The Law and Economics of Simultaneous Countervailing Duty and Anti-dumping Duty Proceedings

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Two of the chief tools of US trade administration are countervailing duties, intended to eliminate the effects of foreign subsidies on US imports, and anti-dumping duties, intended to eliminate the effects of unfairly low prices on imported merchandise. When products are subject simultaneously to both types of trade remedies, care must be taken to avoid the double penalization of the imports. This article models the 'level playing field' rationale that underlies both types of trade remedies and extends that model to cases in which the remedies are applied concurrently. The results demonstrate that proposed changes to law and practice with respect to 'non-market' economy exporters would cause double penalization, creating an additional deadweight loss from trade regulation.

I. INTRODUCTION

On 30 March 2007, the US Department of Commerce announced that it had preliminarily decided to apply countervailing duties to US imports of coated free sheet paper from China.1 Barron’s reported that, ‘The news briefly sent the Dow Jones Industrial Average down more than 100 points.’2 and opined that ‘The new import tariffs on Chinese paper could worsen the dollar’s fall, and thwart capital inflows in the bond market. The impact on trade looks ominous, too.’3

Earlier in 2007, Representatives Davis and English introduced HR 1229, The Nonmarket Economy Trade Remedy Act of 2007.4 The bill proposes to extend to ‘non-market’ economies the provisions of the US countervailing duty (CVD) law, the law that provides for the application of protective tariffs to imports of subsidized products. The bill also provides that Congressional approval precede the graduation of a non-market economy to market status for purposes of the anti-dumping duty (AD) law, the law that provides for the application of protective tariffs to imports sold at unfairly low prices.

The Commerce decision and the pending legislation relate to a previously obscure area of US international trade policy, the interplay of countervailing duty and anti-dumping duty proceedings. In 1982, the Department had to consider this interplay in the context of market economy proceedings and developed methodologies to prevent the double penalization of foreign exporters that faced both types of proceedings. Since 1983, the US Department of Commerce has declined altogether to undertake countervailing duty proceedings against countries that it judges as having non-market economies. This is due to the special rules applied to such countries under the anti-dumping laws – rules that Commerce previously felt prevented meaningful application of the countervailing duty laws to such countries. Since the Department’s practice was upheld in 1986 by the Court of Appeals for the Federal Circuit,5 the Department had held to its position consistently until the 30 March announcement.

The interplay of simultaneous countervailing and anti-dumping proceedings has received little or no attention in the academic literature. Yet this is an area of active legal change that demands the insights that careful economic analysis can provide. Each set of laws addresses a form of ‘unfair’ trade through the same means, offsetting tariffs. Each seeks to ‘level the playing field’ in that the level of unfair trade is quantified, with the consequent tariffs set equal to the amount of unfair trade. The relationship between these leading trade practices requires economic investigation, investigation that can inform the current debate on the non-market economy issue. Absent such analysis, debate will continue based upon

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3 ‘Party Like It’s 1929’, Barron’s, 2 April 2007, at M12.
4 See <www.house.gov/list/press/pa03_english/cvdnme0306.html>.
5 Georgetown Steel Corp. v. United States, 801 F.2d 1308 (Fed. Cir. 1986).
assumptions and unexamined common knowledge. The interplay of the laws must be analyzed in both the market economy and the non-market economy contexts, for a major impetus for the current proposals is the argument that they will extend to non-market economies the same treatment that is applied to market economies.6

This article first reviews the background of the countervailing duty and anti-dumping laws. It then provides a simple economic model for analyzing the ‘level playing field’ rationale for the laws, and then considers their interplay in market economy cases, considering the separate cases of export and domestic subsidies. Finally, it analyzes the proposed extension of the countervailing duty law to imports from non-market economies, given the special anti-dumping rules that apply to those economies.

II. BACKGROUND AND HISTORY

A. Review of US Countervailing Duty Administration

Countervailing duties are imposed by an importing nation to offset subsidies provided by an exporting country. The underlying concept is that an import duty equal to the amount of the subsidy will offset the subsidy’s effects and restore neutrality (‘level playing field’) to competition, as if there had been no government involvement by either the exporting or importing nation. This concept initially found life in American law with the Tariff Act of 1897, which provided that the Secretary of the Treasury could set duties equal to the amount of export bounties granted by foreign governments upon their exports to the United States.7 The Emergency Tariff Act of 1921 affirmed the subsidy’s effects and restore neutrality (‘level playing field’) rationale for the laws, and then considers their interplay in market economy cases, considering the separate cases of export and domestic subsidies.

