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Under Pressure:  
Intractable Trade Conflicts and *Korea -- Pneumatic Valves*

Kristy Buzard and Kathleen Claussen



European University Institute

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## **Abstract**

The Appellate Body (AB) report in Korea -- Pneumatic Valves is among the most structurally complex of recent trade remedies reports. The AB weaves a complicated web to explicate the intricacies of the relationship among the relevant provisions on injury determination in anti-dumping disputes in the midst of a contentious and long-running series of disputes between two close regional trading powers. This Article first examines the Korean investigation and its significance in economic terms. Second, it analyzes the AB's conclusions on Article 6.2 of the Dispute Settlement Understanding regarding the panel request and the significance of the AB's treatment. Third, it studies the AB's comments on the panel's anti-dumping calculations where the AB amplifies its prior pronouncements on the elements of injury and causation. Finally, the Article situates this dispute in the broader political debates playing out both at the AB and between the two disputing parties.

## **Keywords**

WTO, dispute settlement, Appellate Body, antidumping, Korea

**JEL Classification:** F13, F53





## 1. Introduction\*

Japan and Korea's eight World Trade Organization (WTO) disputes against one another stand against a backdrop of a longstanding political and cultural dispute (Maizland 2019). None of their shared dispute settlement proceedings in Geneva can be viewed without reference to this history and the several manifestations of their conflict in economics and in geopolitics. *Korea -- Anti-dumping Duties on Pneumatic Valves from Japan* concerning anti-dumping duties imposed by Korea on imports of valves for pneumatic transmission ('pneumatic valves') originating from Japan is the latest in a series of tit-for-tat actions by each side reflective of their enduring discord.

Apart from manifesting ongoing tensions in their bilateral relationship, *Korea -- Pneumatic Valves* also has significant ramifications for at least two legal and institutional debates in international trade law: first, the powers and reach of panels and the Appellate Body (AB) in light of their terms of reference, and second, the interpretation of Article 3 of the Anti-Dumping Agreement (AD Agreement), which concerns the determination of injury in anti-dumping investigations. This Article takes up these two issues of procedure and substance but notes the larger context in which these two disputing parties pursued this rather technical and complicated trade remedies case.

The AB report in *Korea -- Pneumatic Valves* is among the most structurally complex of recent trade remedies reports, first, because the AB had to address the panel's disposal of several of Japan's claims as falling outside its terms of reference, and second, because the AB weaves a complicated web to explicate the intricacies of the relationship among the relevant provisions on injury determination in anti-dumping disputes.

The controversy over the proper interpretation of Articles 3.2, 3.4, and 3.5 of the AD Agreement finds its root in the negotiations of the 1979 Anti-Dumping Agreement. At that time, Korea and Japan as major exporters found themselves on the same side of the negotiating table, advocating strong protections for imported goods and a carefully circumscribed anti-dumping regime. *Korea -- Pneumatic Valves* turns the tables somewhat, however, with Korea as importer, in a small but highly consequential market. On this occasion, the AB sought to clarify the interaction among the elements of the injury determination. As we argue below, the path to clarification was not so clear.

We begin by explaining the Korean investigation and its significance in economic terms. Next, we turn to the AB's conclusions on Article 6.2 of the Dispute Settlement Understanding (DSU) regarding the panel request. Third, we take up the issue of injury determination through the AB's intricate lens. Finally, we situate this dispute in the broader political and geoeconomic debates playing out both at the AB and between the two disputing parties.

## 2. A Small Industry for a Small Component Part

*Korea -- Pneumatic Valves* concerns anti-dumping duties imposed by Korea on imports of pneumatic valves originating from Japan, as described in the Resolution of Final Determination on Dumping and Injury to Domestic Industry of Valves for Pneumatic Transmissions from Japan adopted by the Korea Trade Commission (KTC) (Final Resolution) and the final report by the KTC's Office of Trade Investigation (OTI) (Report) in January 2015. A key point of contention in this case was whether there was competition between the Korean and Japanese pneumatic valves, so a bit of context about this industry and its products is in order.

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A system is called 'pneumatic' if it uses compressed gas to produce mechanical movement. The most common use for pneumatic technology is in factory automation, where these systems are used to manufacture, process and package products. Pneumatics are also used in medical equipment, food processing equipment, construction machinery and trucks. A pneumatic valve is a key component of a pneumatic system that controls the pressure, flow and direction of the gas in the system (National Fluid Power Association, 2020). Pneumatic valves are a capital good; that is, they are used in the production of other goods and not typically used by end consumers.

In 2015, 70% of Korean demand for pneumatic valves was fulfilled by Japanese pneumatic valves (Yonhap News Agency, 2019). In terms of trade, we look at the statistics for the period of investigation for dumping, which was determined to be 1 April 2012 to 31 March 2013 by the KTC. We see that the overall trading relationship between Japan and Korea is one of imbalance: Korea exported about US \$38 billion worth of goods to Japan during the period of investigation and imported roughly \$63 billion, for a trade deficit with Japan of \$25 billion. Another way to look at the numbers is that 25% of Korea's imports came from Japan, but only 10% of their exports went to Japan. In contrast, in its trade with the world, including Japan, Korea had a surplus of over \$32 billion (Korea Customs Service, 2020). A large portion of Korea's imports from Japan consists of capital goods, such as pneumatic valves, that are used to produce the consumer goods in which Korea has a comparative advantage. There is thus a complementarity between the trade deficit with Japan and the trade surplus with the rest of the world: Korea uses the advanced Japanese capital goods to produce its consumer goods at lowest cost (Visualizing Korea, 2020).

