

**Part I. SHORT ANSWER QUESTIONS.** To answer these questions you must identify (i.e., define) the listed concept and give its significance *to this course*. That is, while many of these concepts may have been used in other ways in other courses, to receive credit for these questions your answers must be correct with respect to usage in this course. Fully correct answers do only this (Do not try to discuss the concept in detail). The answers to these questions can be given in four sentences or less. You will lose points for writing material unrelated to the answer so *think before writing*. **Credit: Answer 6 (six) of the following for 5 points each (30 total points).**

1. *Third-degree price discrimination*: The firm charges a different price to different classes of customer, where the class is based on some readily identifiable trait and associated with different price elasticities of demand. Dumping in international trade law is essentially third-degree price discrimination where the relevant trait is nationality of consumer. Not likely to be welfare worsening in general for the importing country.

2. *Strategic dumping*: Dumping based on a protected domestic market and increasing returns to scale. By excluding foreign firms from the Home market, protection allows the Home firm to expand output, reduce costs, and increase competitiveness in the international market. This is a type of dumping that can lower national welfare for Foreign government, and generate a case for anti-dumping, in which price discrimination plays no essential role.

3. *de minimis rule*: Under the Uruguay Round agreements, the determination of sales at less than fair value must exceed a minimal level before antidumping or countervailing duties can be applied. For ADD the *de minimis* margin is 2%, while for CVD it is 1%. In addition, in both cases, the share of imports must not be “negligible”. In ADD cases the imports from a particular country cannot be less than 3% (unless the countries accounting for less than 3% collectively account for more than 7%) of imports. This is a significant constraint on the use of Title VII mechanisms for harassment.

4. *Suspension of liquidation*: If the preliminary determinations by both the ITC and the ITA are affirmative, customs-entry “liquidations” are suspended on the goods, and all imports of these goods are thereafter subject to the ultimate antidumping duties that are applied. The importer must pay a deposit or bond equal to the preliminary margin. This is significant because it means that imports are exposed to costs early in the process and the potential cost is unbounded.

5. *“Margins analysis”* (in dumping investigations): Prior to 1982, the ITC tried to show the causal connection between the extent of dumping or subsidy (the margin) and the material injury. After 1982, the ITC required only that injury be causally linked to the total volume of dumped or subsidized imports. Thus, it was more difficult to find injury under the margins analysis. [Note: this is **not** the determination of the dumping margin, but the question of whether or not injury is determined relative to the dumping margin or the volume of “dumped” imports.]

6. *International Trade Administration*: A branch of the U.S. Department of Commerce. The ITA is responsible for determinations of dumping and subsidy margins in Title VII investigations. Given the expressions of dissatisfaction with the Treasury expressed when this

responsibility was shifted to Commerce, the apparent tendency to produce affirmative findings relatively easily would appear to be the result of Congressional design.

7. *Constructed value*: In anti-dumping investigations, if direct price information from the exporter's market, or from a comparable third market, is not available, the ITA must construct the normal value (i.e. cost) of the good, by examining production costs and making a number of adjustments—including a statutory minimum of 10% for “administrative costs” and 8% for profits. Since profits are often well-below 8%, it is not surprising that this creates substantial bias toward affirmative findings and upward bias in estimated margins.

8. *Specificity*: One of the key elements in determining whether a subsidy is actionable or nonactionable. With respect to subsidies, a specific subsidy identifies a specific recipient firm or sector. Since nonspecific subsidies are nonactionable, specific subsidies are either actionable or, if they are contingent on export performance, prohibited.

9. *Actionable subsidy*: Actionable subsidies are measures that are permitted but may, if they create adverse effects on the trade of WTO members, give rise to consultations, invocation of dispute settlement procedures, or imposition of countervailing duties. This is the most difficult category of subsidies and an area of considerable conflict among WTO members.

10. *Agent slack*: In the context of general principal-agent models, one of the consequences of imperfect monitoring of the agent by the principal and imperfect alignment of interests between the principal and the agent is that the agent will generally act in ways that are inconsistent with the interests of the principal. This is called agent slack. In this course we particularly applied this concept to the analysis of the relationship between Congress and the Executive in the negotiation of trade agreements. Odell and Eichengreen argue that closer monitoring, and the reduction of agent slack, has made the executive more effective in achieving Congressional ratification of major trade agreements.

**Essays:** These questions ask you to develop an argument in some detail. Your answer must be logical, complete and grammatical (i.e., you must write in complete, well-constructed sentences and paragraphs). If you use graphical or algebraic analysis to support your argument, you must explain fully the elements of your formalism. Think before writing. [70 points total]

**Part II. Answer 1 (one) for 35 points.**

A. Some analysts have argued that Congressional delegation of trade policy responsibility to the Executive branch involves a more-or-less complete surrender of control over trade policy.