Consequently, a duty equal to the amount of the bounty would lead to an increase in the price to the United States to the level prevailing in the home market of the exporter. This in turn would restore a measure of neutrality in trade, allowing American manufacturers to meet foreign competition without having to face the effects of foreign subsidization.8

The inclusion of production subsidies within the reach of the 1921 Act could not enjoy the same rationale of correcting price discrimination. A bounty paid upon each unit of production would not lower the export price relative to the domestic price; in a competitive industry, it would tend instead to lower both the domestic and export prices by the amount of the bounty. The intent of the countervailing duty in this instance clearly was to restore a status quo pro ante, perhaps somewhat theoretical, of the price level that would prevail absent the bounty. Economic niceties concerning the nature of technology and competition were ignored in this remedy. Nonetheless, it received

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6 Levin (2007) enunciates the assumptions behind the proposed legislation: ‘This bill is a constructive proposal that is consistent with sound principles of international trade. . . . H.R. 1229 would, for the first time in decades, treat China and other “nonmarket economies,” the same way we treat market economy countries.’

7 Equating the duty, imposed in reaction to a bounty, to the amount of that bounty does not, however, date to the very dawn of American countervailing duty law. The Tariff Act of 1890 imposed a flat per-unit duty upon refined sugar imported from any country that paid a higher export bounty on refined than on raw sugar. Notably, the amount of duty was not calibrated to the amount of the differential in export bounties, much less the absolute level of bounty upon refined sugar. The Tariff Act of 1894 extended the duty to imports of sugar generally from countries that provided bounties upon its export, but the duty remained a flat per-unit amount without connection to the amount of the bounty. In the meantime, Belgium had enacted in 1892 a provision that allowed for the imposition of a countervailing duty equal to the amount of any bounty paid to an exporter to Belgium, the first example of a duty intended to exactly countervail the amount of the bounty. As Jacob Viner explained in his 1923 assessment of countervailing and anti-dumping duties:

‘. . . the reduction in the export as compared to the domestic price will to that extent offset the benefit of the bounty to the exporter and will leave him in the same position as if there were no bounty. If there is active competition among the exporters who receive bounties, the normal tendency will be for the export price of the bountied article to be less than the domestic prices by the amount of the bounty.’ (Viner: pp. 126–127)

8 The import duty would not necessarily restore the prices that would have resulted had no bounty been granted in the first place. The bounty would encourage increased export sales and therefore decreased production available for domestic sales, assuming some lag in ability of foreign producers to increase production. This would cause the domestic price to rise. While the gap between domestic and export price would be the amount of the bounty, the increase in domestic price would mean that the export price would be greater than that implied by the original domestic price. Viner fully recognized this, and also pointed out that the long-run price outcomes in the domestic and export markets would depend on the nature of technology and competition in the industry (see Viner at pp. 127–128). However, the qualifications left little political legacy compared to the notion of the restoration of neutrality in trade.
the qualified blessing of no less an authority than Viner, who maintained (p. 170):

‘The extension of the countervailing duties to goods coming from countries in which they receive production bounties is a reasonable one. The significance for the importing country of production bounties and of export bounties in the country of export is essentially the same: both types of bounty tend to result in the artificial cheapening of foreign goods, and thus to give them an artificial advantage in their competition with foreign goods.’

The economic reasoning was that a competitive industry will reflect, in its pricing, the full amount by which costs are lowered due to a production subsidy.

The economic rationale for countervailing subsidies thus originated with the idea that a lowered price in the importing country could be harmful. The cause of the lowered price could be price discrimination occasioned by an export bounty, or lowered production costs occasioned by a production subsidy; in either case, the remedy was to offset the bounty with a tariff of equal magnitude.

The essential elements that characterized countervailing duty actions and their rationale in the early 1920s remain the same in current practice. Modern practice now distinguishes export subsidies from ‘domestic’ subsidies, a somewhat broader term than production subsidies, that incorporates all manner of aid. Countervailing duties are set equal to the degree of subsidization, whether the subsidy is a simple export bounty or a complicated set of loans. The rationale for countervailing duty laws is that they level the playing field, restoring trade to the conditions that would exist absent the initial subsidization.

Academic economic analysis has displayed considerable scepticism concerning the logic of imposing countervailing foreign subsidies (Cass and Boltuck, 1995). The essential element of this analysis is that the importing country benefits from the foreign subsidy: it is essentially a gift from taxpayers in the exporting country to consumers in the importing country. Harm to the importing nation as a whole, was damaging to the domestic industry and the likelihood of a higher price level eventually resulting, are strong, and economists point to a paucity of empirical evidence demonstrating such harm.

