ELSEVIER

Journal of International Economics 72 (2007) 176–201

Journal of INTERNATIONAL ECONOMICS

www.elsevier.com/locate/econbase

Trade deflection and trade depression

Chad P. Bown [a,*], Meredith A. Crowley [b,1]

[a] *Department of Economics and International Business School, MS 021, Brandeis University, Waltham, MA 02454-9110 USA*

[b] *Department of Economic Research, Federal Reserve Bank of Chicago, 230 S. LaSalle St, Chicago, IL 60604-1413 USA*

Received 16 September 2005; received in revised form 15 May 2006; accepted 9 September 2006

Abstract

This is the first paper to empirically examine whether a country's use of an import restricting trade policy distorts a foreign country's exports to third markets. We first develop a theoretical model of worldwide trade in which the imposition of antidumping and safeguard tariffs, or "trade remedies," by one country causes significant distortions in world trade flows. We then empirically test this model by investigating the effect of the United States' use of such import restrictions on Japanese exports of roughly 4800 products into 37 countries between 1992 and 2001. Our estimation yields evidence that US restrictions both deflect and depress Japanese export flows to third countries. Imposition of a US antidumping measure against Japan deflects trade, as the average antidumping duty on Japanese exports leads to a 5–7% increase in Japanese exports of the same product to the average third country market. The imposition of a US antidumping measure against a third country depresses trade, as the average US duty imposed on a third country leads to a 5–19% decrease in Japanese exports of that same product to the average third country's market. We also document the substantial variation in trade deflection and trade depression across different importing countries and exported products.

Keywords: Deflected trade; Depressed trade; Antidumping; Safeguards; MFN

JEL classification: F10; F12; F13

* Corresponding author. Tel.: +1 781 736 4823; fax: +1 781 736 2269.
E-mail addresses: cbown@brandeis.edu (C.P. Bown), mcrowley@frbchi.org (M.A. Crowley).
URL: http://www.brandeis.edu/~cbown (C.P. Bown).
[1] Tel.: +1 312 322 5856; fax: +1 312 322 2357.

0022-1996/$ - see front matter
doi:10.1016/j.jinteco.2006.09.005

1. Introduction

In March 2002, the United States imposed a "safeguard" – a broad-based set of tariffs and quotas – on imports of steel to shield its domestic industry from foreign competition. Shortly thereafter, the European Union and a number of other steel-importing countries responded by imposing their own import restrictions on steel.[2] The EU partially justified its trade policy by arguing that the change in US trade policy would re-route or "deflect" Asian steel exports – initially destined for the newly closed US market – to what would have otherwise been a relatively open EU market.[3]

Are the EU's concerns in the steel case consistent with historical experience? When a large importing country, such as the US, uses import restrictions such as a safeguard or antidumping duties to protect domestic producers from imports, does this lead to the substantial deflection of exports to third country markets like the EU? To our knowledge, this is the first paper to address this question empirically. We begin by presenting a simple theoretical model to illustrate the EU's argument on deflected trade. This model embodies the potential differential impact on world trade flows of a country-specific antidumping duty (AD) versus a nondiscriminatory safeguard measure (SG).[4] We then test the model's implications on a panel of Japanese product-level exports from 1992–2001 that is matched at the product level to changes in US trade policy through the application of antidumping duties and safeguard measures. We investigate whether there is evidence that the US use of such AD and SG "trade remedies" has an impact on Japanese export patterns to third markets and then whether there is variation across importing countries and/or products of the size of any potential distortions.

In the empirical investigation, we use a dynamic panel data model to estimate the impact of US import restrictions on Japanese exports to third countries. We construct a dataset of Japanese exports of roughly 4800 products into 37 countries between 1992 and 2001 to assess the effect of US import restrictions, thus exploiting the substantial variation across products and time of Japanese exports to third countries. Our empirical approach allows us to estimate the impact of a US-imposed, Japan-specific antidumping duty on Japanese exports, identifying whether trade is deflected to third markets. In addition we are able to identify a second impact of US antidumping duties on Japanese exports; when a US duty is applied against a third country's exports, Japanese exports of the targeted product to the third country market are depressed.

[2] In addition to the EU, other WTO members that imposed at least preliminary safeguard protection on steel products between March 2002 and October 2003 included Chile, China, Czech Republic, Hungary, Poland and Venezuela (WTO, 2002, 2003). Canada and Bulgaria had also initiated steel safeguard investigations after the US imposition of protection but did not apply protection.

[3] The 25 March 2002 EU press release announcing its steel safeguard response to the US steel safeguard of 5 March noted that "[w]hilst US imports of steel have fallen by 33% since 1998, EU imports have risen by 18%. Given that worldwide there are 2 major steel markets (EU with 26.6 m tonnes of imports in 2001 and US with 27.6 m tonnes), this additional protection of the US steel market will inevitably result in gravitation of steel from the rest of the world to the EU. This diversion is estimated to be as much as 15 m tonnes per year (56% of current import levels)." (European Union, 2002).

[4] A 'nondiscriminatory' trade policy (tariff) is one that is applied equally to all exporting countries, e.g., all imports into a country face the same tariff rate. The term most-favored-nation (MFN) will be synonymous with 'nondiscriminatory' for the purpose of this paper. A 'discriminatory' or 'preferential' trade policy is one in which an importing country applies different tariffs to imports from different exporting countries. For example, the import tariff on goods from regional trade agreement partners is usually lower than that imposed on goods from other countries. Although the WTO requires that all its members have nondiscriminatory trade policies, there are numerous exceptions to this rule. Two of the most important exceptions in practice are that the WTO allows for discriminatory tariffs when countries participate in preferential trade agreements and when countries impose antidumping duties.