REGULATORY AND TRADE DEVELOPMENTS

THE CITT'S *BABY FOODS* DECISION: EVALUATING DUMPING-RELATED INJURY WHEN THE DOMESTIC PRODUCER IS A MONOPOLIST

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Introduction

On May 26, 2004, the Federal Court of Appeal upheld the Canadian International Trade Tribunal's (CITT) 2003 Expiry Review decision in the inquiry into *Certain Prepared Baby Foods Originating in the United States of America.*[1] The Federal Court held that none of the CITT's contested factual determinations in its April 28, 2003 decision was patently unreasonable. The Expiry Review concerned whether existing anti-dumping duties imposed on the foreign producer of jarred baby food, Gerber Products Company (Gerber), a subsidiary of Novartis, should be renewed or allowed to expire. The CITT concluded that although the domestic producer's profits would be negatively affected if the duty regime on Gerber's imported baby food was allowed to lapse, this would not for the most part constitute dumping-related injury even were Gerber to resume dumping in the Canadian market. Accordingly, the anti-dumping duties were allowed to expire. At the heart of the CITT's decision were sound economic principles commonly applied in the analysis of competition policy.

The CITT found in a previous set of hearings in 1998 that Gerber had dumped the products in question in Canada, in the sense that Gerber's prices in Canada were below its prices in its home market. The CITT also found that the sole domestic producer, Heinz Canada Limited, had suffered material injury due to this dumping.[2] The anti-dumping duties initially proposed were substantially reduced following a Public Interest Inquiry in June of 1999. Nonetheless, in light of the duties imposed Gerber chose to leave the market in 1998 and has not returned. Heinz Canada was left as the only producer of the baby food in question during that time period.

With the five-year term of the duty regime nearing a close, the Canada Customs and Revenue Agency (CCRA) conducted an investigation of the likelihood of a resumption of dumping if the duties were allowed to expire. The CCRA found in late 2002 that Gerber was likely to resume dumping if the duties were lifted. As a technical matter a finding of dumping is not surprising given that Gerber was the premium producer in the U.S. and that incomes and, correspondingly, the prices of many goods are higher in the U.S. than in Canada. The remaining question that the CITT had to answer in the Expiry Review was whether Heinz Canada would be "materially injured" by the resumption of dumping. If injury was found the duty regime would be renewed and Gerber would presumably continue to stay out of the Canadian market.

A narrow and shortsighted application of the concept of "injury" would suggest that Heinz Canada will be injured in a certain sense of the term: entry by any additional producer (dumping or not) would very likely lead to a decrease in Heinz Canada's profits. However,

this case was unusual in that Heinz Canada had effectively been a monopolist in the sale of baby food in the intervening period. Given that the majority of any injury found using the usual approach would be in the form of lost monopoly profits, a more nuanced treatment of the concept of dumping-related injury was called for.

An Injury Test Based on Concepts from Competition Policy

The correct approach in the (not very common) case where a sole domestic producer exists involves establishing whether there is likely to be any injury of the type that an economically reasonable public policy (such as competition policy or trade policy) is intended to prevent. Protection of monopoly profits is not a socially desirable policy goal (except perhaps under circumstances that are not relevant here).[3]

An economically sound method of determining whether dumping-related injury exists involves two steps: first, the sole domestic producer's actions are examined for evidence of the exercise of monopoly power; and second, the foreign producer's probable pricing strategy is explored for evidence of an intent to engage in predatory behaviour. Dumping-related injury would then be found when the domestic incumbent passes the former "monopoly conduct" screen, while at the same time the foreign entrant's probable pricing strategy fails the "predatory dumping" screen. If, on the other hand, the domestic incumbent is found to have exercised monopoly power in various ways and the foreign producer intends to set prices at non-predatory levels, it is likely that the majority of any "injury" that would arise is due to an erosion of monopoly profits. This must be separated from any legitimate harm before dumping-related injury can be found. Thus, dumping-related injury has to entail more than the loss of monopoly rents that the domestic incumbent would suffer from the entry of any effective competitor.

The rationale for this two-pronged test is rooted in the economic ideas commonly applied in the analysis of competition policy. Total welfare (the sum of consumer and producer surplus) is in most cases higher under duopoly than monopoly, and thus it will normally be in society's immediate interests to encourage more rather than less competition.[4] The only type of competition we might remain wary of is destructive "competition" that is purely predatory and transitory in nature (and which is thus in fact anti-competitive). A firm engaging in predatory pricing sets price below its average variable cost in order to induce the exit of a rival, with the intention of recouping its investment in below-cost pricing by acting as a monopolist at a later time. Putting these concepts together, it is easy to see that sound competition or trade policies should not promote the entrenchment of monopolies that are threatened by entrants pricing at pro-competitive levels. In the trade context it is thus not appropriate to recognize such lost monopoly profits as legitimate dumping-related injury, provided that the "dumping" at issue is non-predatory. To hold otherwise would be to argue that the worse the monopoly conduct, the greater the injury, since the potential for reduced profits to the domestic incumbent from being exposed to competition is greater the stronger the domestic firm's monopoly power. This cannot be a sensible result.

