Can Competition Policy Control 301?

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Competition policy is not an antidote to 301. To preserve the economic benefits of the open international trading system, it may be necessary to regress to a more primitive legal and political system.
Summary findings

Should fair trade rules be replaced by national or international competition rules? A familiar argument for doing so is that more rigorously enforced competition standards might eliminate the basis for the burgeoning number of antidumping cases of recent years.

A less familiar argument is that the implementation of internationally agreed competition standards might reduce the frequency with which the U.S. government uses section 301 of U.S. trade law. Section 301 lists foreign government toleration of systematic anticompetitive activities as one of the bases for taking retaliatory action against foreign exporters.

Finger and Fung found that of 82 “301” actions taken from 1975–92, in only three was the uncompetitive clause the basis for the complaint.

The authors found that a number of additional disputes involved allegations of foreign uncompetitive practices but were taken up through other mechanisms; extraterritorial application of U.S. antitrust law or direct negotiations sometimes capped by an understanding at the presidential level. These negotiations often included the threat of initiation of antidumping, “301,” or other trade remedies cases. (The structural impediments initiative negotiations with Japan are the most familiar example.) In several of these cases, the foreign government agreed to and implemented more rigorous antitrust enforcement, but these actions seldom ended the dispute. The U.S. government pressed on for tangible evidence of increased U.S. export sales.

Finger and Fung conclude that removing the basis for these disputes — alleged lax enforcement of competition policy — did not remove the motive for them — increased U.S. exports. Competition policy then is not the antidote for “301.”

The last section of the paper reviews the compatibility of “301” with the preservation of open international trading system. Of 70 “301” cases (through December 31, 1992) that have led to policy changes, 52 have led to liberalizations, and only 18 have led to increased trade restrictions. Viewed from the point of view of results, the major shortcoming of “301” is that the United States is the only country whose policies do not come under its scrutiny.

This paper — a product of the Trade Policy Division, Policy Research Department — was prepared for discussion at a research seminar on “Approaches to Competition Policy in International Trade,” held in St. Gallen, Switzerland, in September 1993. The study was funded by the Bank’s Research Support Budget under the research project “Antidumping: Follow-up on Newly Emerging Issues” (RPO 678-16). Copies of this paper are available free from the World Bank, 1818 H Street NW, Washington, DC 20433. Please contact Minerva Patena, room N10-013, extension 37947 (45 pages). February 1994.
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by

J. Michael Finger and K.C. Fung

The contributors to this session were asked to address the following question: Should 'fair trade' rules be replaced by national or international competition rules? Professor Messerlin has examined competition policy as a substitute for antidumping, our assignment is to look in the same way at other kinds of fair trade rules. We have concentrated on "301," for obvious reasons. "301" is controversial -- one of the big issues at the Uruguay Round. And in an important dimension it is different from antidumping and other 'trade remedies' -- it is about forcing other countries to relax their trade barriers rather than about creating new ones for oneself.

As we see it, the issue in this session is discipline over the burgeoning use of antidumping restrictions and against the escalating use by the United States of another unilateral instrument,1 "301." In examining "301" we will attempt to answer the following questions:

1. Would more rigorous application in victim countries of competition policy eliminate the basis for "301" actions?

2. Would more rigorous application in victim countries dampen the motive for these actions?

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1 GATT Article VI allows antidumping actions and the 1989 antidumping code elaborates the procedures through which they are to be decided and applied. Since the code was implemented, GATT panels have completed reviews of five national antidumping actions and have determined that each of the five was taken in violation of the GATT or of the code. These five are more suitably described as typical of rather than as exceptions to the 2000 antidumping cases reported to the GATT since the code is in effect. See Finger and Fung, 1993.
Anyone who studies policy institutions knows that the issue that justifies a policy action is often far removed from the motives that propel its advocates, and that when push comes to shove, it is the motive, not the issue that dictate what the action will be. Hence the two questions are not the same.

Section I below reviews how "301" works, after which sections II and III ask if "301" is, in any significant sense, about the lack of competition in foreign markets. We concluded that it is not. It is about increased sales of U.S. exports in foreign markets. In section IV we review the results of "301" actions. This section has two purposes: (a) to put aside concerns that "301" is just another legal way to excuse trade restrictions, and (b) to point out that the overwhelmingly larger proportion of "301" outcomes have been multilateral liberalizations.

We conclude from the information reviewed in sections II, III and IV that competition policy is not an antidote for "301." The last two sections present our interpretation of why "301" has been a success for the United States and our preliminary thoughts on the possibility of an international dispute settlement mechanism made up of national "301s." As systemic concerns and abiding by agreed international norms seem to have little force today, to preserve the economic benefits of the present international system it may be necessary to regress to a more primitive political and legal system.

