

THE ROLE OF EXCHANGE RATES IN THE PRICES OF IMPORTS

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ABSTRACT

Over the last two decades a rising number of nations relying on “contemporaneous” exchange rates in determining the fair-market value of imports, have imposed antidumping measures against foreign exporters and/or domestic importers. Prior research has shown, however, that currency values impact import prices on a “lagged” – pass-through period – basis. The U.S. and other nations may have failed to take this into account, causing antidumping measures to have effectively become tools in protecting indigenous producers from fair import competition. This study aims to empirically investigate this issue by subjecting the pass-through period concept to quarterly U.S. data covering 1985:1-2009:4.

The study is organized as follows. First, we review the U.S. government rules, regulations and procedures regarding “unfair” imports’ perceived injury to an indigenous producer. The U.S. Department of Commerce’s International Trade Administration (ITA) has a unit called Import Administration (<http://trade.gov/ia/index.asp>) in charge of what the DOC emphasizes is to enforce “effectively the U.S. unfair trade laws (i.e., the anti-dumping and countervailing duty laws) and to develop and implement other policies and programs aimed at countering foreign unfair trade practices.” In turn, the Import Administration has what it calls the Antidumping (AD) / Countervailing Duty (CVD) Petition Counseling and Analysis Unit which helps domestic producers “to understand U.S. unfair trade laws dealing with dumping and unfair foreign government subsidies, and the process of filing a petition requesting the initiation of an investigation.” Various agencies and their respective rules and regulations are reviewed.

Next, there is a detailed examination of the available data on anti-dumping cases. Two sources are utilized to illustrate the prevalence of this issue: U.S. Anti-Dumping and Countervailing Duty Cases, covering 1985 through the end of 2009, is highlighted based on statistics supplied by the U.S. DOC: <http://ia.ita.doc.gov/stats/pet-init.htm>; <http://ia.ita.doc.gov/stats/iastats1.html>. Data covering the other member countries of the World Trade Organization is secured from: http://www.wto.org/english/tratop_e/adp_e/adp_e.htm. The available data demonstrate the significant rise in the number of such cases worldwide.

The Third Section focuses on the concept of pass-through period. This concept captures the behavior of a foreign producer reacting to fluctuations in the value of the U.S. dollar against its home currency by raising or lowering its prices on a *lagged* (several months or quarters) basis. The lagged response is the key aspect of this concept, causing a mismatch between contemporaneous exchange values (as used by both indigenous producers claiming unfair import prices and the U.S. government in imposing tariffs) and “historical” exchange rates implied in targeted import prices. This concept is subjected to an empirical analysis intended to capture the duration of the lag time. The following functional relationship is investigated over 1985:1-2009:4:

$$P_t = f(R_{t-i}; FP_{t-i}; MUP_{t-i}; PC_t)$$

where P is an index of the U.S. import prices of nonpetroleum products; R is a nominal exchange rate index of the U.S. dollar; FP is the foreign producer price index adjusted by bilateral trade weights; MUP is the foreign producer markup also adjusted by weighted bilateral trade; PC is the index of world nonpetroleum commodity prices; and i denotes the number of lag periods. *A priori* the independent variables are expected to have the following correlations with P : negative for *lagged* R , positive for FP , negative for MUP and positive for PC . All variables are expressed in natural log form. The data are obtained from the following sources: P is an index constructed from figures on the U.S. import prices of nonpetroleum products with base data secured from the U.S. DOC (http://www.bea.gov/international/bp_web/list.cfm?anon=71®istered=0) and IMF's *International Financial Statistics*. The independent variable R is a nominal "broad" index (weighted average of the foreign exchange values) of the U.S. dollar against the currencies of a large group of major U.S. trading partners (26 countries, constituting about 94% of the total U.S. imports in 2003). Quarterly numbers are derived from monthly figures supplied by: (<http://www.federalreserve.gov/releases/H10/Summary/>). Variable FP represents an index of foreign producer prices adjusted by using the 2003 bilateral weights of the U.S. trading partners described above. The country data are from the IMF's *International Financial Statistics*. The independent variable MUP stands for the foreign producer markups (proxied by the ratio of foreign consumer to producer prices and adjusted by the aforementioned bilateral weights). The country statistics are based on the IMF's *International Financial Statistics*. Finally, PC is the index of world nonpetroleum commodity prices, with 2005 = 100, obtained from the IMF's *International Financial Statistics*. This variable is intended to capture the effects of changes in the prices of nonpetroleum products on the U.S. import prices.

Preliminary results show that by responding to currency fluctuations foreign exporters do indeed adjust their prices, but on a rather limited scale and on a lagged basis. Also, foreign producers' markups yield a low correlation vis-à-vis exchange rate movements. Thus, U.S. prices of imported items may be "disproportionately" high or low, with the latter condition triggering the usual call for governmental imposition of antidumping measures.

In the past, various U.S. government agencies, including the DOC, have relied on *current* (contemporaneous) exchange rates for determining imports' fair or normal value prices. Of course, the U.S. dollar fluctuates on a daily basis against a wide array of other currencies whose respective exchange rates float vis-à-vis the dollar. Since 2002, though, the dollar has recorded long-periods of depreciation when measured against a basket of other major currencies. Interestingly, though, its value has held steady with respect to one specific currency, the Chinese yuan. With the exception of "revaluations" administered by the Chinese government, the yuan has continued to be pegged to the U.S. dollar. Yet, the (unwarranted, but expected) U.S. reaction has been a significant increase in the number of antidumping charges levied against Chinese exporters. Of course, the ever-expanding Chinese economy and its supply of cheap labor heretofore are the primary reasons behind the ability of that country's exporters to have kept their export prices from rising.

When the U.S. dollar depreciates, foreign producers are expected to increase the dollar-based prices of their products to compensate for the lower exchange rate. This price adjustment, however, may take place on a lagged basis. Additionally, depending on economic conditions in the U.S. and abroad, foreign producers may absorb some of the currency-related loss by reducing their profit margins. The net result is that inappropriate exchange-rate conversion scheme used by the U.S. government may lead to the imposition of antidumping charges. A number of factors, including currency values, help shape the selling

price of an item in international trade. During the last twenty five years, both advanced and emerging economies have adopted antidumping regulations mainly to influence the competitiveness of foreign companies in the host nation. By penalizing consumers and foreign producers alike, domestic welfare is negatively impacted, leading to losses for consumers. Those supporting the imposition of antidumping measures base their economic arguments on the notion that jobs are saved by the importing nation. Our review of prior research reveals, however, that if a nation remains a net importer of “dumped” products, the gains accruing to domestic buyers will exceed the losses sustained by domestic producers. Moreover, with tariffs generally considered to be welfare-reducing in the long-run, countries do have better policy tools at their disposal – including tax relief for retraining of labor and giving direct subsidies to indigenous firms.