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Stamping out Logic and Reason: EU Anti-Dumping Duties on Leather Shoes

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Introduction

On 23 March 2006, the European Commission adopted a regulation imposing provisional anti-dumping duties on imports of leather shoes from the People's Republic of China and the Socialist Republic of Vietnam for an initial period of six months. From 7 April onwards, the duties will be imposed progressively over a period of five months, beginning at about 4 percent and rising to 16.8 percent in the case of leather shoes from Vietnam as well as to 19.4 percent with regard to the respective products from China. This approach has been chosen – in the words of the Commission – "in order to minimise any sudden impact on imports" and thus apparently to appease the substantial opposition against these measures among European importers and a considerable number of EU member states. According to the Commission, the duty will lead to an average increase in the import price from €8.50 to €10.00. Another source estimates that the duties will lead to an increase of between €5 and €20 on the average sales price of leather shoes in Europe, which currently range from €30 to €100. Interestingly, however, the provisional anti-dumping duties do not apply to children's leather shoes "so as to ensure that even the small price rises are not passed on to poorer families". Finally, due to a lack of injury to EU producers, "Special Technology Advanced Footwear" is exempted from the duties (Press Release IP/06/364 of 23 March 2006).

The regulation, already portrayed in the media as the beginning of a "shoe war", is undoubtedly going to result in a resurgence of the tensions in the trade relations between the EU and China that have only recently been relieved following the preliminary settlement of the dispute over cheap Chinese textile imports (the "bra war"), in September 2005. In addition, it is also likely to overshadow the ongoing negotiations of Vietnam's accession to the WTO. However, aside from these trade policy implications, the Commission's wisdom in this regard is also subject to challenges from an economic and legal point of view.

While it is impossible to engage in a comprehensive evaluation of all of these challenges in the course of this Policy Paper and although the respective Commission regulation has not been published yet, this contribution intends to provide – on the basis of the information as being publicly known today (24 March 2006) – a preliminary assessment of at least some of these controversial issues of the provisional anti-dumping on leather shoes from an economic as well as a legal perspective.

Background: The European House Divided

The Commission's decision originates from a complaint lodged by the European Confederation of the Footwear Industry (CEC) on 30 May 2005 alleging that the imports of certain footwear with leather uppers, originating in China and Vietnam, are being dumped and are thereby causing material injury to the Community industry. In response to this complaint the Commission published on 7 July 2005 a notice of initiation of anti-dumping procedures (OJ C 166/14 of 7 July 2005).

Following an investigation undertaken in factories jointly agreed with the Chinese and Vietnamese governments, Trade Commissioner Peter Mandelson confirmed in a statement made on 23 February 2006 that the Commission has found "compelling evidence of serious state intervention on a large and strategic industrial scale in the footwear sector" such as "non-commercial loans or capital grants from the state to producers; improper evaluation of assets; non-commercial rates for land-use and important tax breaks for exports". These and other "disguised subsidies" would allow Chinese and Vietnamese producers to export leather shoes to Europe "at below the true cost of production in their own countries". Taking into account that the Commission also found evidence of "serious injury to European industry", Mandelson recommended on the basis of his "judgement of the Community's overall economic interest" the introduction of the above mentioned scheme of anti-dumping duties.

Although the proposal brought forward by the Trade Commissioner was intended to be a compromise, it was not successful in overcoming the schism among the European industries of shoemakers and shoe retailers as well as the respective EU member states backing them. While on the one side countries like Italy, Portugal, Spain and Hungary with significant domestic shoe production continued to demand the imposition of considerably higher duties, importers of shoes from Asia such as the Scandinavian countries, Ireland and Slovenia rejected the need for anti-dumping measures at all. This situation of the European house divided found its most graphic expression in the respective consultation by the Commission with the member states that took place on 16 March 2006 in the EU Advisory Committee on anti-dumping established under Article 15 of Council Regulation (EC) No. 384/95 as last being amended by Council Regulation (EC) No. 461/2004. According to media reports, in the course of this confidential consultation only three member states – Belgium, Malta and Slovakia – actually voted in favour of the Commission's proposal, nine or ten voted against it, while eleven abstained. Despite the fact that the