B. Review of US Anti-dumping Duty Administration

Anti-dumping duties are imposed by an importing nation to offset ‘unfairly’ low prices offered by a foreign producer or exporter. Originally they were formulated to offset a form of foreign price discrimination by which a foreign exporter charges a lower price in its export market than in its domestic market. The economic concerns that underlay the first US antidumping statutes, those of 1916 and 1921, were short-term or intermittent dumping designed to penetrate and win market power in an export market, possibly by destroying the indigenous industry. The political concerns were broader and included long-term dumping, which, while perhaps beneficial to the importing nation as a whole, was damaging to the competing industry. While the 1916 Act was narrowly drawn to address the economic concerns, the 1921 Act reflected the broader political concerns as well by providing for administrative proceedings that resulted in an anti-dumping tariff being set equal to the amount of the dumping. This set the theme that continues in modern anti-dumping practice, that the duties are remedial, restoring a state of the world without dumping; in modern political terms, guaranteeing a level playing field.

In present practice anti-dumping duties are calculated as the difference between the net US price and the ‘normal value’, also called ‘fair value’. Net US price may be thought of as the price netted to the factory gate in the exporting country, although there are various complexities to the actual calculation. Normal value may be the factory gate price for sales in the exporter’s domestic market or, in exceptional cases, the factory gate prices for sales made to a third country. Normal value may also be based on cost of

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9 19 U.S.C. 1676(a) Domestic subsidies are not limited to ‘bounties’, that is, payments contingent upon the level of production, but also includes lump-sum grants, loans at preferential rates, production inputs at preferential rates, and a variety of other mechanisms for easing the financial burden or risk of economic activity. This has resulted in considerable calculation complexities. For example, large subsidies are allocated over time, keeping the present value of the subsidy amount constant, so that a foreign producer receiving a large cash infusion would be penalized by a countervailing duty for many years, not just the year of the infusion.

10 The Department of Commerce need not demonstrate an effect upon US prices in order to impose countervailing duties. This practice was encoded by 1995 amendments to the controlling statute, the Tariff Act of 1930.

11 The 1916 Antidumping Act addressed this through criminal sanctions against predatory dumping, dumping designed to damage and ultimately diminish the domestic industry. As a criminal statute requiring American judicial findings against foreign nationals and firms, the 1916 Act rarely was applied and was repealed by Congress in 2004 following an unfavourable World Trade Organization ruling.
production rather than sales prices when comparison sales do not exist or are considered out of the ordinary course of trade. The role of costs is explained in more detail in the formal modelling below. Finally, for sales from ‘non-market’ economies, normal value is based on costs, but these costs are calculated based on a combination of information from the non-market economy and from a ‘surrogate’, market-oriented economy. This calculation is also explained in more detail in the formal modelling below.

Present US anti-dumping practice enjoys equal shares of enthusiasm from politicians and opprobrium from academic economists. Political support has been based largely on the view of a ‘fair price’, as reflected in the old term for normal value, ‘fair value’. Economists find the notion of a ‘fair price’ to be analytically murky at best, and see few signs of the original economic rationale, short-term dumping to gain a long-term advantage. As with subsidies, the importing nation as a whole would be damaged only if price levels eventually increased after capacity had been shuttered in the domestic industry. Mankiw and Swagel (2005) represent the accepted wisdom of the profession in stating ‘From an economic standpoint, selling at prices below “fair value” can be considered normal business practice. . . . Rather than the result of predatory practices by foreign firms, lower prices are often the result of healthy competition: outlawing them denies American consumers the benefits of such competition.’

C. The Current Importance of the Interplay of CVD and AD Proceedings

Simultaneous countervailing duty and anti-dumping cases against the same country and set of goods have occurred with some frequency and have led to practices, detailed below, to prevent a double-count of the remedial duties. In the special case of non-market economies the United States had declined, until recently, to undertake countervailing duty investigations at all. The preliminary reversal of this practice has opened the door to multiple simultaneous countervailing duty and anti-dumping cases against non-market economies,12 thrusting the issue of simultaneous cases to the forefront of trade administration. At the same time, legislation is pending in Congress to extend the reach of the CVD law permanently to non-market economies to ‘treat China and other “non-market economies” the same way we treat market economy countries’ (Levin 2007). With US imports from China alone approaching USD 300 billion in 2006, the application of an additional tariff tool could have considerable impact on the US economy.

While the focus of this work is US administration of simultaneous AD and CVD cases, these considerations apply to many other countries that use similar approaches to simultaneous AD and CVD cases.

III. Modelling the Interplay of CVD and AD Proceedings in Market Economy Cases

As described in the prior section, the motivation behind the imposition of anti-dumping or countervailing duties is the perception that a duty in the amount of the dumping or subsidy will negate its effects on trade. This may be an indirect or long-run outcome, but the equation of the duty to the degree of the offending action provides the oft-stated rationale for these measures. In brief, trade practice in the United States adopts a social welfare function that stresses the restoration of the ‘level playing field’, the state of the world without government subsidization or dumping.