In pneumatic valves,<sup>1</sup> Korean imports from the world were valued at about \$141 million, while its exports were only about \$77 million. With respect to Japan, the gap in trade of pneumatic valves is even more extreme as a proportion of trade: Korea imported \$36 million worth of valves and exported only \$7.6 million. While the trade was massively imbalanced, Korean imports of Japanese pneumatic valves still only made up less than 0.06% of total imports from Japan. Imports of pneumatic valves from all sources made up a little less than 0.03% of total Korean imports.<sup>2</sup>

The main consumers of imported Japanese valves were Hyundai Motor Group and Samsung Display, two of the very largest Korean business groups. As might be expected, it was two producers of pneumatic valves who filed the application for anti-dumping protection: KCC Co., Ltd. (KCC) and TPC Mechatronics Corporation (TPC).<sup>3</sup> TPC is small relative to KCC, specializing in pneumatic valves, 3D printing and motion control technologies (TPC, 2020). KCC, on the other hand, is a leading Korean firm in heavy industrial products, including industrial painting.<sup>4</sup> Moreover, the acting chairperson of KCC is first cousin to the chairman of Hyundai Motor Group (Korea JoongAhn Daily, 2020). This may, in part at least, explain why the major consumers of these valves did not exert sufficient pressure to prevent the application of the anti-dumping duties.

Why would the Korean users of pneumatic valves import so much from Japan instead of sourcing domestically in the first place? It is not because the Japanese valves are cheaper: neither party in this

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<sup>1</sup> Note that the finest detail available is HS code 8481.20, which also includes oleohydraulic valves. It is not clear what proportion of Korea's trade in this category is made up of the pneumatic valves to which anti-dumping duties were applied.

<sup>2</sup> *Trade Statistics*, [https://unipass.customs.go.kr/ets/index\\_eng.do](https://unipass.customs.go.kr/ets/index_eng.do) and authors' calculations.

<sup>3</sup> Although the Korean authorities determined that nine firms make pneumatic valves that are similar enough to the imported Japanese valves to be considered 'like product,' only these two firms submitted data for the original anti-dumping investigation.

<sup>4</sup> In Korea's submission to the panel, TPC was identified as the leading domestic producer of like product (Panel Report, para. 7.46), despite its smaller overall size. According to Bloomberg, TPC has 211 employees (Bloomberg, 2020) while KCC reports that it has over 4,000 employees (KCC Corporate Information, 2020). The two other domestic producers that are identified in the Panel and AB proceedings--Yonwoo Pneumatic and Shin Yeong Mechatronics--both have fewer than 100 employees (EC21 Global B2B MarketplaceA and EC21 Global B2B MarketplaceB, 2020). These two firms did not originally respond to the OTI's questionnaire, citing insufficient personnel (AB Report, para. 5.44).

case disputed that the Japanese valves to which Korea applied anti-dumping duties cost more on average than the Korean 'like product.' Japan argues that Korean firms import the Japanese valves because the Japanese valves are highly precise and are used in applications such as the production of semiconductors and automotive engines, while the lower-precision Korean valves are used in, for example, machinery for painting cars (Reuters, 2019). Although the Korean investigating authorities disputed that there was no competition between the Japanese and Korean valves, they did report that the Korean domestic industry had been investing in 'technological development' during the period of investigation (Panel Report, para. 7.157). The Korean authorities likely conceptualized the pricing strategies of the Japanese firms as predatory dumping to discourage new competitors, behavior for which Japanese industry has often come under fire for decades (National Research Council 1997, p. 34).

Against this backdrop and the imposition by Korea of the anti-dumping duties on these products at the start of 2015, on 15 March 2016, Japan requested the establishment of a panel under the WTO Agreement challenging the KTC resolution, and on 4 July 2016, a panel was established. Japan raised a host of challenges to Korea's injury determination in this anti-dumping investigation: its definition of the domestic industry, its analysis of a significant increase of the imports under investigation, its determination regarding the effect of the imports under investigation in the domestic market for like products, its conclusions regarding impact of the imports under investigation on the domestic industry, and its demonstration of causation. Japan also challenged certain procedural aspects of the Korean investigation concerning the treatment of confidential information, among other related questions. Notably, Japan did *not* challenge Korea's determination that its exporters had dumped.

On 12 April 2018, the WTO circulated a panel report, finding some inconsistencies in Korea's injury determination but rejecting many of Japan's claims as falling outside its terms of reference. Both parties appealed certain issues of law and legal interpretations in the panel report in May and June 2018; however, the AB report was not circulated to members until September 2019. According to a communication issued by the AB chair, the delay was the result of the backlog of appeals pending with the AB, among other factors. One consequence of this delay was that the term of one AB member would expire even before work on these appeals began -- a matter garnering attention from not just the disputing parties but other WTO members preoccupied with the institutional legitimacy and integrity of the AB such as the United States.<sup>5</sup>

Despite these institutional difficulties, at its meeting on 30 September 2019, the Dispute Settlement Body (DSB) adopted the AB report and panel report as modified by the AB report. Thereafter, Japan and Korea agreed on an eight-month reasonable period of time for Korea to implement the DSB's recommendations and rulings, that is, by 30 May 2020. On 28 May 2020, Korea informed the DSB of its compliance in this dispute.

### **3. Structural Considerations in Structuring a Claim**

The question as to how much detail a complaining party must include in its initial complaint is an issue that both domestic and international systems have addressed in their respective adjudicatory spaces. Some such national systems have the benefit of an extensive program of discovery that can enable document production in support of a plaintiff's claims or the opportunity for amendment well after the case is underway to address problems with a complaint. No such mechanisms exist in WTO dispute settlement. The absence of a fact-gathering stage and an opportunity to correct in the WTO's adversarial system put more pressure on the statement of the claim in the request for the establishment of a panel.

