

**BEFORE THE
TRADE POLICY STAFF COMMITTEE
OFFICE OF THE UNITED STATES TRADE REPRESENTATIVE**

In the Matter of)
)
)
CERTAIN PASSENGER VEHICLE)
AND LIGHT TRUCK TIRES)
FROM THE PEOPLE'S REPUBLIC)
OF CHINA)

**Testimony in Support of Implementation of the Remedy
Proposed by the
U.S. International Trade Commission
in Connection with ITC Inv. No. TA-421-7 under Section
421 of the Trade Act of 1974**

By

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Senior Vice President
Economic Consulting Services, LLC**

August 7, 2009

I. Introduction

I am Kenneth R. Button, Senior Vice President of Economic Consulting Services, LLC. I am accompanied by Kathryn Kobe.

II. Commission Staff's Statistical Analysis

In its remedy analysis, the Commission made use of its COMPAS economic model, which has been widely used in a variety of other Commission investigations. The model's forecasts, however, are highly sensitive to the elasticity assumptions employed. Although the Commission's high-end elasticities for the U.S. and Chinese supply elasticities and the substitution elasticity are reasonable, we believe that the low-end elasticities probably lead to an underestimation of the beneficial impacts of the remedy.

III. Conditions of Competition in the U.S. Tire Industry

Let me note three of the conditions of competition in the U.S. tire industry that should be kept in mind as you consider the likely impact of the Commission's recommended remedy:

**China Tires 421:
Conditions of Competition**

- U.S. and Chinese tires are in direct competition in all segments of the market
- The U.S. tire industry has substantial unutilized capacity
- Third-country imports will take only a minority of the volume lost by Chinese tires

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A. Competition Between U.S. and Chinese Tires in All Three Categories of the Market

First, the Commission examined the Respondent's assertion that the U.S. industry had abandoned the lower-priced, so-called tier 3 portion of the tire market. The Commission concluded that the assertion was simply wrong. The Commission found that the U.S. producers continue to sell about 19% of their volume into the lower-priced portion of the market – or about 25 million tires, which is obviously a very substantial quantity, given that the total of Chinese tire imports sold into all portions of the U.S. market last year was 46 million tires.

B. U.S. Tire Industry Has Substantial Unutilized Production Capacity

Second, the Commission found that the U.S. industry has substantial unutilized capacity and is able to expand production to fill the new demand for U.S.-produced tires. Under the proposed remedy, the U.S. industry would increase its sales by somewhere between 5 million and 9 million tires, which is quite feasible, given that the U.S. industry's unutilized capacity amounts to 26 million tires, as measured by the Commission. However, the USW has submitted information indicating that the industry's unutilized capacity is even greater.

C. Third-Country Import Supply

And, finally, as to third-country suppliers, the Commission concluded that there would be an increase in the volume of third-country imports into the United States, but that they would take only a minority of the volume lost by Chinese tires.

IV. Tire Prices in the U.S. Market

The Commission estimated that the tariff “is likely to result in a modest increase in prices

for domestic and imported tires.”¹ The weighted-average price of tires sold into the U.S. distribution market from all sources would increase by range of about 5 to 7 %, in other words, by approximately \$3.50 per tire.

V. U.S. Tire Industry Employment

The COMPAS model does not directly provide an estimate of the remedy impact on tire industry employment. However, the employment impact can be estimated separately.

Commissioner Lane estimated that the tariff relief would result in approximately 1,200 jobs.

Chairman Aranoff estimated that the relief would create as many as 1,800 jobs.

VI. U.S. Industry Revenue and Profitability

With greater volume and higher prices, the U.S. industry’s profit would increase by between \$126 million and \$216 million, which is calculated by the COMPAS model and is termed the “producer surplus.”

**China Tires 421:
Remedy Impacts Considered by ITC**

- Modest price increase of about \$3.50 per tire
- Create 1,200 to 1,800 tire industry jobs
- Increase industry profits by \$126 m to \$216 m

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¹ USITC Pub. 4085 at 37.

VII. Benefits for U.S. “Upstream” Suppliers of Goods and Services to the U.S. Tire Industry

With respect to the impact of the remedy on “other industries,” the Commission found that the relief would not have a negative impact on the U.S. auto sector, but the Commission did not directly address the impact on the “upstream” supplier industries to the U.S. tire producers. Purchases from “upstream” suppliers of goods and services has a “multiplier” effect on economic activity. Based on data from the Commerce Department’s Bureau of Economic Analysis, we estimated that this secondary “upstream” gain to the U.S. economy would be between \$364 million and \$727 million. Clearly, there would be a substantial positive effect on “upstream” employment, as well.

VIII. Benefit to Local Communities

An additional type of benefit required to be considered under the statute is the impact of the remedy on “the communities” where production facilities of the tire industry are located. These effects are not directly measured by the COMPAS model. The additional jobs in the U.S. tire industry result in increased spending in local communities, which we estimate at between \$60 million and \$85 million. Through the “downstream” multiplier effect, this local spending, in turn, supports additional businesses and jobs in the community.