This section develops a formal model of the policies that implement this social welfare function and assesses the interaction of simultaneous CVD and AD proceedings under the level playing field rationale. The goal is not to provide yet another critique of the perhaps wobbly economic foundations for the CVD and AD laws, but to instead take as given the public policy motivation behind those laws. The modelling, while not complex, provides an unambiguous method to evaluate the current debate concerning simultaneous trade proceedings with respect to non-market economies.

A. The Relationship between Export Subsidies and Anti-dumping Penalties

In US practice, an export subsidy is met with a countervailing duty equal to the amount of subsidy. Given an initial price to the United States of $P_U$ and a unit subsidy of $r$, the countervailing duty $D_C$ is set equal to the subsidy ($D_C = r$) with the assumed result that equilibrium price $P_C^*$ to the United States will reflect the countervailing duty:

$$P_C^* = P_U + D_C \quad (1)$$

In the anti-dumping calculation, absent a companion CVD case, underselling is met with a duty $D_A$

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12 Since the Department’s preliminary decision, published 9 April 2007 (Coated Free Sheet Paper From the People’s Republic of China: Amended Preliminary Affirmative Countervailing Duty Determination, 72 FR 17484, 9 April 2007) to allow CVD cases against NMEs, simultaneous CVD and AD cases against China have been filed, and initiated by the Department, with respect to off-road tires, circular steel tubing, rectangular steel tubing, and laminated woven socks. See <http://ia.ita.doc.gov>.
equal to the amount of the amount of underselling, so that the equilibrium price $P_A^*$ is the original price to the US $P_U$ plus the amount of the anti-dumping duty $D_A$:

$$P_A^* = P_U + D_A \quad (2a)$$

Underselling is defined, in the basic case, as the excess of domestic price in the foreign market $P_F$ over price in the United States, $P_U$:

$$D_A = P_F - P_U \quad (2b)$$

Which, by simple substitution, yields:

$$P_A^* = P_F \quad (2c)$$

That is, the intended US equilibrium price equals the price in the domestic market of the exporter.  

Should export subsidy and anti-dumping cases proceed simultaneously, statute provides explicit instruction. In the AD calculation, US price shall be increased by ‘the amount of any countervailing duty imposed on the subject merchandise under subtitle A to offset an export subsidy’ (19 U.S.C 1677 2).

Concurrent export subsidy and anti-dumping proceedings thus lead to the following modifications to equations (2b) and (2c) by the express terms of the statute:

$$D_A = P_F - P_U + D_C \quad (3a)$$

$$P_A^* = P_U + D_C \quad (3b)$$

Thus the intended US equilibrium price in the anti-dumping calculation is increased by the amount of any CVD imposed to correct an export subsidy. The reason is that this addition is necessary to avoid a double penalty for the same pricing behaviour. An export subsidy favours exports by the amount of the subsidy and will therefore create price discrimination in that same amount. The CVD corrects for the subsidy itself. To further correct for the price discrimination created by the subsidy through the AD remedy would impose twice the amount of the corrective penalty and thus do violence to the notion that countervailing and anti-dumping duties restore a level playing field.  

Consider the example of a steel firm that initially charges USD 500 per ton for steel pipe in both its domestic and its export market. Assume for simplicity that this is an ex-factory price. The steel firm’s government then places a bounty of USD 50 per ton on steel pipe exports. Assuming competitive conditions, the firm will respond by lowering its export price by the amount of the subsidy, leaving ex-factory prices at USD 500 for the domestic market and USD 450 for the export market. A countervailing duty set at USD 50 restores the pre-existing state of the world, leaving the firm in effect facing no net benefit for exports over domestic sales. An additional dumping duty to reflect the price discrimination created by the subsidy would in effect force the company to make a USD 550 return on its export sales compared to the initial USD 500 return on sales in both markets. This would create a distortion that did not exist in the original state of the world by double-counting the penalty.

### B. The Relationship between Domestic Subsidies and Anti-dumping Penalties

A ‘domestic’ subsidy does not create an incentive on the part of a producer or exporter to favour the export over the domestic market. In general the corresponding CVD is calculated as a percentage against the overall value of sales of the relevant product, or as a per unit amount based on all sales of that product. Consequently, equation (1) applies equally to domestic subsidies: the intended US price, that is, the price that restores the ‘level playing field,’ is the price to the United States plus the amount of the CVD, the latter in turn equaling the subsidy rate.  