I. "301" -- How it Works

Section 301 (of the trade act of 1974) is part of the U.S. Congress's response to U.S. exporters' complaints about foreign practices and policies that reduce U.S. exporters' access to foreign markets. As a weapon against foreign practices, the section ultimately authorizes the U.S. Trade
Trade Representative\textsuperscript{2} to retaliate by reducing foreign access to the U.S. market. The section, as amended in 1979, 1984 and 1988, explicitly covers not only merchandise trade, but services, investment and intellectual property as well. Cross-retaliation is allowed, e.g., the Trade Representative may retaliate by restricting imports of \textit{merchandise} from a country in which U.S. \textit{investment} or sales of \textit{services} has been compromised.

"301" deals with three categories of practices that burden or restrict U.S. commerce -- unjustifiable, unreasonable and discriminatory. "Unjustifiable" is defined as any act, policy or practice that violates the international legal rights of the United States -- including (but not limited to) those under a trade agreement such as the GATT, a bilateral Voluntary Export Restraint Agreement, or an agreement that settled a previous "301" case. When the agreement in question has its own dispute settlement process (as the GATT does) the Trade Representative is required to submit the matter to that dispute settlement process simultaneous with his investigation under "301." In U.S. procedure, the schedule and the terms of the "301" investigation are dominant.

If the U.S. Trade Representative finds a foreign violation that is "unjustifiable," she must retaliate.\textsuperscript{3} But, the section also allows the President to waive retaliation if the GATT dispute settlement process decides against the United States, the foreign government takes action to remove or offset the violation, or if retaliation would backfire and significantly harm U.S. commercial interests or U.S. national security.

Section 301 defines "unreasonable" as an act, policy or practice that is unfair and inequitable, though not necessarily a violation of explicit U.S. legal rights. Specific actions are listed as unreasonable: the list including denial of workers' rights, export targeting, denial of fair and equitable

\textsuperscript{2} The section has been modified and extended in the trade acts of 1979, 1984 and 1988. Until the 1988 amendments, "301" authority rested with the President.

\textsuperscript{3} Since 1988, retaliation may not be on the case's subject product or service, e.g., if the subject practice affects US exports of rice, retaliation cannot be a restriction on US imports of rice.
market opportunities, and government toleration of systematic anticompetitive activities.  

"Discriminatory " means any act, policy or practice that denies national or most favored nation treatment to U.S. goods, services or investment. Retaliatory action in these cases is discretionary.

Besides tightening "regular" 301, the 1988 trade act added "Super 301" and "Special 301."

Super 301 mandates that the Trade Representative, in May 1989 and April 1990, submit to Congress a list of "priority countries" and "priority practices" that pose significant barriers to U.S. exports. The act also requires the Trade Representative to initiate investigations concerning each priority practice of each priority country. Special 301 provides similar requirements to identify and investigate countries that maintain significant barriers to market access by U.S. persons who depend on intellectual property protection.

II. "301" and Competition Policy

As we noted above, governmental toleration of systematic anticompetitive activities is one of the practices that "301" defines as "unreasonable," and therefore a basis for retaliatory action by the United States. The wording in the law is as follows:  

Acts, policies, and practices that are unreasonable include, but are not limited to any act, policy, or practice, or any combination of acts, policies, or practices, which denies fair and equitable market opportunities, including the toleration by a foreign government of systematic anticompetitive activities by private firms or among private

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4 The 1988 act introduced a provision to permit foreign governments to defend themselves against accusations of "unreasonableness" by pointing out that the United States does the same thing. (Hudc, 1990, p. 22)

firms in the foreign country that have the effect of restricting, on a basis that is inconsistent with commercial considerations, access of goods to purchasing by such firms.

The inclusion of this definition is by and large due to the perception by Congress that at least some of the invisible barriers in the Japanese market stem from the anticompetitive behavior of private firms; for example, bidrigging, group boycotts and exclusionary procurement practices by private firms. (Bello and Homer, 1990)

The U.S. Trade Representative determines, in junction with an interagency group, whether a specific practice is unreasonable or unjustifiable. Though the Justice Department is part of the "301" interagency committee that reviews cases, the standard of proof to label practices as anticompetitive and then unreasonable is not necessarily the standard required to pursue court cases under the U.S. or foreign antitrust statues. According to some officials in U.S. Trade Representative, the determination of an unreasonable act is not one that requires the same rigorous standard of proof as in antitrust court cases. As only one "301" action has ever been based on the uncompetitive practices clause, the acceptability of a lower standard in "301" cases has not been thoroughly tested legally.

Despite the inclusion of this designation of unreasonable practice, the Executive Branch of the U.S. government has to this date cited only once the anticompetitive clause as the basis for a "301" determination. Instead, the Administration has attempted to use instruments other than "301" to deal with possible anticompetitive conduct abroad. These extra-301 instruments include the 1992 reinterpretation of the guidelines for the application of antitrust laws in overseas operation, the Structural Impediment Initiatives (SII), and ad hoc commitments made by heads of states.