Swedish trade minister Thomas Ostros was subsequently quoted as saying that Mandelson should withdraw his proposal in light of what he called a "very unusual (voting) result" and that the Commission "should really reconsider its whole policy at this stage and how they work with anti-dumping measures", the Trade Commissioner now saw himself "in a position to recommend to the European Commission that it adopts his proposals for provisional measures" which he considered to represent "a middle ground". The necessary consensus among member states on a definite course of action will only be established "when the investigation is concluded in the autumn".

Unfair Trade or Comparative Advantage?

The world market for leather shoes is both very competitive and highly segmented. Due to low labour costs of mainly Chinese and Vietnamese producers, the European leather shoe industry has specialized in high-quality products. The down-market segment is indeed supplied by Asian exporters but there is still strong competition between European and Asian producers in the medium-quality sector. Within the framework of China's accession to the WTO, the EU-China Agreement provided for the gradual abolition of all quantitative restrictions by 2005. Since then, European producers face full competition and they are not only highly vulnerable to Asian exports but they also fear the Asian growth potential as prices will further drop at a time when foreign production expands and economies of scale will become effective. Since 2001 European leather shoe production has shrunk by 30 percent and about 40,000 jobs have been lost in this sector. In 2005 the European Union imported about 215 million pairs of leather shoes from China worth some €5 billion. During the period from 2001 to 2005 these imports increased tenfold with respect to China, and almost doubled with respect to Vietnam. At the end of last year, China and Vietnam held a 24 and 14 percent share in the European leather shoe market respectively.

The Commission argues that this comparative advantage enjoyed by China and Vietnam as a result of low wages (leather shoes are highly labour-intensive goods) is artificially magnified by unfair state intervention in the form of subsidies. Thus, in the Commission's view this unfair practice has to be offset by an anti-dumping duty. However, as frequently pointed out in the discussions preceding the decision of the Commission, the "additional" comparative advantage by the alleged subsidies is too insignificant in order to justify anti-dumping duties.

Questionable Calculations

During the investigation the Commission granted market-economy

status neither to China nor to Vietnam. In doing so the investigating authority is not obliged to rely on Chinese and Vietnamese market data with respect to the cost calculation and the determination on whether sales were priced below costs. The actual calculation was based on Brazilian data, thus partly offsetting the Chinese and Vietnamese comparative advantage due to low labour costs and cheaper raw materials. The term "particular market situation" in Art. 2.2 WTO Anti-Dumping Agreement (WTO-ADA) which could be interpreted as a non-market-economy situation is neither specified in the WTO Agreement nor does clarification exist in form of a Panel or Appellate Body decision. The indeterminacy of this term and the resulting discretion of the investigating authority lead to uncertainty and unpredictability within the multilateral trading system. The elimination of the term "particular market situation" was proposed by a group of WTO Members since this term has been used for situations that were not addressed by the negotiators during the Uruguay round. Further elaboration on this issue is undoubtedly needed.

Over and above this general problem the used method of "sampling" is also problematic. According to Article 6.10 WTO-ADA the investigating authorities may, in cases where the number of exporters involved is too large to calculate individual margins of dumping for each of the known exporters, limit their examination by using "statistically valid" samples on the basis of the information available. According to Chinese officials the Commission should have undertaken investigations on the basis of all leather shoe exporters since in China, for instance, only fifteen percent of the footwear production sector was examined. This percentage would only result in a "statistically valid sample" if a random sampling plan had been elaborated prior to the sampling. Furthermore, only thirteen big Chinese leather shoemakers were investigated and none of them was granted market-economy status although they submitted an application in order to obtain the market-economy status individually. It is very unlikely that the application of the sampling method in this regard could be accredited as "statistically valid" since hundreds of smaller Chinese businesses also export leather shoes to the European Union.