1. First, discuss the statutory foundations of this delegation and the historical circumstances of the delegation. [Note: this question asks you to specify both the terms under which Congress has the power to delegate and the statutory content of the delegation.] (10 points)

Article 1, section 8 of the US Constitution grants Congress the power to “.lay and collect Taxes, Duties, Imposts and Excises, ...” and “To regulate Commerce with foreign Nations...”. Beginning with the RTAA of 1934, Congress delegated to the President the power to negotiate reciprocal reductions in tariffs with trading partners. That is, Congress delegated general authority, not specific levels of tariff reduction, but made this delegation subject to temporal and quantitative constraints. In addition, Congress attempted to give legislative meaning to a general norm of avoiding *serious injury* to domestic industry by fine tuning existing administrative protection mechanisms (like antidumping) and creating new ones (like peril points and escape clauses). Like liberalization authority, this delegation does not specify a particular level of protection, but rather specifies general rules under which protection will be granted.

2. Second, to what extent has Congress in fact transferred decision-making authority to the Executive? [Note: I am not looking for an answer like “a little” or “a lot”, but for a concrete discussion of the authority that has and has not been transferred]. That is, to what extent, and in what ways, does Congress retain control over trade policy outcomes? (15 points)

While Congress has delegated considerable authority to the Executive, this authority is constrained in a number of ways. First, Congress *can* relegislate. This acts as a continuing constraint on the activities of the executive branch. In addition, Congressional hearings during both the trade legislation and appointment process give Congress the opportunity to express its preferences. Finally, Congress-people often intervene directly in both trade negotiations and in the administered protection process. ). The Executive knows that Congress must ultimately approve trade agreements and that, if the administrative protection mechanisms are not working satisfactorily, not only will Congress seek to relegislate the rules, but it may fail to ratify international trade agreements. Considerable historical and econometric research suggests that Congressional preferences have a sizable impact on trade policy outcomes in both negotiations and protection. In understanding this phenomenon, it is important to bear in mind that, as a Principal, Congress has both direct and relatively indirect mechanisms for controlling its agent (“police patrol” and “fire alarm” oversight).

3. Finally, what are the consequences of this transfer, and the form of the transfer, for the outcomes of trade policy? (10 points)

While it is true that Congress retains considerable control over the structure and content of US trade policy, the institutions of the modern trade policy system created by the delegations beginning with the RTAA of 1934, have had a major impact on the levels of protection produced by the political system in a number of ways. First, by transforming the politics of trade from distributive to regulatory politics, the equilibrium level of protection has been dramatically reduced. Second, transferring liberalization authority to the President, who is generally believed to prefer greater liberalization than Congress, has the effect of producing greater liberalization. Finally, by committing the US to the GATT/WTO process, this system has created constraints on future protection.

- B. Unlike the previous half century, the domestic politics of international trade in the post-Second World War era the domestic politics of international trade in the United States has been exceptionally uncontroversial. That is, there was minimal partisan disagreement on the broad nature of U.S. trade policy and minimal public interest in, or engagement on, the issue.

1. Explain this high degree of political consensus on trade policy. (10 points)

It is useful to distinguish between elite consensus (among the politicians and bureaucrats engaged in making and implementing trade policy) and general public opinion. With respect to the latter, the essential condition was the agreement among elites to treat trade policy as part of foreign policy and, essentially, to remove it from electoral contestation. Thus, even though public opinion was never particularly supportive of liberalization, trade policy essentially ceased to be a matter for public discussion, permitting the liberalization process to proceed without public check. As long as the Cold War created a general sense of emergency, any issue attached to foreign policy was going to permit a considerable amount of Executive independence. More broadly, both public and elite opinion tended to view trade policy primarily in terms of noneconomic goals, with economic costs. In addition, relatively strong economic performance, supported by Keynesian macroeconomic policy and provision of minimal income security via the welfare state meant that no strong coalition in favor of a turn away from trade liberalism developed. Explaining the elite consensus is considerably more difficult, though the existence of that consensus is uncontroversial. However, some combination of the broader acceptance of Liberal market norms and the economic successes of Post WWII era, seem to have supported that consensus down to this time.