On the anti-dumping side, there is no equivalent to 19 U.S.C. 1677 2, no provision for US price to be increased by the amount of the countervailing duties. As shown above, 19 U.S.C. 1677 2 operates to prevent the double-counting that arises due to the price differential permitted by the export subsidy: the CVD corrects for the subsidy itself, so the statute prohibits applying a second penalty for the price differential by mandating an arithmetic adjustment to anti-dumping duties. Domestic subsidies do not create such a price differential and therefore the explicit correction to the anti-dumping US price calculation does not appear in the statute.

The danger of a double-count still exists when countervailing domestic subsidies, due not to price

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13 This basic model abstracts from issues such as product diversity and the occasional oddities of the dumping calculation, which do not affect the conclusions herein. Prices should be considered netted back to the factory gate of the exporting country throughout the analysis. The analysis applies only when the US net price is below the domestic net price (the normal value) in the exporting country; dumping does not occur and dumping duties are simply zero if the normal value is below US price.

14 Depending on the nature of the industry in the exporting country, the export subsidy could lower the quantity available for consumption, and thus raise prices, in the domestic market of that country. While this changes the levels of the prices in the two market, it does not change the analysis in the text.

15 It should be emphasized that what is being modeled is not necessarily the pass-through behaviour of economically rational agents in the short run, but the setting of countervailing duties in the amount of benefit of the subsidy to the recipient based on the assumption that this best corrects the effects of the subsidy on US pricing; once again, the level playing field.
discrimination effects, but to the use of production costs in the anti-dumping calculation. Equations (2) and (3) above are based on the comparison of domestic and export prices, domestic prices forming the basis for normal value. But anti-dumping policy has long reflected the view that costs can be used in the absence of domestic sales to form normal value; this is known as ‘constructed value’. More controversially, US anti-dumping practice has, since the mid-1970s, eliminated most domestic sales made below the cost of production from normal value; this is called the ‘cost test’ and frequently leads either to the complete elimination of sales and the resulting use of costs, or to the partial elimination of sales with the surviving sales used for normal value. The cost test is applied in most anti-dumping actions. Higher costs therefore can raise normal value either by raising constructed value or by eliminating sales below cost, leaving the surviving sales with a higher average price. The use of costs in the AD calculation is relevant to the CVD calculation because domestic subsidies typically reduce the costs facing a firm. This forces the Department of Commerce to decide whether to use the costs actually faced by the firm, which may have been reduced through the agency of a domestic subsidy, or to use the costs that would be faced absent the subsidy.

The current US practice with respect to this issue can be clarified by extending the above model to allow for the use of costs in AD and for domestic subsidies in CVD actions. Since a domestic subsidy does not create price discrimination, the subsidy potentially affects the dumping calculation only through costs. For purposes of this section, we will assume that normal value is based on costs, so that constructed value rather than domestic sales are compared to US sales. In section IV below, we consider the case in which some, but not all, domestic sales are eliminated by the cost test.

Anti-dumping practice calculates the unit cost of production \( C_U \) as the simple addition of materials, labour and overhead expenses, divided by production quantity:

\[
C_U = \frac{(M + L + O)}{Q}
\]  

(4a)

For cost-based normal value, profits are also added to costs to reach the normal value used in the anti-dumping calculation. For simplicity, the profit rate is assumed to be zero in the following analysis. So the original normal value \( NV_O \), absent subsidies, can be written simply as:

\[
NV_O = C_U
\]  

(4b)

The dumping duty is then equal to the difference between net US price and normal value, as in equation (2b), but with the more general normal value substituted for price:

\[
D_A = NV_O - PU
\]  

(4c)

On the subsidy side, it is necessary to outline the calculation of domestic subsidies, for domestic subsidies are rarely paid as a simple bounty per unit upon sale, as is frequently the case with export subsidies, and the calculation holds the key for understanding the treatment of simultaneous CVD and AD cases. The domestic subsidy calculation determines \( S \), the dollar equivalent of the subsidy during the period of review. \( S \) is divided by a measure of total production or sale to arrive at per unit or an \( \textit{ad valorem} \) subsidy. For simplicity we will assume that the subsidy is allocated over the volume of production to reach the unit subsidy \( SU \), to which the countervailing duty is set:

\[
D_C = SU = S/Q
\]  

(5)

Consider the Commerce policy in the face of simultaneous anti-dumping and domestic subsidy cases. Assume that the firm is receiving a subsidy of \( S_U = S/Q \); for example, this might be due to subsidized electricity rates. The costs faced by the company decrease by \( SU \) relative to the unsubsidized state of the world. Since the subsidy is measured against market benchmarks, this also represents the departure of the company’s costs from market costs. Observed costs are now \( C_U - SU \); given cost-based normal value and the simplifying zero profit condition, the normal value \( NV_R \) equals the observed costs and thus differs from the original normal value, absent the presence of a subsidy, simply by the subsidy amount:

\[
NV_R = C_U - S_U = NV_O - S_U
\]  