Combining these two concerns the question arises as to how sampling applies in a non-market economy. If it is not possible to make a comparison between the export price and the domestic price for the like product (due to the "particular market situation"), the margin of dumping can be determined by comparison with an appropriate price in a third country. That means the costs of production are reconstructed under a market-economy situation and the export price is taken from a sam-

pling method. In consequence, the "margin of dumping" is calculated on a basis that takes into account two modelled figures, namely the normal value of the product derived from a comparison with the Brazilian market and the export price taken from thirteen Chinese leather shoe exporters. The outcome of such a calculation is a biased dumping margin that cannot possibly prove "compelling evidence" of material injury to the European leather shoe market.

Legal and Institutional Issues at the European Level

The Commission's decision on provisional anti-dumping measures raises several legal questions with regard to its compatibility with WTO law. First, it is highly doubtful whether anti-dumping law is actually the appropriate forum for the issue; the entire proceeding seems to be more convincingly a countervailing measures case. Second, the determinations of dumping and of injury by the Commission might be challenged on several grounds, most importantly with regard to the sampling used by the Commission (see Art. 6.10 WTO-ADA). Some of the problems in this regard have already been indicated in the preceding section but these and further legal problems under WTO law would require more in-depth analysis. Here, we rather concentrate on the institutional problems of the case within the framework of the common commercial policy of the EU.

The applicable legal rules for the decision taken by the Commission and the entire anti-dumping proceeding concerning leather shoes are laid down in Council Regulation (EC) No 384/96 of 22 December 1995 on protection against dumped imports from countries that are not members of the European Community (OJ 1996 L 56/1, as amended) (AD Regulation). According to Art. 7 (1) AD Regulation, provisional AD duties may be imposed by the Commission if an AD investigation has been properly initiated, if affected and interested parties had the possibility to submit relevant information and make comments, if a provisional affirmative determination has been made of dumping and consequent injury to the relevant Community industry, and if the Community interest calls for intervention to prevent such injury. Art. 7 (4) AD Regulation grants the Commission the competence to impose provisional AD duties if the mentioned conditions are fulfilled and after consultation with Member States. Provisional AD duties may be imposed for six months. They may be extended for a further three months or for a further nine months, if additional prerequisites are given (see Art. 7 (7) AD Regulation). Moreover, the Council has the competence to overrule (i.e. to annul) the decision of the Commission on provisional AD duties by qualified majority (Art. 7 (6) AD Regulation).

Cloudy Competences

Taking these legal rules into consideration, it seems at first sight impossible to raise doubts about the competence of the Commission to impose provisional AD duties on Chinese and Vietnamese leather shoes. However, to fully understand the underlying problems of the decision of the Commission it is necessary to broaden the perspective on the general division of competences between Member States, the Commission, and the Council in AD procedures. In this regard, it is important to highlight revisions to the AD Regulation made in 2004 as a consequence of the Eurocoton judgement of the ECJ of September 2003 (Case C-76/01 P). According to the new Art. 9 (4) AD Regulation, a proposal of the Commission on a definitive anti-dumping duty "shall be adopted by the Council unless it decides by a simple majority to reject the proposal, within a period of one month after its submission by the Commission". This quasi-automatic imposition of definitive anti-dumping duties, and thus the Council's restricted discretion in rejecting a respective proposal by the Commission, is in line with the holding of the ECJ that anti-dumping proceedings are more of an administrative than of a legislative character.

If one takes the procedural rules on provisional and definitive anti-dumping duties together, an interesting picture emerges with regard to the competences of the Commission. The Commission may impose provisional anti-dumping duties unless the Council decides otherwise by qualified majority. Similarly, the proposal of the Commission to enact definitive anti-dumping duties will pass through unless the Council rejects the proposal by majority vote. Thus, in a situation in which it is not possible for the Member States to form a qualified or simple majority position on a specific anti-dumping proceeding, the Commission is in fact free to determine any anti-dumping measure on its own. This is exactly what has happened concerning anti-dumping duties on leather shoes. Because the Member States have different opinions on whether and to what extent the respective anti-dumping duties are necessary, the Commission does not have to fear any intervention by the Council in its decisions on provisional or definitive anti-dumping duties. The split of the Member States thus plays for the Commission. In fact, the more disputed the anti-dumping proceedings are among Member States, the more (factual) competences the Commission gains.

