must work in the same group as Assignment #1. Submit only one solution for the group (recording all group members names).

• Submit the assignment through NYUClasses by

**6:00pm, Thursday, June 13**

**Dumping Chinese Solar Panels in the US**

The term “dumping” has long been used in the area of industrial organization to refer to a strategy whereby a large, well-capitalized firm deliberately loses money by choosing to sell its product at a price below its average cost. The goal of such a strategy is to bankrupt less-well-capitalized competitors, become the sole producer in the industry and thereby more than make up for any short-term losses by charging monopoly prices forever. Given what we know about the inefficiencies associated with monopolies, should this strategy actually succeed, it wouldn’t just be bad for the bankrupted firms, it would be bad for social welfare more generally.

Surprisingly, there is very little evidence of anyone successfully implementing such a strategy. Note that it doesn’t just involve bankrupting the current competition. It also requires successfully preventing anyone else from entering the industry in the future and competing away the monopoly profits. Obviously, even well-capitalized firms can’t price below their average costs forever, hence, this tends not to be an attractive competitive strategy absent some other method of preventing entry and competition. Nonetheless, “predatory pricing” is illegal in most countries. More importantly, since everyone loves a conspiracy theory, it is easy to stir up public fears by claiming that a competitor’s low price isn’t simply a reflection of efficiency but is rather de facto evidence of dumping (eg, WalMart has been a popular target for predatory pricing claims by small local retailers, yet there is no evidence of monopoly-like pricing by WalMart). The US Federal Trade Commission has never successfully prosecuted anyone for predatory pricing. But when the competitor is from a foreign country, xenophobia makes it even easier to play the “us versus them” card and claim dumping. As a result, dumping and predatory pricing have become a standard fare in the world of international trade.

President Barack Obama made this a central point of his 2012 State of the Union Address:

*We’ve brought trade cases against China at nearly twice the rate as the last administration--and it’s made a difference. But we need to do more. Tonight, I’m announcing the creation of a Trade Enforcement Unit that will be charged with investigating unfair trading practices in countries like China.*

Not to be outdone, Mitt Romney’s presidential campaign rhetoric on trade with China is equally inflammatory:

*I understand what happens when China cheats, or when others cheat and dump products into this country. That's one of the reasons I'm running is to make sure we crack down on cheaters. (Republican primary debate, 1-16-2012)*

Since dumping and predatory pricing were traditionally part of domestic industrial regulations, international trade agreements like the World Trade Organization (WTO) or its predecessor the General Agreement on Tariffs and Trade (GATT), have never treated the issue of anti-dumping actions as a serious barrier to international trade on par with high tariffs, duties or quotas. This has left a very large loophole for “legal” trade barriers through anti-dumping penalties.

When a domestic firm (or more often, a coalition of firms) files an antidumping petition, two conditions have to be met to trigger an antidumping tariff: It must be found (1) that the imports are being sold at below “fair value,” and (2) that these dumped imports have caused, or threaten to cause, material damage to a domestic industry. In the US, two agencies are responsible for antidumping investigations. The Department of Commerce (DOC) is given the task of determining if the goods in question are being sold at below “fair value”, and the International Trade Commission (ITC) determines if the imported goods have caused material injury to the domestic industry.

Determining the “fair value” price of an import is not a simple uncontroversial calculation. If the DOC can observe the identical good being sold in the exporting firm’s home market, the home market price is considered the fair value price, irrespective of any differences in demand between the two countries. If chicken feet sell for a higher price in China where the demand is high, than in the US where the demand is very small, under the DOC’s definition of “fair value,” US chicken producers could be accused of dumping chicken feet on the Chinese market. It is rarely the case, however, that an identical good is ever marketed in the exporter’s home country. Lacking an identical good for comparison, the DOC will compare the average U.S. price to the average home market price of the “next most similar product.” Defining a comparable product in the exporter’s home country is arbitrary and creates scope for manipulation in the dumping criteria. In addition, the DOC makes several additional arbitrary price adjustments before arrive at the final “fair value” price. (Notice how far we’ve drifted for the original notion of predatory pricing in these arbitrary price calculations.)

Trade with China opens up additional pricing issues. The most frequent target of U.S. antidumping investigations is China. Worldwide, 20% of all anti-dumping cases since 1995 have been brought against China. One reason for this is that the DOC has declared China to be a “nonmarket economy.” In practice what this means is that they can simply ignore prices charged in China (or any other economy deemed “nonmarket”). The DOC applies a special methodology in this case: prices of goods in other countries with “market economies” are used to construct the fair value price of goods in the nonmarket economy. This methodology opens up even more scope for arbitrary and easily manipulated “fair value” calculations.

When the DOC decides that dumping has occurred, they apply anti-dumping duties against the offending foreign firms. Note that unlike standard tariffs which apply to all firms in all countries, these anti-dumping duties target specific producers in specific countries, which is anathema to the WTO’s nondiscrimination provisions and most favored nation rule. Antidumping duties are not intended to be punitive; the antidumping duty is supposed to exactly offset the difference between the price charged by the firm and the fair value price. The determination of fair value, and the arbitrariness associated with it, therefore, establishes both the claim of dumping behavior and it’s remedy, ie, the size of the penalty. These countervailing duties are typically much higher than the maximum 25% tariff allowed under WTO. Moreover, antidumping duties do not have a fixed duration. The WTO does review anti-dumping duties after 5 years. Not too surprisingly, 5 years is the median length of time they are kept in place -- although sometimes they are kept for a long time as in the case of a 60% duty protecting a US manufacturer of “soluble silicate” from competition from a French manufacturer of the same chemical, which stayed in place for 24 years.

On October 3, 2012, the ITC heard one of the largest anti-dumping cases ever brought against China. The product in questions was solar panels. The case was brought before the ITC by SolarWorld, a German company producing in the US (these guys have no sense of irony!). SolarWorld CEO Gordon Brinser testified that “Chinese imports have accelerated losses of high-paying jobs and plant closures at a time when the United States is struggling to jump-start a struggling economy.” (Somehow we went from predatory pricing to a German company trying to protect US jobs? I don’t know about you, but I’m a bit confused.) The ITC found in favor of the dumping allegation, and has levied substantial tariffs on a variety of Chinese manufacturers who export photo-voltaic cells to the US.

The EU seems to be following suit. EU Pro Sun Glass, a conglomerate of European solar glass makers, filed a compliant with the European Commission earlier this year accusing Chinese solar exporters of “unfair competition.”

**Assignment**

Read the overview of the US-China situation in the attached articles from Forbes, The Economist, the NY Times, and the Wall Street Journal. (If you are really a glutton for punishment, you can even look at the ITC report, but prepare yourself for lots of legalese without much economic content.) You are also more than welcome to read about the current situation in any other source material you find. Along with the description of dumping above, you may also find the article by Mankiw and Swagel useful.

Write a brief summary (3-5 standard typed pages) of the situation including a discussion of the following questions:

* What is the evidence of dumping? Is there any other reason that Chinese firms are able to sell at lower prices than manufacturers operating in the US?
* Do Chinese manufacturers receive government subsidies? Do US manufacturers receive government subsidies? How does this affect the argument?
* Who benefits and who loses from an anti-dumping finding against Chinese photo-voltaic producers?
* What are the likely consequences of this anti-dumping action in the US for the organization of the solar power industry, future trade relations with China, and the efficiency of the US economy more generally?