(6)

Leading to the calculated AD of:

\[
D_A = NV_O - S_U - PU
\]  

(7)

With the CVD calculated as in equation (5) above, the combined effect of the anti-dumping and countervailing duties is:

\[
D_C + D_A = S_U + NV_O - S_U - PU = NV_O - PU
\]  

(8)

This is the same result as equation (4d), the duties due in a stand-alone AD case with no subsidies. That is, the introduction of a countervailed domestic subsidy leaves the total remedy – anti-dumping plus countervailing duty – unchanged. The reduction in cost due to the subsidy decreases the anti-dumping duty; under the assumptions of the model, that reduction will equal the amount of the countervailing duty. This in turn is the same result as equation (4), the export subsidy case: the combined effect of the two proceedings is the same as a stand-alone dumping case with no subsidies. As with export subsidies, the Department’s anti-dumping and countervailing duty methodologies in the context of domestic subsidies are coordinated to avoid a doubled penalty. Consider an observed US price \( PU \); in the presence of a domestic subsidy, this price is assumed to represent a tilted playing field, with pass-through of the subsidy assumed to be 100 percent and the correct remedy to be a border
tax (CVD) at the amount of the subsidy, raising the US price to the unsubsidized $P_U + S_U$. At the same time, the observed US price $P_U$ would be below unsubsidized domestic costs by $S_U$ as well. Since competition would drive factory-gate prices, including $P_U$, down to the actual costs faced by the company, which are the subsidized costs. So an anti-dumping calculation based upon unsubsidized costs would attribute an anti-dumping margin of $D_c = S_U$ to the same US sales that face a potential countervailing duty of $S_U$, effectively double-counting the effects of the subsidy. That is, with the countervailing duty countermanding the effects of the subsidy, using unsubsidized costs in the anti-dumping calculation would further penalize the company for the same subsidy.

This follows a consistent logic of preventing a double-count between the two proceedings. Consider again the example of a steel firm that initially charges USD 500 per ton for steel pipe in both its domestic and its export market, and again assume for simplicity that this is an ex-factory price. The steel firm’s government then provides a subsidy by, for example, providing lower electricity prices, with the effect that production costs are lowered by USD 50 per ton. Assuming competitive conditions, the firm will respond by lowering its prices, domestic and export, by the amount of the subsidy, leaving ex-factory prices at USD 450 for both markets. A countervailing duty set at USD 50 restores the pre-existing state of the world so far as the United States is concerned, leaving the firm in effect facing no net benefit for exports over domestic sales. An additional dumping duty to reflect the excess of original cost over the lowered price created by the subsidy would in effect force the company to make a USD 550 return on its export sales compared to the initial USD 500 return on sales in both markets. This would create a distortion that did not previously exist by double-counting the penalty.

**IV. THE INTERPLAY OF CVD AND AD PROCEEDINGS IN NON-MARKET ECONOMY CASES**

Both anti-dumping and countervailing duty actions are fundamentally grounded in the market economy context. They are aimed at foreign firms that are perceived to be exploiting market power, or at imports from foreign markets that carry with them market distortions introduced by government subsidization. The ‘level playing field’ rationale for AD and CVD actions, modelled above, aims for a market ideal in which US prices cannot be undercut by either deliberate price discrimination or by the subsidized distortion of comparative advantage. The calculations rely on market prices to determine the degree of dumping or subsidization.

In this context, ‘non-market economies’ (NMEs) are troublesome. NMEs are those in which prices are not good measures of value due to pervasive government involvement in the economy. Past US practice, now under review, has been to adopt a special ‘surrogate economy’ methodology for AD cases while refusing to consider CVD actions against NMEs.

The surrogate economy dumping calculation accepts the physical factors of production from the NME respondent, that is, the quantity of materials, labour, energy and other factors used to produce a unit of output. The calculation does not accept the prices paid for those factors with the limited exception of imported material inputs. Instead, the US Department of Commerce uses input prices from another, market economy at a similar level of economic development. Typically an individual firm or a narrow industrial sector in the market economy is preferred for the valuation of the factors. Materials, labour, and many overhead items are determined per unit of the input, with these amounts then converted to US dollars and multiplied by the physical factor amounts from the NME. Consequently, the calculations of materials, labour and overhead are designed to replicate market outcomes at the physical efficiencies of the respondent firms.\(^{16}\)

Inputs that are not easily quantified on a per unit basis, such as some overhead items, general and administrative expenses, and debt costs, are calculated as ratios based on figures from the chosen market economy; the resulting ratios are then multiplied by the manufacturing costs that have been valued on a unit basis. For example, based on the experience of a steel firm in India, the Department might impute a general expense ratio of 20 percent to a Chinese firm, meaning that the sum of materials, labour and overhead is increased by 20 percent to reflect general expenses. Finally, a profit is imputed in the same way, as a ratio of the profits experienced in the surrogate market economy to the total costs.