One may argue that the described situation is perfectly in line with the AD Regulation. This might be true if one looks exclusively in the AD Regulation as secondary EC law. However, it is undisputed that secondary EC law has to be interpreted in accordance with primary EC law, i.e. the EC treaty. Thus, the ques-

tion is whether the described imbalance in the relationship of Commission and Council has to be corrected with regard to constitutional legal requirements of the EC treaty. In this regard Art. 10 ECT comes into play. The ECJ has stated that, on the basis of Art. 10 ECT, "inter-institutional dialogue […] is subject to the same mutual duties of sincere cooperation as those which govern relations between Member States and the Community institutions" (Case C-65/93, Parliament v. Council, ECR 1995, I-643 para. 23). The Member States reaffirmed this principle in a declaration attached to the treaty of Nice, which reads as follows: "The Conference recalls that the duty of sincere cooperation which derives from Article 10 of the Treaty establishing the European Community and governs relations between the Member States and the Community institutions also governs relations between the Community institutions themselves" (OJ 2001 C 80/77).

It seems to be doubtful whether the decision of the Commission to impose provisional anti-dumping duties on leather shoes is in line with the duty of sincere cooperation. Even though anti-dumping proceedings are to a large extent administrative in nature, they are still rooted in the overall constitutional system of institutional balance. According to the ECJ, "[o]bservance of the institutional balance means that each of the institutions must exercise its powers with due regard for the powers of the other institutions" (Case 70/88, Parliament v. Council, ECR 1990 I-2041, para. 22). Therefore, in light of the duty of sincere cooperation and the principle of institutional balance, it may be argued that the Commission may not exercise its powers under the AD Regulation in a situation where the Council will obviously not be able to exercise its respective powers because of political, economic and legal ambiguities and disagreements.

A Lose-Lose Situation

Who will gain and who will lose? One could not even say that the European leather shoe industry will be the winner in the imposition of the countermeasure as importers, wholesalers and retailers will have to face higher purchase prices. Even taking into account the long supply chain, the duties will be passed on to consumers. Now the economically unpersuasive situation occurs where neither producers nor consumers win, but at least in the down-market sector an uncompetitive industry is protected. If the European consumer price elasticity of demand is high, about 1,200 Chinese footwear plants and one million Chinese workers will have to deal with the increase of production costs. Predominantly small Chinese and Vietnamese producers will be driven out of the market and the trade dispute will impose a socially unjustifiable burden on large numbers of Asian workers. If the Commission and the Chinese and

Vietnamese governments are unable to settle the dispute, the case will be brought to the WTO. In the meantime Asian producers will have to adjust to the changed circumstances. This could be done, for example, by circumventing the duty, i.e. producing shoes made of resin or leatherette, or by switching to higher-quality production to offset the duty. This would result in a lose-lose situation for all concerned.

The current case also highlights the problematic manner in which competences are granted to the Commission in the AD Regulation and provides further evidence of the most unsatisfactory way in which the prerequisites of "community interests" are drafted in Art. 21 AD Regulation. The leather shoes case demonstrates that the interests of the affected domestic industry are almost exclusively taken into account when assessing the community interest, at the expense of broader economic considerations. Thus, we have a situation in the case of leather shoes in which provisional anti-dumping duties are imposed, even though Member States have severe doubts about whether this is actually "in the interests" of the EC.

In sum, a preliminary assessment of the Commission's move reveals that the imposition of provisional anti-dumping duties must not only be regarded as being irrational from an economic perspective, but is also highly questionable under Community as well as WTO law. It is thus, particularly in light of recent announcements made by Chinese shoe-manufacturers in this regard, most likely that the measure will be subject to judicial review by the European Court of First Instance and, presumably, by a WTO panel. The Commission will find it extremely difficult to defend its measure.

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