In WTO dispute settlement, the interpretation of Article 6.2 of the DSU defines the parameters of that inquiry. The language provides:

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<sup>5</sup> Para. 1.12 and accompanying note explains that work would not 'gather pace' until after Servansing's term ended.

The request for the establishment of a panel shall be made in writing. It shall indicate whether consultations were held, identify the specific measures at issue and provide a brief summary of the legal basis of the complaint sufficient to present the problem clearly.

Article 6.2 requires the complaining party to identify the measure and the legal basis for the challenge. The adequacy of the complaint in this respect will determine whether the claim results in a ruling and potentially a DSB recommendation, or gets thrown out by the panel on jurisdictional grounds. Here, Korea challenged whether Japan's panel request complied with requirements of Article 6.2 of the DSU, and consequently, whether these claims were outside the panel's terms of reference. In its final report, the panel excluded eight of Japan's twelve claims as falling outside the terms of reference because the panel request failed to provide a brief summary of the legal basis of the complaint which was sufficient to present the problem clearly. Thus, not only did the panel throw out the bulk of the case, but it did so more than one-and-a-half years after Korea first raised those objections rather than through a preliminary ruling that could have addressed them and permitted Japan to seek a second panel - the DSB equivalent of a revise and resubmit.

More important than the particularities of the excluded claims is the significant disparity in the way Article 6.2 has been applied in practice. Compare disputes challenging multiple provisions of an article of a WTO agreement with those challenging a single provision, for instance. Or compare those in trade remedies from those in other types of disputes. The degree of precision that panels and the AB have required falls along an underexplored spectrum (Chilton and Beshkar 2016). Past disputes have created confusion and this dispute does not provide much added clarity.

In a tariff measure dispute, for example, identifying the measure is often reasonably straightforward. Trade remedies disputes are fundamentally different, however. Identifying the measure in the statement of the claim is more challenging in those instances given that the disputed issue is typically not the objective elements of an individual measure, but rather the *analysis* underlying a state entity's imposition of a measure including whether that analysis was carried out consistently with the AD Agreement's many procedural requirements. Identifying where within an opaque internal anti-dumping determination process another government violated the AD Agreement presents unique challenges absent from the average border measure case. These challenges then manifest in the panel request where it may be difficult to identify the precise issue giving rise to the problematic result. The difficulty is compounded for respondents, who may find it difficult to understand what the complaining party is contesting. These details have led to multiple disputes over what counts as an argument versus what counts as a claim. The panel here was firm in suggesting a higher degree of particularity was needed perhaps *especially* in trade remedies cases where there are so many conceivable issues at stake. Without insight into the internal process of the respondent party's determination, the complaining party may only get to some of the critical and determinative issues by writing a broad-based panel request. The AB, on the other hand, was less forthcoming. Historically, the AB has been clear that the complaint must be more precise than to simply identify the anti-dumping measure. It has been less clear, however, on how much more is required. Concerns about fairness and providing an appropriate degree of notice to the responding party as to the claims at issue remain.

The panel deployed the AB's prior language in Article 6.2 inquiries and required Japan to demonstrate 'how and why' actions of the Korean authority violated Article 3 of the AD Agreement (Paras. 5.371-5.385). It explained that Japan needed more, not just a statement of the measure and the provision of the AD Agreement that it violated. At the center of this question is whether Japan's panel request 'provide[d] a brief summary of the legal basis of the complaint sufficient to present the problem clearly' within the meaning of the latter part of the second sentence of Article 6.2 of the DSU (Paras. 5.125-5.126). The AB noted that 'the degree of brevity that is permissible under Article 6.2 is a function of its clarity in presenting the problem' (Para. 5.6). In certain circumstances, the identification of the treaty provision alleged to have been breached may not alone be sufficient to comply with the requirements of Article 6.2.

In a long line of cases, the AB has found that, to meet this requirement, a panel request must 'plainly connect the challenged measure(s) with the provision(s) of the covered agreements claimed to have been infringed' (Para. 5.6). Beginning in *EC – Selected Customs Matters*, the AB used the phrase 'how or why' in connection with the requirement that the summary of the legal basis 'be sufficient to present the problem clearly.' In considering the panel's findings in this dispute, the AB emphasized that its prior use of the phrase 'how or why' 'does not imply a new and different legal standard for complying with the requirements of Article 6.2 of the DSU' (*EC – Selected Customs Matters* AB Report, Paras. 5.7 and 5.12). Rather, that language intends to echo the same standard demanded by Article 6.2, the AB explained: consideration of whether the panel request plainly connects the measure with the provision of the covered agreements claimed to have been infringed. According to the AB, the sufficiency of a panel request under this standard is to be assessed on a case-by-case basis (*EC – Selected Customs Matters* AB Report, Paras. 5.7).

In rejecting the panel's invocation of the AB's prior 'how and why' language, however, the AB was not clear whether it thought the panel was overextending prior AB prescription or whether the AB was intending to switch course, perhaps in response to criticism from DSB members that its 'how and why' standard overstepped its bounds – a complaint frequently echoed by the United States. Instead, the AB frequently parrots its prior language or seeks to paraphrase, creating a risk that it is creating a new standard and counseling in favor of careful drafting. Here, as elsewhere, the AB's language makes it difficult to parse whether it was shifting position or whether it considered the panel here to be aberrational.