2. In the latter part of the 20<sup>th</sup> century this consensus has begun to break down. What are the major factors explaining this breakdown. Explain your answer. (10 points)

A number of factors play a key role here. At the systemic level, these include: the successes of the GATT/WTO system is reducing protection to a level that makes other forms of protection (with deeper connections to core domestic political goals) relatively more important; increased exposure of the US economy to trade and other forms of globalization; relative decline of the US (real and imagined); and, perhaps most importantly, the end of the Cold war and, thus, the end of the foreign policy justification for trade policy. All of these

may be leading to a breakdown in the system that kept trade policy out of the domestic political arena. The elite consensus, and the domestic political system that protected trade, also show signs of stress: there is a breakdown in the Congressional system, centered on the House Committee on Ways and Means, that dominated trade policy; increased budget constraints that make cutting tariffs more difficult; the emergence of trade policy as a focus for entrepreneurial politics by Congress-people and others; and, possibly the development of a new (anti-global) ideology providing a focus for new public and elite beliefs.

3. However, even in the face of such breakdown, the U.S. government was able to complete and pass the Uruguay Round agreements which, among other things created the World Trade Organization. By contrast, in an earlier period, the U.S. Executive failed to secure passage of the International Trade Organization. Explain the key differences between these two periods. (15 points)

The key components explaining the success in the later period, relative to the earlier, are *stronger executive leadership* and better links between Congress, high demand constituencies, and the Executive during negotiations and the approval process (*reduced agent slack*). In addition, Odell and Eichengreen argue that *poorer exit options* contributed to the better outcome in the current period. A complete answer explains each of these and gives their significance.

### **Part III. Mandatory essay, (35 points).**

- C. A clear economic analysis of the implications of dumping law requires an explicit analysis of the government's objective in adopting such a law.

1. What is the relationship of "sales at less than fair value" to national welfare? [Note: this question requires that you give a correct definition of the legal phrase in quotation marks and then analyze the implications for national economic welfare of applying that definition to cases of alleged international dumping.] (10 points)

"Sales at less than fair value" is essentially international price discrimination, a form of 3<sup>rd</sup> degree price discrimination, where the higher price is charged in the foreign market. This can occur for a variety of reasons, the most common being the existence of a more elastic demand in the US market than in the exporter's home market. Because the US market is being served at a lower price, this will generally be welfare improving (though there are tricky issues having to do with rent transfer). Market creating dumping, by making consumers aware of alternatives, will also be welfare improving. Sporadic "dumping" seems to have no systematic welfare effects. In the context of oligopolistic competition or strong increasing returns to scale, the case is somewhat different. It is completely possible that dumping, defined in some way, would reduce national welfare. In the case of strategic dumping, where the combination of IRS and a closed home market for the exporter, price discrimination is not even necessary. This seems a relatively rare case, so the main case for a strong concern with dumping in international trade, as with domestic antitrust, involves predation. Predation does involve 3<sup>rd</sup> degree price discrimination, pricing below cost, with the expectation that this will yield a monopoly position in the future, the profits from which will be sufficient to pay the costs of predation.

2. The most obvious justification for concern with dumping is related to predation. Why is predation a problem, both in general and in the international context? (5 points)

From the point of view of national welfare, there are at least two problems. In general, i.e. whether international or purely domestic, predation results in the creation of a less competitive national economy, with the concomitant loss of consumer surplus and increased deadweight losses. In the international context, there is also the loss of profits from national income.

3. One of the prominent approaches to evaluating predation involves first asking the question, “does the market structure in this industry support predation?”; and then, if the answer to the first question is yes, asking whether there is evidence of predation. What are the main conditions necessary for successful international predation? [Note: A complete answer to this part involves an explanation of why these conditions support predation.] (10 points)

To make predation profitable, the firm considering predation must have a reasonable expectation of establishing a monopoly position in the new market and using that position to extract monopoly profits. Thus, the injuries to the market incumbents must endanger their ability to compete in the market. With the exit of incumbents, the predator must expect the market to be more concentrated and expect that it will itself have a dominant position in the market. Thus, there must be high barriers to entry to ensure that, once the incumbents exit and the predator starts to price monopolistically, new firms do not enter the market resulting in increased competition. If there are a number of predators in the market, it necessary that they can establish and maintain collusion.

4. How significant is predation as an explanation of affirmative findings in dumping cases? [Note: in answering this part of the question you must provide evidence supporting your conclusion.] (10 points)

As established in the papers by Shin, Dutz, and Bourgeois and Messerlin, market structures supporting predation are only rarely present in affirmatively determined antidumping cases. A complete answer discusses not just the result, for all three countries, but the method used by the authors to derive the result.

### Summary Statistics for Exam

	Short	Essay A	Essay B	Essay C	Total	N Total	Diff.
Mean	19	16	23	24	63	78	5
Median	19	20	24	25	67	83	2
Std. Dev.	7	7	5	4	16	19	11
Min	1	5	12	13	19	23	-7
Max	29	22	28	27	81	100	31