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9 In parallel, the standards of proof and evidence required to establish dumping in an antidumping investigation are weaker than those necessary to establish price discrimination in an antidumping case. Finger, 1993, ch. 2, provides documentation
According to the U.S. Trade Representative's (mandatory) reports on "301" to Congress, the case of Japan construction and construction-related services (301-69) is the only case in which a positive "301" determination is based on the anticompetitive clause. Inadequate access to Japan's architectural, engineering, and construction markets has been a long-standing U.S. concern. Until 1987, U.S. companies had received only small contract awards totaling about $1.6 million for contracts given on the $8 billion Kansai International Airport (USTR, 1987). Section 1305 of the 1988 Trade Act required the USTR to initiate an investigation regarding acts, policies and practices of the Japanese government, and of entities owned, financed, or otherwise controlled by the government of Japan, that are barriers in Japan to the offering of performance by U.S. persons of architectural, engineering, construction and consulting services in Japan. On November 21, 1988, the U.S. Trade Representative initiated such an investigation.

The U.S. Trade Representative's investigation concluded the Japanese government's practices to be unreasonable, and a burden to U.S. commerce, that the Government of Japan implemented procurement policies in the construction sector in a way that limited competition and facilitated collusive bidding practices, including inadequate use of administrative measures restricting collusive activities, and operation of the designated bidder system. In other words, the U.S. Trade Representative concluded that the Government of Japan did tolerate anticompetitive practices by these construction companies and thereby did impede sales of foreign construction firms.

On April 26, 1991, U.S. Trade Representative proposed to impose restrictions on the provisions in the U.S. by Japan of such services. No Japanese contractor would be eligible to enter into contracts for such services with certain federal agencies.

On July 31, 1991, an agreement was reached through an exchange of letters and thus no retaliation action was taken under 301. This agreement extended the 1988 Major Projects
Arrangement (MPA). The 19.1 agreement provided for special measures designed to facilitate foreign access to 23 additional projects, worth an estimated $26.7 billion. This brought to 40 the number of public works construction projects covered by such measures.

Since the original agreement in May 1988, 12 U.S. contractors have obtained construction licenses to work in Japan, and eight companies have registered as first-class architects’ offices. As of December 1992, U.S. firms had been awarded a total of approximately $463 million in contracts for MPA projects. Prior to the MPA, U.S. firms had complained that they had virtually no access to the public work market in Japan.

As stated earlier, the Japanese public construction case is the only case in which the anticompetitive section of "301" was used by USTR as a basis for positive determination. There are, however, two other instances where the 301 petitioners invoked the 301 anticompetitive clause in their petitions. One instance is the issue of access to the Japanese market of amorphous metals, a high technology product used primarily to improve efficiency in electric power transmission. On March 5, 1990, Allied-Signal Inc., a U.S. firm with patent rights to amorphous metals, filed a "301" petition against Japan. Allied-Signal Inc. alleged that it had been denied market access to Japan through a combination of Japanese targeting and toleration of anticompetitive practices (USTR 301 Report to Congress, July-December 1990). One complaint was that the Japanese government allowed a boycott by Japanese electric utility companies of purchases of clearly superior amorphous metal transformers. Allied-Signal Inc. also accused the Japanese government of tolerating the refusal by certain individual Japanese companies to negotiate separate license agreements with Allied which would allow Allied to enjoy significant participation in the Japanese market.

On April 18, 1990, the Administration obtained a commitment from the Japanese government to engage in negotiations on market access in Japan for amorphous metals. Rather than starting a one-year section 302 investigation, the Administration used the leverage of the pending petition to obtain a
commitment from Japan to continue negotiations for finding a solution to this issue within 150 days. Allied-Signal thereafter withdrew its petition. Negotiations were completed with a joint announcement in September 1990. One result was that the government of Japan agreed to require Japanese utilities to evaluate bids using standards similar to those applied by U.S. utilities in their purchases. In addition, Japanese utilities would buy from Japanese manufacturers 2,000 units of amorphous metal transformers over two years in order to conduct tests to see whether the amorphous metal transformers can be effectively mass-produced in Japan. The transformer manufacturer would, in turn, buy amorphous metals produced in the U.S. or by a licensee of Allied-Signal. This test was set up to allow Japanese manufacturers to achieve economies of scale and to acquire know-how in production of amorphous metal transformers. It would also allow the performance of amorphous metal transformers to be compared with the performance of their substitute, silicon steel transformers.

The agreement did not provide for any market share allocation or for any purchases after the completion of the test period. As a result of this resolution, Allied-Signal announced that it would not re-file its petition (USTR 301 Report to Congress, July-December 1990).

A second instance in which the petitioners (P&M Cedar Products, Inc. and Hudson ICS) argued that foreign practices are unreasonable because of toleration of anticompetitive conduct is the case of Indonesian pencil slats, small wooden boards used in the production of pencils (301-90). The petitioners, competitors to the Indonesian government in both the U.S. and in third markets as suppliers of these slats, alleged that in addition to export targeting, the Indonesian government had been encouraging vertical integration of Indonesian logging and processing activities. They also accused the Indonesian government of not promoting competition in the logging industry and of not protecting the interests of the consumers.

On October 2, 1992, the USTR initiated an investigation to determine whether the allegations contained in the petition warranted actions. Based on the investigation, USTR determined that factors