Normal value is thus based on costs, not sales prices, with the dumping calculation the same basic equation as (4d) above:

$$D_A = NVT - P_U \quad (9a)$$

where the subscript on the NV (normal value) term indicates that input prices are taken from a third country.

The modelling applicable to market economies can be extended readily to NMEs to allow economic analysis of the policy question of extending countervailing duties to NME subsidies. Consider a subsidy paid to a
NME firm by its government. Leaving aside the measurement problems inherent in quantifying a subsidy in a country in which prices and commercial rates are held suspect, let the amount of the subsidy be $S$, as in the market economy case. Assume an observed US price $P_U$ and a successful CVD action that results in the imposition of a CVD of $D_C = S_U$, raising the US price to the unsubsidized level $P_U + S_U$. On the dumping side, in the absence of a subsidy, if the surrogate economy methodology does its job well, a competitively set US price would equal the costs derived by that methodology. (This is the same result as in market economies.) In the presence of a domestic subsidy, the US price would be reduced by the amount of the subsidy. In the latter case, the observed US price $P_U$ would be below imputed domestic costs by $S_U$, leading to a calculated dumping margin of:

$$D_A = NV_T - P_U = S_U \quad (9b)$$

for the same US sales that face a potential countervailing duty of $S_U$. As in the market economy case, this would effectively double-count the effects of the subsidy. In the market economy case, the calculation method automatically adjusts by using the subsidized costs actually faced by the firm. But in the NME case, the costs faced by the firm are not used due to the surrogate economy methodology. Therefore the automatic correction does not occur. With the CVD countermanding the effects of the subsidy, using the surrogate unsubsidized costs in the AD calculation penalizes the company for the same subsidy. The total assessed penalty would be twice the level of subsidization:

$$D_C + D_A = S_U + NV_T - P_U = 2S_U \quad (10)$$

Unlike the market economy case, the Department cannot directly observe the firm’s subsidized costs. To avoid the double count, therefore, the Department must either add $S_U$ to US price, or not impose the countervailing duty. In fact the Department has followed the former solution with respect to export subsidies, and the latter solution with respect to domestic subsidies. For export subsidies, there is no separate treatment under the statute for NMEs, so the rule modelled in section III.A above applies equally to NMEs: the countervailing duty is added to US price in the anti-dumping calculation. For domestic subsidies, the Department of Commerce refused to take action with respect to alleged subsidies paid in NMEs until 2007. The change in policy enunciated in *Coated Free Sheet Paper* would create the outcome shown in equation (10), the double-count of the subsidy.

The modelling exercise undertaken here replicates the ‘level playing field’ rationale for anti-dumping and countervailing actions. The model demonstrates that the Department’s treatment of simultaneous CVD and AD actions to date has been consistent across the contexts of export subsidies, domestic subsidies in market economies, and domestic subsidies in non-market economies. The proposal to apply countervailing duties to non-market economies would, in the absence of a change in anti-dumping policy, create a double-count of the corrective duties, in violation of the ‘level playing field’ rationale, and would create an inconsistency with the treatment of export subsidies generally and domestic subsidies in market economies, on the one hand, and the treatment of domestic subsidies in NME’s, on the other.

V. REVIEW OF ASSUMPTIONS

The countervailing duty and anti-dumping calculations modelled above reflect the basic cases. Most actual proceedings involve more complicated calculations. This section relaxes the simplifying assumptions made above and demonstrates that the conclusions of the preceding sections are not altered as a result.

A. Competitive Conditions

In each case – export subsidies, market economy domestic subsidies, and NME domestic subsidies – competitive conditions were assumed that would lead to a price effect equal to the amount of the subsidy. For an export subsidy, this would be a decrease in US price relative to domestic price; for a domestic subsidy, this would be a decrease in price to all markets reflecting the lower costs. Depending on the structure of the industry in both the exporting country and the United States, 100 percent pass-through to price of the subsidy may not occur. For example, an element of pricing power in the United States could lead exporters to pass through less than 100 percent of the subsidy to US customers, or increasing returns to scale in production could lead to a price effect in the United States of more than 100 percent of the subsidy.