The AB's decision to rein in the panel here from any higher pleading standard but without further explanation has costs on both parties. While it may lower initial costs to filing a panel request by allowing for members to not identify with significant particularity the core of their complaints, it should make it easier for less-experienced members to bring complaints, even if it could also incentivize strategic and creative lawyering and frivolous claims. On the other hand, opening the book and allowing complaining parties to throw in the kitchen sink could create costs for respondent states to prepare defenses on multiple issues that ultimately may not be part of the dispute. Moreover, the effect of broader-premised disputes is more work for an already heavily taxed system. If members wanted to restrain the length and work of the AB and panels, one route might be to apply tougher standards at the outset and require a greater degree of particularity, but that does not appear to be the members' preference as noted further below. Members may wish to consider pursuing a middle ground such as through preliminary rulings or through a yet-to-be negotiated complaint amendment system, though neither was available here.

Taking this broader issue out of this immediate dispute or even the dispute settlement system, the problem with potential reform in this area is that powerful states fall on both sides of disputes with little incentive to push the pendulum one way or the other – even if many would agree in the abstract that shorter, and possibly faster, reports would be desirable. A broader standard for panel requests could encourage longer submissions more generally, making WTO dispute settlement more complex and increasing reliance on litigation over negotiation across the system. These problems are particularly acute in trade remedies where, in addition to the complexities involved, extensive domestic processes precede the WTO proceedings and parties, or perhaps their lawyers, feel compelled, or perhaps motivated by industry, to re-raise and re-air the issues litigated in the domestic proceedings. The result is AB reports of more than a hundred pages with excruciating detail on technical points taking two years to complete.

The systemic concerns raised by the AB's wording here did not go unnoticed. At the DSB meeting adopting the AB report, the United States, a strong critic of the AB's perceived requirements to explain 'how and why' a measure is inconsistent with a provision cited by a complaining party, argued that the AB's reversal of the panel regarding the terms of reference issues was done in a way 'that creates confusion and more uncertainty, without any assurance that the difficulties that have been identified will be alleviated' (United States, 2019). Other members also commented on the AB's use of this terminology

and offered their views on what the standard ought to be (Monicken, 2019). Canada, for example, argued that a panel request should, at minimum, cite the provisions a measure is violating, but added that there could be cases where citing provisions does not satisfy the requirement in the DSU. Generally, it appears from statements made at the DSB meeting that members prefer flexible rules on Article 6.2 so as to avoid having many claims excluded on this basis. These debates continue in the broader context of WTO reform.

## 4. Twists and Turns through the AD Agreement

### 4.1. Cartwheels and Clarifications

The substantive heart of *Korea -- Pneumatic Valves* rests on disparate views of how to conduct the determination of injury and how the elements of causation interact with other elements of the injury determination. Getting to and understanding the AB's conclusions on these issues is made more complicated, however, by the structural somersaults in which it had to engage to piece together its analysis owing to the panel's rejection of eight of Japan's claims as outside its terms of reference. Nevertheless, in its report, the AB appears to re-tangle and then somewhat untangle a series of longstanding questions in trade remedies practice.

The AB report works through the relationship between Articles 3.2 (volume of dumped imports), 3.4 (impact of dumped imports on domestic industry), and 3.5 (causation) of the AD Agreement in extensive detail. The AB had to undertake these analytical gymnastics because the panel had dismissed large parts of the claims related to Articles 3.2 and 3.4 but the AB then appears to use the analysis that the panel carried out with respect to Article 3.5 to address the same issues raised by the parties in their Article 3.2 and 3.4 arguments. This all plays out in the more confusing and the more legally delicate aspects of the report. On the one hand, the AB goes to great lengths to complete the analysis where it otherwise could not do so. On the other hand, these overlapping and seemingly concentric circles of analysis create more complication than clarity. In what follows, we set out some of the salient points of the AB's analysis and conclusions that are of general interest. We leave their nuance for a more extensive exposition designed for trade remedies specialists.

The central legal question of relevance here, although not squarely presented, is how Articles 3.2, 3.4, and 3.5 interact: whether they work together or not. Article 3.5 invokes Articles 3.2 and 3.4, but provides few clues on their interaction. The panel discarded Japan's Article 3.2 and Article 3.4 claims, but it reached a significant number of findings with respect to Article 3.5 on causation. The AB, on the other hand, first considers the Article 3.2 and 3.4 claims under Article 6.2 of the DSU analysis as outlined above, and finds that those claims should have been preserved. Nevertheless, given that the panel did not complete the analysis on those claims, neither can the AB.

With respect to Article 3.5 where the panel did make a number of findings, the AB wrestles with the question as to whether those determinations were properly raised under Article 3.5 or whether they qualify more appropriately as determinations in relation to Article 3.2 and Article 3.4. That these provisions are related is not surprising nor is the legal challenge of deciphering the bounds between them new. Article 3.2 demands consideration of price effects: the volume and price of imports with an obvious connection to causation. The language states: 'With regard to the *effect of the dumped imports* on prices, the investigating authorities shall consider whether there has been a significant price undercutting by the dumped imports as compared with the price of a like product of the importing Member, or whether the *effect of such imports* is otherwise to depress prices to a significant degree or prevent price increases, which otherwise would have occurred, to a significant degree' (Para. 3.2, emphasis added).

Likewise, Article 3.4 sets out a series of factors for consideration in determining injury. It provides, in part: 'The examination of the *impact of the dumped imports* on the domestic industry concerned shall

include an evaluation of all relevant economic factors and indices having a bearing on the state of the industry, including actual and potential decline in sales, profits, output, market share, productivity, return on investments, or utilization of capacity; factors affecting domestic prices; the magnitude of the margin of dumping; actual and potential negative effects on cash flow, inventories, employment, wages, growth, ability to raise capital or investments' (Para. 3.4, emphasis added).