Moreover, all of this additional income in the communities generates tax revenues for local, state, and the federal governments.

In this respect, it is important to understand that providing an inadequate remedy or no remedy will result, not only in the loss of these beneficial impacts, but also in the imposition of additional costs on the communities, as (i) further jobs are lost, (ii) additional plants are closed, (iii) tax revenues are foregone, and (iv) new costs for unemployment and other benefits are

imposed on these communities.

**China Tires 421:
Additional Remedy Impacts**

- Upstream supplier benefit:
U.S. economy gains \$364 m to \$727 m
- Spending in Tire Plant Communities:
U.S. economy gains \$60 m to \$85 m
- Other Benefits:
 - Additional jobs in plant communities
 - Increased government tax revenue

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**China Tires 421:
Costs of Not Providing Relief**

- More jobs lost
- More plants closed
- Tax revenues foregone
- New costs for unemployment, retraining, other government benefits

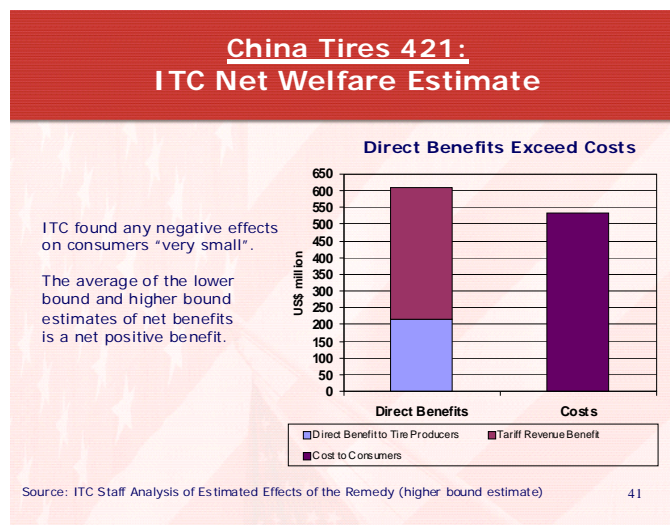
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IX. Net Welfare Effects

Any increase in tariff obviously has the effect of increasing consumer cost. However, as to the impact of the tariff relief, the Commission concluded: “Any negative effects on U.S. consumers will likely be very small in absolute terms and even smaller in relative terms, given

that tires are generally a small cost component in their ultimate end uses in passenger vehicles and light trucks.”²

Moreover, the relevant measure of the impact of such a tariff is not consumer cost alone. Rather, it is the “net welfare effect,” which also incorporates the gains to U.S. producers and the additional tariff revenue to the U.S. Government. Using the COMPAS model, the Commission estimated the “net welfare” effect to range from a gain of \$73 million to a loss of \$71 million.



However, I emphasize that these net welfare calculations do not take into consideration the other gains to the economy that the remedy would generate with respect to (i) job creation and preservation, (ii) the hundreds of millions of dollars of multiplier benefits for “upstream” suppliers, (iii) the impact on surrounding local economies, and (iv) the tax and outlay effects on local, state, and federal governments. Incorporating all of these other effects, the net benefit from the proposed remedy is very large and clearly in the public interest.

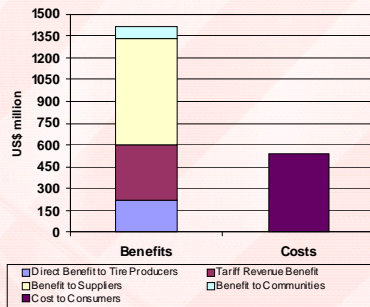
² Id.

China Tires 421: Total Benefits Far Outweigh Costs

Once benefits to tire industry suppliers and tire plant communities are taken into account, the total economic benefit of implementing the ITC's recommended tariff remedy in the first year greatly exceeds the estimated costs to consumers.

These total benefits are two-and-a-half times greater than the costs.

Total Benefits Exceed Costs by 2 to 1



Source: ITC Staff Analysis of Estimated Effects of the Remedy (higher bound estimate); Economic Consulting Service Analysis for USW 42

X. Rebuttal

In closing, let me note that the Respondents have presented a report by Dr. Prusa which asserts that the Commission's proposed remedy will not provide benefits to the U.S. industry and workers and will have a large net welfare cost to the country. We believe that there are major deficiencies in that report. I will briefly note four of them here:

1. Employment Loss for Tire Wholesalers and Retailers

First, Dr. Prusa asserts that the Commission's tariff remedy will lead to the loss of "at least 25,000 U.S. jobs" among tire wholesalers and retailers. There is no logical foundation for this assertion. With the tariff remedy, the volume of Chinese tire imports would, of course, fall, but the total volume of tires consumed in the U.S. market would change very little. Therefore, the volume of tires being handled by U.S. tire wholesalers and retailers would be largely unchanged, as the reduction in the volume of Chinese tires handled would be essentially off-set

by the increase in the volume of U.S.-produced and third-country import tires.³ No significant reduction in tire distribution employment is likely.