However, the policies assessed here eliminate the effect of countervailing duties, not the subsidies themselves, when anti-dumping duties simultaneously

Notes

17 Much of the debate concerning the application of the CVD law to NME’s has revolved around the question of whether a ‘subsidy’ can even be defined, let alone measured, when a government’s involvement in an economy is so pervasive that it is termed ‘non-market’. The Department has initially addressed this set of concerns in its recent decision *Coated Free Sheet Paper From the People’s Republic of China: Amended Preliminary Affirmative Countervailing Duty Determination*, 72 FR 17484, 9 April 2007, and the internal memoranda cited in that decision. This article does not consider this debate, instead taking as a given the existence and measurement of a subsidy in a non-market economy.
address the same pricing concern, so variations in pass-through are not relevant to the analysis. We should also note that the level playing field rationale for countervailing duties itself assumes 100 percent pass-through in setting duties equal to the amount of the subsidy. In assessing policy alternatives, while taking as given the level playing field rationale, this article necessarily adopts the same assumption of competition that underlies that rationale.

B. Domestic Subsidies and the Cost of Production

The analysis of the relationship of domestic subsidies and cost in the normal value calculation incorporated two material assumptions: that normal value is based on constructed value, that is, purely on costs rather than on sales, and that the subsidy affects the per unit countervailing duty and the per unit cost of production used for normal value equally.

Concerning the former assumption, constructed value is used when there are no comparison sales in the domestic market, which can occur when there are no sales of the same or similar products, or when the prices are below cost, leading to the elimination of the sales. However, in many proceedings some sales are eliminated under the cost test, while some survive and form the basis for normal value. The cost test compares the net home market price with the unit costs. If the price is above cost the sale is retained for the calculation of normal value, otherwise it is dropped. For a given product, the sales that survive the cost test form the basis for normal value, so that cost affects normal value by determining which sales are dropped, but the actual calculated normal value is price-based. In such cases, US practice treats costs in the same way as modelled above, with the subsidized costs used in the cost test, while the subsidy itself is addressed through the companion countervailing duty case. As such, the potential doubled inclusion of the subsidy is avoided. The effect on the anti-dumping duty, as compared to the case in which the subsidy were double-counted, cannot be calculated without knowing the distribution of prices and is not likely to equal exactly the amount of the subsidy, unlike the situation modelled above. However, the logic remains the same, to prevent the subsidy from having a dual impact, in the anti-dumping and countervailing duty: to the extent that costs affect the dumping calculation, the subsidized costs are used to prevent redundant penalization with the countervailing duty case.

The second important assumption is that the subsidy affects per-unit countervailing duty and the cost of production used for normal value equally. This is incorporated in equation (6) as the condition that subsidized costs are simply unsubsidized costs less the amount of the subsidy, \( C_U - S_U \). However, the methodologies that the Department uses to calculate and allocate subsidies for CVD purposes may differ from the accounting methods used by the subsidized companies. As a simple example, the company may purchase plant and equipment at a subsidized rate; the subsidy will be accounted through the depreciation schedules of the plant and equipment, and the opportunity (economic) effect of the subsidy will be to save the company the cost of financing the subsidy amount. The dumping calculation will reflect the lowered depreciation amounts as well as any interest savings. The Department’s subsidy calculation approximates this treatment for subsidies that are sufficiently large and non-recurring, but for small or recurring subsidies the amount of the subsidy is reflected in the subsidy calculation entirely in the year of receipt. Thus for the latter subsidies the countervailing duty and anti-dumping calculations would have very different timing assumptions and the subsidies would affect the respective duty calculations differently.

This affects equation (6) above, and therefore the level of the numeric effect noted in equation (8). But the significance of this is not great. First, the Department seeks to leave the present value of any subsidy unaltered in its calculations, so timing differences will be self-correcting over time. Second, the differences between the amount of subsidy and the effects on costs are zero in expectation; this is, there is not a systematic bias for the (present value of the) calculated subsidies to be greater or smaller than the effect of the subsidies upon costs. Third, unsubsidized costs are in general unobservable; companies record the costs that they actually face. Therefore any calculation of unsubsidized costs would require the addition of the calculated per unit subsidy, exactly the logic reflected in equation (6).

VI. Conclusions

The modelling exercise demonstrates that past US practices have recognized that dumping margins can be a symptom of subsidy, not a separate cause of action, and have sought to avoid double penalties when simultaneous CVD and AD proceedings occur. Past practice has created a consistent set of policies
for export subsidies, domestic subsidies in the market economy context, and domestic subsidies in the non-market economy context. As shown by equation (10), proceeding with CVD cases in non-market economies will create a doubled penalty. Given the logic of the outcome, ameliorative steps to somehow resolve the contradiction are unlikely to be successful.

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