Here, the AB concludes that beyond the injury factors, investigating authorities ought to analyze the relationship between the subject imports' 'explanatory force' (Para. 5.99 et seq.). This language and repeated reliance on the 'explanatory force' is not new. The AB recalls its statement in *China – HP-SSST (Japan) / China – HP-SSST (EU)*, which in turn recalled *China – GOES*.<sup>6</sup>

Accordingly, in the AB's words, there has to be an 'explanatory force' between the imports and these effects: the analysis under Article 3.4 requires an evaluation of the relationship between the imports and the state of the industry. In this respect, Articles 3.2 and 3.4 serve somewhat as steps in the analysis for the causation decision to be taken according to Article 3.5. They comprise the components that inform the relationship between imports and the industry as a foundation to the determination of causation. Unfortunately, the AB's re-invocation of 'explanatory force' does little to un muddy the waters on this supplemental notion to Article 3.4. In reliance on this idea, the AB reverses the panel's finding that Japan demonstrated that Korea's investigating authorities acted inconsistently with Arts. 3.1 and 3.5 in their causation analysis as a result of flaws in their analysis of the effect of the dumped imports on prices in the domestic market. It concludes that the panel's analysis carried out purportedly to resolve Japan's claims under Article 3.5 were done in service of Articles 3.1, 3.2, and 3.4.

Given the availability of this information, the AB uses the panel's findings from the panel's Article 3.5 determinations to complete the analysis, in part, on Japan's claims brought under Articles 3.2 and 3.4 (Paras. 5.185-286). For example, in respect of the volume of dumped imports, while the panel had discussed this issue in the context of Japan's Article 3.5 claim, the AB considered Japan's arguments under Articles 3.1 and 3.2 to encompass broader considerations and thus it was unable to complete the legal analysis. Further, the AB found that the panel's conclusions regarding volumes and price trends were 'in error', but on the issue of profit trends, the AB found Japan's arguments to mischaracterize the investigating authorities' determinations and thus ultimately nevertheless upheld the panel's finding that Japan did not demonstrate that the Korean investigating authorities acted inconsistently with Articles 3.1 and 3.5 in their conclusion that the dumped imports, through the effects of dumping, were causing injury to the domestic industry (Paras. 5.287-5.302).

Others of the AB's conclusions track this reasoning, using the panel's findings in respect of Japan's Article 3.5 claim to complete the analysis on others of the claims earlier discarded such as those concerning divergent price trends. Nevertheless, with respect to another half dozen or so claims such as the objectivity and evidentiary foundation of the price suppression and price depression findings, the price overselling claims under Articles 3.1 and 3.2, and the price effects analysis, among others, the AB was unable to complete the legal analysis (Paras. 5.303-367). Thus, on those matters, additional clarity from the AB will have to wait for another day -- should the AB's work be sustained.

#### **4.2. Failures and Falsifications**

When an imported product is on average more expensive than the domestic like product, it is more complicated than usual to demonstrate that the imports are being dumped and that those dumped imports are causing injury to the domestic industry. In the absence of price undercutting by the dumped imports, it is difficult to see how an investigating authority could demonstrate injury without relying on some kind of counterfactual analysis.

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<sup>6</sup> Paragraph 5.110 cites Appellate Body Reports, *China – HP-SSST (Japan) / China – HP-SSST (EU)*, para. 5.205, which quotes Appellate Body Report, *China – GOES*, para. 149.

The Korean authorities in fact constructed a counterfactual 'reasonable sales price' for use in their analysis. The ODI calculates the unit cost as the sum of the manufacturing cost per unit and the selling, general and administrative (SG&A) expenses per unit. The reasonable sales price is then the unit cost inflated to take account of a 'reasonable operating profit ratio' (AB report, Para. 5.222).

Although Japan contested several aspects of the ODI's reasonable sales price including both its estimation and the way it was employed in the analysis, this is one of the areas in which the AB repeatedly found itself unable to complete analyses because of a lack of factual findings by the panel.

The SG&A expenses element of the 'reasonable sales price' calculation points to a repeated theme in this case: the amount and type of competition between the valves imported from Japan and the domestic like product. The injury analysis in an anti-dumping case requires investigating authorities to focus on the injury to the domestic industry that comes as a result of the dumped imports and to leave to one side injury that comes from other sources, including presumably any injury that derives from fair (i.e., non-dumping) competition with foreign producers and competition with domestic producers. Including *all* SG&A expenses in the 'reasonable sales price' assumes that *all* the changes in SG&A expenses were a result of dumping. Since there is evidence in this case that a lot more was going on than just dumping by SMC Korea, including all SG&A expenses seems unwarranted.<sup>7</sup> The AB report in *Russia--Commercial Vehicles* (paras. 5.55-5.64) upholds the panel finding in that case that the target domestic price (what the Korean authorities mean when they use the term 'reasonable sales price') must be the price that 'otherwise would have occurred in the absence of the dumped imports.'

The Korean investigating authorities found that 'strengthened marketing activities' by the importer of the Japanese valves helped to explain why the imported Japanese valves had a price-suppressing effect on the domestic like product. The key quotation, referred to repeatedly in both the panel and AB reports, is from page 19 of the KTC's final resolution:

The Commission finds that the dumped products suppressed price increases of the like product and caused decreases thereof, although the average sales price of the dumped products was higher than that of the like product.

The average sales price of the dumped products was higher due to their price differentiation in accordance with models, option details or customers, but it was found that the sales price of the dumped products was much lower than the average sales price in the case of certain products or customers for which the degree of competition with the domestic industry was fierce, which had the effect of suppressing increases in the price of the like product or causing decreases thereof. It was investigated that SMC Korea [\*\*\*] strengthened marketing activities of SMC Korea, which consistently expanded its sales organizations and used its dominant position to attract distribution agents or discourage defections of its distribution agents, and thus the domestic industry had to respond to such strengthened marketing activities of SMC Korea and become forced to decrease the sales price or refrain from increasing prices.