**China Tires 421:
Deficiencies in Prusa Study**

- 25,000 job loss assertion has no basis
- Total quantity of tires handled will change little
- Decline in sales of Chinese tires offset by sales of U.S. and other tires
- No significant reduction in tire distribution and sales employment

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2. Logical Contradictions

Second, while Dr. Prusa has not disclosed information about his model, the credibility of his analysis is undercut by significant logical contradictions in his results.

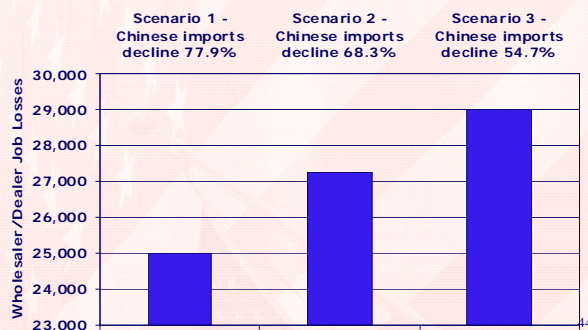
- For example, across his three scenarios, he reports that wholesaler/dealer job losses worsen when the Chinese import volume is less restricted.
- A second contradiction is his report that the cost to consumers is highest when Chinese imports are less restricted.

Such internal contradictions suggest that Dr. Prusa's underlying model does not produce economically meaningful results.

³ Chairman Aranoff further notes: "Nor are there likely to be significant adverse effects on domestic retailers of replacement tires or on consumer choice because the U.S. market is served by a large variety of tires at different price points and different performance levels." Id. at 42.

China Tires 421: Deficiencies in Prusa Study

Model Produces Contradictory Results



3. Miscalculation of Net Welfare Impact

Third, it appears that Dr. Prusa has miscalculated the “Net Welfare Cost” of the relief. For example, in his Scenario #1, he states that there is a “Net Welfare Cost” of \$284 million. Using his own data, however, the “Net Welfare Cost” is actually \$3 million.⁴

China Tires 421: Deficiencies in Prusa Study

Net Welfare Costs Do Not Add Up

| Scenario 1 | Prusa Results | Corrected Results |
|----------------------------|------------------|-------------------|
| Benefits to Tire Producers | + \$421 m | + \$421 m |
| Tariff Revenue | + \$173 m | +\$173 m |
| Costs to Consumers | - \$597 m | - \$597 m |
| Net Welfare | - \$284 m | - \$3 m |

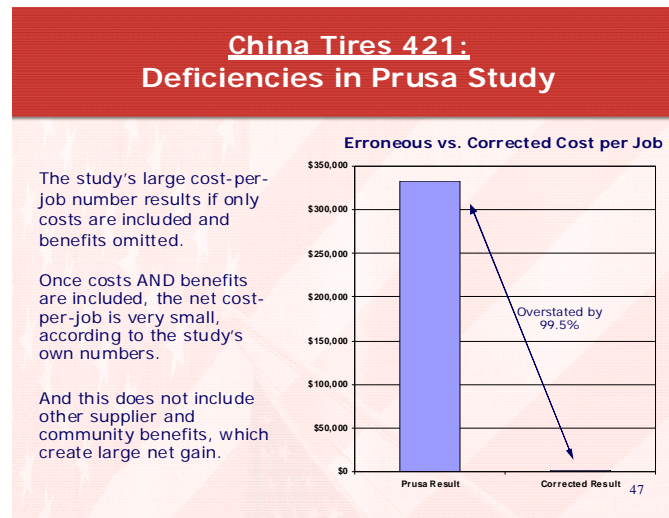
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⁴ Per Dr. Prusa’s footnote to Table 2: “Net Welfare Costs” equal “Total consumer costs {\$597} minus benefits to U.S. producers {\$421} and tariffs collected {\$173}.”

4. Cost Per Job

Fourth, Dr. Prusa’s cost per job calculation is not a meaningful measure. It is based only on his estimate of consumer cost and ignores the other elements of Net Welfare impact. In his Scenario #1, for example, if the calculation is based on the actual Net Welfare impact, the cost per job drops from his estimated \$332,229 figure to a cost of about \$1,700 per job.

And, that figure shifts from a cost to a gain figure if one were to incorporate the \$364 million to \$727 million positive multiplier impact that would accrue to the “upstream” supplier industries to the tire producers. That gain figure would be larger still if it were to incorporate the “downstream” multiplier benefits arising from additional tire worker spending in local communities.



We invite you to ask us about these points. Thank you.