This test proves easy to apply to the case at hand. Substantial evidence showed that Heinz Canada enjoyed monopoly power during Gerber's five-year absence from the Canadian market for baby food. Specifically, Heinz raised its prices on a number of occasions, leading to both an elastic demand response and improved financial results;[5] it was sanctioned by the Commissioner of Competition for entering into potentially harmful exclusive and long-term contracts

with retailers;[6] and it cut back on both promotional efforts intended to expand the market and on new product introductions.[7] All of these are consistent with the exercise of monopoly power and accord well with how economists understand monopolists to behave.

It was also evident that Gerber's pricing was likely to reflect normal, pro-competitive conduct with the price set above Gerber's average total cost of serving the Canadian market, and in fact at what might be considered "premium" levels.[8] Further, Gerber's company practices suggested an interest in preserving the high-end segment of the market, with an emphasis on new and differentiated products likely to enhance consumer demand.[9] Thus, Gerber would not be engaged in predatory activity should it be allowed to re-enter. The injury test thus leads to the result that much if not all of any harm Heinz Canada would suffer as a result of entry by Gerber is due to erosion of its monopoly profits, which cannot therefore be considered dumping-related injury.

The CITT's Injury Determination

This economically sensible result was largely endorsed by the CITT. With regard to Gerber's probable pricing, the CITT noted that "if Gerber U.S. re-enters the Canadian market, it will do so at a premium, albeit dumped, price and will maintain this premium price position,"[10] a finding which is consistent with the notion that Gerber intends to price at pro-competitive and non-predatory levels.

On the question of whether harm to Heinz Canada can be considered dumping-related injury, the CITT tellingly remarked:

> Any new and successful entrant into this market, be it a domestic or foreign supplier, would gain some market share from Heinz Canada solely because renewed competition would end Heinz Canada's monopoly. In light of this, the Tribunal needs to differentiate the injury caused by the entry of renewed competition into the market from the injury caused by resumed dumping. In its analysis, the Tribunal must consider the nature of competition posed by the new supplier and determine to what extent that competition is based on non-dumping factors.[11]

This is precisely the correct economic approach.

The CITT noted a number of offsetting factors suggesting that demand for baby food would likely be enhanced upon entry by a high-end producer such as Gerber, which would tend to mitigate any harm suffered by an incumbent such as Heinz Canada.[12] But, crucially, the CITT found that should any such harm be suffered much of it is irrelevant because of Heinz Canada's failure to pass the monopoly conduct screen:

> [T]he Tribunal does not consider any such volume likely to be captured by Gerber U.S. to be injury to Heinz caused by dumped imports. Rather, the Tribunal considers this impact on sales volume to be caused by the renewal of competition in the market.[13]

> [I]t is the Tribunal's view that Heinz Canada will lose market share and possibly lose small volumes of sales, suffer some price erosion and incur additional costs as the result of imports from the United States entering the market. These effects, however, are the result of introducing competition into the market; they are not, in the Tribunal's view, due to dumping.[14]

To summarize, the CITT was of the view that renewal of the duty regime imposed on Gerber in 1998 was

inappropriate, in light of the absence of significant dumping-related injury to Heinz Canada. The CITT's determination in this regard represents an economically sound approach to trade policy.

Notes

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[1] Canadian International Trade Tribunal, Expiry Review No. RR-2002-002, Order ("Expiry Review Order").

[2] The products in question, "certain prepared baby foods", are a broad class of products defined by the CITT as prepared baby foods "containing finely homogenized vegetables, fruit and/or meat which may include some visible pieces of not more than 6.5mm in size, and strained juice, put up for retail sale as food and beverages for infants of ages 4 to 18 months, in containers of a net volume not exceeding 250 ml, excluding organic baby food and frozen baby food preparations, originating in or exported from the United States of America" (Expiry Review Order at 2). Heinz Canada was not the only producer selling baby food generally in Canada between 1998 and 2003. Various smaller niche brands were available and organic baby food selling at slightly higher price points was also making inroads. However, Heinz Canada was effectively the sole seller of the Canadian equivalent to "certain prepared baby foods" as defined by the CITT.

[3] There is an argument for tolerating or even protecting monopoly returns gained as a result of investment in new technology or in innovation, or simply the existence of a superior product. Patent policy is an example of an instance where possible market power is tolerated in return for improved welfare over time. However, inasmuch as such policies seek to allow firms to capture returns on their specific investments, the returns themselves are often properly considered "quasi-rents", rather than the pure rents accruing as a result of protectionist policy described here.

[4] An exception might be the case of "natural monopoly", where cost efficiency realized through economies of scale requires a single firm serve the market.

[5] Expiry Review Order at 7, 22.

[6] Expiry Review Order at 11.

[7] Expiry Review Order at 7, 10.

[8] Expiry Review Order at 17-18.

[9] Expiry Review Order at 12.

[10] Expiry Review Order at 18.

[11] Expiry Review Order at 19.

[12] Expiry Review Order at 19-20.

[13] Expiry Review Order at 20.

[14] Expiry Review Order at 21.