The KTC seems to take the position that the importer of Japanese valves, SMC Korea, invests in expanding its sales force in Korea, and this move forces the domestic producers to both expand their own sales operations and to also respond to the increased competition by altering their pricing. Combined with two examples where the sales prices of the Japanese valves were 'much lower' than those of the domestic average sales price, this is the main evidence in support of both the price effects and causation arguments. The OTI also alleged that SMC Korea engaged in price discrimination for nine other models but did not provide evidence or analysis (Panel report, para. 7.114).

We turn first to the argument that the domestic producers were forced to expand their sales operation in response to SMC Korea's expansion. Recall that only the two firms that brought the complaint are included in the main analyses by the Korean investigating authorities. In response to an argument by Japan in the profit analysis, the OTI investigated the status of two further Korean producers of like

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<sup>7</sup> Para. 5.356 gives a list of potential other factors, such as an increase in demand and increased domestic production capacity.



product that submitted limited production and profitability data: Yonwoo and Shin Yeong. The OTI found that these 'two companies spent a relatively small amount of [SG&A] expenses as their sales focused on regular customers and they maintained smaller sales forces' (Panel Report, para 7.52 and AB Report, para 5.46). Although there may be something different about these two producers that allowed them to *not* respond to SMC Korea's increased sales efforts, without an explanation of what those factors might have been, this seems to falsify the Korean authorities' assumption that the 'domestic industry had to respond to...[the] strengthened marketing activities of SMC Korea' (AB Report, para. 5.213). This would presumably raise the bar for the Korean authorities to have demonstrated injury to the industry.

However, Japan could not directly address the degree of competition between SMC Korea and the domestic producers if it wanted to maintain its argument that the Japanese valves were not *at all* in competition with the Korean 'like product' (AB Report para. 208).<sup>8</sup> The Panel rejected Japan's argument in this regard and thus undermined several of Japan's major points of attack, but Japan doubled down on this line of argumentation before the AB instead of taking a more nuanced approach, which might have been sufficient to win several more of its claims in this context requiring demonstration of injury in the absence of price undercutting.

Competition between the foreign and domestic producers is explicitly listed in Article 3.5 as one of the 'known factors other than the dumped imports which at the same time are injuring the domestic industry,' the injuries from which must not be attributed to the dumped imports. Korea acknowledges this kind of competition and deploys it to argue that the dumped imports caused injury to the domestic industry without providing evidence that the injury was the result of the dumping behavior as opposed to permissible competitive practices.

To be clear: although dumping may be the outcome of any given instance of competition, most competition does not lead to dumping. Similarly, dumping may arise out of price discrimination between markets, but price discrimination between customers in one market is not evidence of dumping even by the permissive definition in the AD Agreement. On its face, competition in the form of expanding one's sales force and working to retain current business relationships does not fall under the definition of dumping either.

In this case, Japan's claim that there could be no injury because there was no competition seems to push the argumentation in a strange direction, with Korea opening the door to an attack that distinguishes between the effects of competition and those of dumping by emphasizing the non-price related aspects of the competition between its domestic industry and Japanese valve makers. Japan declined to walk through this open door.

Given the AB's various findings of flaws in the panel's approach, it is not clear that Japan demonstrating this additional weakening of the 'explanatory force' of the dumped imports could significantly impact the outcome of the case. Similarly, although Japan could have used this nuanced view of competition to present a stronger argument that the Korean investigating authorities' profit trends analysis was deficient, it seems likely that the AB would have declined to complete the analysis even if it found in Japan's favor on this aspect of Japan's claim that the Korean investigating authorities acted inconsistently with Article 3.1 and 3.5 on injury.

In contrast, a more nuanced approach might have made a real difference in the outcome on Japan's claim that the Korean investigating authorities acted inconsistently with Articles 3.1 and 3.4 in their analysis of the magnitude of the margin of dumping. We will return to the complicated historical and legal environment surrounding this claim in the next section. Here, we focus on the ways in which Japan both under- and over-played its hand in this challenge.

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<sup>8</sup> There is a way to at least partially reconcile the almost absurdly different positions taken by Korea and Japan on the question of how much competition existed in this case. If competition from Japanese valves push Korean producers out of the market altogether, then there would be no competition to observe, but the state of the industry would be a result of that competition.

At the base of Japan's claim here is a question about whether the Korean investigating authorities provided analysis that was sufficient to demonstrate that the alleged dumping by SMC Korea negatively impacted the domestic industry and therefore caused injury.

In making this claim, Japan continued to insist on the idea that there was no competition between the dumped imports and the domestic like product. For this reason, Japan could not argue that the Korean investigating authorities failed to distinguish between unfair competition embodied in dumping and competition in the form of normal business practices that should not be subject to anti-dumping duties. Japan instead focused on this one aspect of the analysis -- a failure to properly evaluate the impact of the magnitude of the margin of dumping -- and, in particular, made an argument that the deficiency was due to the lack of a very specific kind of analysis, that is, a counterfactual analysis. Further, Japan did not make clear arguments as to why this kind of analysis is required.

In choosing to focus on one aspect of the impact analysis--the magnitude of the margin of dumping--the broader question of whether the Korean investigating authorities comprehensively took account of the competitive environment gets lost. Although the panel found no fault with Korea's argument that there was indeed competition between the imported valves and the domestic like product, Japan belabored this point about taking into account the amount of competition--which Japan argues is nonexistent. Japan may have found success if it had instead made this argument from the point of view that there was 'fair' competition and that Korea did not clearly demonstrate that the impact came from the 'unfair' portion. Ultimately, the AB found Japan's arguments overly specific and not well supported and upheld the panel's finding that Korea's analysis in this regard was sufficient.

#### **4.3. Context and Compromise**

The AB's elaboration on the relationship between Articles 3.1, 3.2, 3.4 and 3.5 is welcome and long overdue, even if it leaves many questions unanswered. While this application is highly fact-specific, it is the result of an awkward compromise reached in the negotiation of the agreement text that created significant confusion and ambiguity around another question: whether the causation analysis anticipated by Article 3.5 involves an analysis of the injury caused by dumped imports or the injury caused by dumping. To understand this distinction, consider an example. Imagine an imported product that is found to have been dumped within a one percent margin. That imported product is also undercutting the domestic product by 30 percent. If the investigating authority analyzes the *effects* of dumping, the one percent margin is all that matters because only that is attributable to the dumping. If, however, the authority considers the injury caused by the dumped imports, then the thirty percent undercutting becomes relevant. When reviewed closely, Articles 3.2 and 3.4 do not address the effects of dumping, but rather the effects of dumped imports.

This issue, long subject to widespread ideological disagreement among members, has never been fully resolved. Given the rifts in views, during the Tokyo Round of negotiations leading up to the conclusion of what is known as the 1979 AD Agreement, negotiators added two footnotes to that agreement as a means of clarification, or at least of compromise. That text provided : 'It must be demonstrated that the dumped imports are, through the effects (fn 4) of the dumping, causing injury within the meaning of this Agreement. There may be other factors (fn 5) which at the same time are injuring the industry, and the injuries caused by other factors must not be attributed to the dumped imports' (*Antidumping Agreement*, Article 3.4). Footnote 4 provided: 'As set forth in paragraphs 2 and 3 of this Article' referring to text that is largely similar to Articles 3.2 and 3.4 of the present Agreement, but without the 'magnitude of the margin of dumping' phrase. Footnote 5 provided that: 'Such factors can include, inter alia, the volume and prices of imports not sold at dumping prices, contraction in demand or changes in the pattern of consumption, trade restrictive practices of and competition between the foreign and domestic producers, developments in technology and the export performance and productivity of the domestic industry.' The footnotes allowed one side to claim victory regarding the

main text while allowing the other likewise to find solace in the footnote which effectively canceled out the meaning of 'effects of dumping.'

In the *United States -- Salmon* dispute of 1992, a panel confronted this language for the first time (Committee on Anti-Dumping Practices Panel Report, 1994). There, the panel walked through the negotiating history of the footnotes to conclude that the agreement defined 'the effects of dumping' as the effects described in the 1979 Agreement, i.e., the volume and price effects of the dumped imports and consequent impact of these imports on the domestic industry (United States -- Salmon panel report, Para. 567).

At the Uruguay Round, negotiating parties including both Japan and Korea argued for a correction to this language that they found problematic as primary exporting states. They argued that causation requires consideration of the magnitude of the margin of dumping. In other words, in our example above, Japan and Korea argued that only the one percent margin is relevant to the investigating authority's calculations, not the 30 percent undercutting. At the time, these states advocated adding language to Article 3.5 on causation to this effect. In response, states like the United States and the European Union advocated the opposite approach and the preservation of the *Salmon* principle as well as the tricky drafting they achieved in the Tokyo Round. They insisted that the proper measure for domestic investigating authorities was dumped imports rather than the effects of dumping.

To be sure, the margin of dumping is not a major indicator of either the state of the domestic industry or its causes. Imagine again two exporters selling at the same export price to the importing/investigating country at very different normal values in the exporting country. They would have the same underselling margins but very different dumping margins. The question would be how, if at all, the difference in dumping margins means that one exporter is a greater cause of injury than the other if they are underselling at the same rate but have different dumping margins.

Again as a compromise, states agreed to add language regarding consideration of the margin of dumping but to put it in Article 3.4 rather than Article 3.5. So, the final language as it appears today inserts considerations of the margin of dumping into the state of the industry analysis even if somewhat strangely given that the margin of dumping--while a potential cause of the state of the industry--concerns conditions of imports.<sup>9</sup> But politics and geoeconomic strength being as they are, negotiators inserted that language into Article 3.4, creating an awkward synergy among the provisions that has heretofore not been fully fleshed out. This new compromise position again allowed states like Japan and Korea to claim victory in achieving the insertion on margin of dumping, but likewise the United States and EU can claim success with this language in Article 3.4 because it really would not ever present as part of the analysis on the state of the industry.

Since the peak of this debate in the Uruguay Round, other panels have taken up the problem.<sup>10</sup> The AB in *EC -- Tube or Pipe Fittings* noted that there is no requirement in each and every case to examine 'the collective effects of other causal factors, in addition to examining those factors' individual effects' (EC - Tube or Pipe Fittings AB Report, para.190). However, 'there may be cases where, because of the specific factual circumstances therein, the failure to undertake an examination of the collective impact of other causal factors would result in the investigating authority improperly attributing the effects of other causal factors to dumped imports' (EC - Tube or Pipe Fittings AB Report, para.192).

In *Korea -- Pneumatic Valves*, the AB advances the ball one step farther, but undoubtedly this will not be the last time these issues are raised. The parties found themselves exceptionally at odds on the

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<sup>9</sup> Note that the margin of dumping is the only item in Article 3.4 that is a potential cause of the state of the industry and not a measure of the state of the industry itself.

<sup>10</sup> Interestingly, the 'through the effects of dumping' issue has a parallel in the Agreement on Subsidies and Countervailing Measures where the AB has been clear that it is the effect of subsidized imports, not the subsidies, that must be analyzed. Even more interestingly, the case in which the AB made that clear was one against Japan by Korea. See WTO Appellate Body Report, *Japan — Countervailing Duties on Dynamic Random Access Memories from Korea*.

issue. In this instance, the AB crosses the proverbial bridge, linking the Article 3.4 language to the Article 3.5 causation analysis. On this point, the AB emphasizes that the language regarding the magnitude of the margin of dumping requires an examination of the dumping not just the dumped imports.

## **5. Repetitions and Ramifications**

After the AB report was released, both sides claimed victory (Yonhap News Agency 2019 and Nikkei Asia, 2019). At the end of May 2020, Korea announced that it had adjusted its anti-dumping duties on pneumatic valves according to the DSB's recommendations. Japan disputed whether the revised duties were consistent with the recommendations, but Korea announced that it would not seek to renew the duties at the end of the five-year period starting from their initial imposition. On 19 August 2020, the anti-dumping duties were completely removed, effectively ending this dispute (METI, 2020).

We do not have access to detailed information on the current state of the domestic producers of like products; indeed the Korean investigation authorities faced this challenge in their analysis (AB Report para. 5.44). However, detailed trade statistics may tell us something about the effects of the anti-dumping duties, which were first imposed on 19 August 2015.

Korea's trade deficit with Japan for HS Code 8481.20 'Valves for oleohydraulic or pneumatic transmissions' was larger in 2019 -- the last year for which we have complete data -- than it was during the period of investigation in 2012-2013. However, looking at the trade balance with all trading partners for this HS Code, what began as a trade deficit of over 25% of trade value in 2012 turned into a trade surplus in three out of the last four years. In 2018 and 2019, there was a trade surplus of over 8% of the value of total trade in HS Code 8481.20.

There is so much fluctuation in month-to-month trade values that little can be said about the effect of the changes in the duties in May and August 2020. Trade statistics for August and September 2020 show the smallest quantities and lowest values of pneumatic valve imports from Japan since January 2020, although these figures may be affected by the global pandemic.

Drilling down into the trade statistics a bit further, the value of Korean exports to the world in HS Code 8481.20 more than doubled from 2015 to 2016 and the value of exports was almost three times its 2015 level by 2019. Import value also increased from 2015 to 2016, but by proportionally less. Import value grew a bit in 2017 but has declined slightly since then. Total value per ton--a very rough proxy for quality--shows interesting patterns. Value per ton of exports grows from 2012 to 2016 and then declines sharply, while value per ton of imports grows consistently until 2017 and then holds more or less steady.

Looking at the same measures for Korea's trade with Japan in HS Code 8481.20, the value of imports was at a low point in 2012 and 2013, grew dramatically until 2017, and has fallen off a bit since then. There is no clear pattern in the value of Korean exports, although they also peaked in 2017. As for value per ton, the numbers are again volatile. The value per ton of imports during 2018-2019 was about one-third higher than the value per ton of imports during 2012-2013. For exports, the value per ton is at roughly the same levels as in 2012-2013 (Korea Customs Service, 2020).

Although the actual effects of the anti-dumping duties are not necessarily indicative of Korea's original motivation, if there had been dramatic increases in the value per ton of Korean exports, we might guess that the large, politically-powerful companies who are the main users of the Japanese pneumatic valves went along with the anti-dumping duties because they saw it as an opportunity to develop, and upgrade the quality of, their own production and domestic supply chains. Although data on pneumatic valves that were both produced and used domestically are not available, there is no evidence of quality upgrading in the export data. It is unlikely, therefore, that the duties functioned to provide significant space for the Korean industry to catch-up to the technologically superior Japanese

producers. There does, however, seem to have been some effect on the total amount of valves that Korean producers were able to sell on international markets.

But perhaps we have to look elsewhere to understand the motivation for this trade dispute more fully. As noted at the outset, given the small size of the industry and effects of the measure at issue, the pneumatic valves dispute cannot be viewed in isolation. Rather, it reflects the decades-long debate between Korea and Japan on non-trade political matters. President Geun-hye Park's conservative-leaning government imposed the duties despite the fact that prior conservative administrations in Korea had traditionally taken more favorable policy stances toward both Japan and free trade (Kwon, 2014). This break with tradition might be viewed as an attempt by the Park government to take advantage of anti-Japanese sentiment for domestic political gain given the tensions that had been mounting between the two countries since the start of the Abe administration in Japan in 2012, particularly with respect to the 'comfort women' dispute. After Jae-in Moon assumed the presidency in the wake of a corruption scandal, he continued the aggressive stance toward Japan (The Economist, 2019).

Notably, just after the news about this AB report became known, Korea filed another dispute against Japan, for a total of eight formal disputes between them in the last fifteen years, let alone the unfiled tiffs. Whether the WTO is well suited for managing these arguably non-economic disputes in other forms is a question for another day. However, it seems at least likely that Japan's refusal to join the Multi-Party Interim Appeal Arbitration Arrangement, an optional dispute resolution mechanism created by a small number of WTO members to hear appeals in the absence of a functioning AB, is influenced by its displeasure with this among other AB rulings (Tillett, 2020).

## **6. Conclusion**

In *Korea -- Pneumatic Valves*, the AB offered certain clarifications on both matters that affect nearly all disputes (the threshold level of detail to state a claim with a panel's terms of reference) and on matters that affect a small percentage of those trade remedies cases in which Articles 3.2, 3.4, and 3.5 of the AD Agreement are at play. Although these elucidations in some respects create greater fodder for debate and disagreement, without a functioning AB as this Article goes to press, they may be the last word for some time on these matters -- themselves the product of delicate compromises among members in negotiation. Whether future negotiations can address these concerns more effectively remains to be seen.

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**Author contacts:**

**Kristy Buzard**

Associate Professor, Economics Department  
Syracuse University

Email: kbuzard@maxwell.syr.edu

**Kathleen Claussen**

Associate Professor, University of Miami School of Law

Email: kclaussen@law.miami.edu





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