The Offsetting Duty Norm and the Simultaneous Application of Countervailing and Antidumping Duties

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Abstract

World Trade Organization (WTO) members have long expressed a norm concerning the trade “remedies” of countervailing (anti-subsidy) duties and antidumping duties: that these measures offset the behavior that gives rise to them, restoring trade to a “level playing field.” The WTO agreements provide that the duties imposed should be calculated accordingly, that countervailing duties are measured against subsidies and anti-dumping duties are measured against the excess of a benchmark “normal” value over export price. This paper makes two principle contributions in light of this norm. First, it develops formal models of antidumping and countervailing duty actions conforming to the offsetting duty norm. Economists have often shown little patience with the rationale for these duties, leading to a dearth of formal analysis that takes into account the social welfare function—the offsetting duty norm—included in the WTO agreements; the formal models here provide that analysis. Second, the paper extends this analysis to the simultaneous prosecution of countervailing and antidumping cases. Once rare, simultaneous countervailing and antidumping duty proceedings have become perhaps the most prominent expression of trade protection permitted under WTO rules. The analysis establishes the conditions to identify any overlap in the application of countervailing and antidumping measures and demonstrates that recent practice of WTO members has created excessive application of duties. The analysis also provides the methods for preventing this double-count in simultaneous cases. These results have direct application to current policy debates.

KEYWORDS: antidumping, countervailing duty, WTO, international trade

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1. Introduction

Nations employ a variety of mechanisms to protect domestic industries from the competitive pressures of imports. Among these, countervailing duties and antidumping duties enjoy the special political status of being viewed not as creating distortions in trade, but rather as correcting, indeed rather precisely, market failures introduced by subsidization by foreign powers or exporter market power. While economists largely disagree with this view, this offsetting duty norm is a political reality, enshrined in international agreements and national legislation.

Countervailing duties are imposed in response to subsidies, defined in World Trade Organization (WTO) agreements as a financial contribution by a government that confers a benefit to its recipient. Antidumping duties are imposed in response to “dumping”, defined in WTO agreements as selling products in an export market at less than “normal” value, the latter defined against a basis of prices or costs. While the economic and political histories of subsidization and dumping are intertwined, and confusion lives on in phrases such as “dumping subsidized merchandise”, they are clearly distinguished substantively in both WTO and member governments’ codes and practices.

Procedurally, the WTO makes provision for separate actions to investigate subsidization and dumping. With respect to subsidies, member governments may undertake countervailing duty (CVD) proceedings against imports from another member accused of granting an actionable subsidy. The WTO’s Agreement on Subsidies and Countervailing Measures (the SCM Agreement) defines the permitted response, a tariff applied to the subsidized imports in an amount equal to or less than the subsidy (WTO 2010). With respect to dumping, the WTO Agreement on Implementation Article VI of the General Agreement on Tariffs and Trade 1994 (the Antidumping Agreement of the GATT 1994) permits member governments to impose a tariff on the dumped imports in an amount equal to or less than the amount of dumping (WTO 2010). Thus CVD and AD proceedings result in similar outcomes, tariffs quantified under general rules incorporated in the WTO agreements, capped by the level of the behaviors being addressed, subsidization and dumping respectively.

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1 The SCM Agreement also provides for more direct action by the WTO against governments determined to be providing prohibited subsidies (Part II of the SCM Agreement, Articles 3 – 4) and actionable subsidies (Part III of the SCM Agreement, Articles 5 – 7). Under both Part II and Part III, remedies are directed on a case-by-case basis by the WTO. Part V of the SCM Agreement provides for countervailing duties, the focus here. Outside of the restraints on national power articulated in Part V, the WTO itself plays no role, except possibly on appeal, in a CVD case between nations.
The WTO agreements allow simultaneous CVD and AD actions against the same set of products from the same country. Simultaneous proceedings have become common in recent years in, at least, American and Canadian practice, and appear to be important in emerging European Union and Chinese practice. In 2006, none of the cases decided in the United States involved simultaneous proceedings. This changed in 2007 and 2008 following a change in U.S. policy, and of the cases filed in the United States in 2009, well over half of the products covered faced both AD and CVD filings; these accounted for 70% of the cases and over 75% of the value of imports subject to investigation, based on imports in the prior year, amounting to several billion dollars. (United States International Trade Commission (2010), author’s compilation). In Canada, simultaneous filings account for eight out of thirteen products investigated in any CVD or AD case from 2006 through the first half of 2010, a far higher proportion than in the past (Canada Border Services Agency (2010); author’s compilation). The increase in the occurrence of simultaneous cases in the United States and Canada has been largely a result of the growth in CVD cases against economies or sectors considered to be government-controlled, particularly those in China. The European Union, which has pursued occasional simultaneous cases, has recently initiated its first anti-subsidy case against a country that it considers government controlled, involving a product also subject to an antidumping investigation, possibly opening the door for a flood of similar proceedings. (European Commission 2010.) In 2010, China completed its first two paired investigations (Government of China 2010). With this remarkable growth in frequency of cases and in value of affected imports, simultaneous cases have achieved pressing practical importance. Moreover, the threat of such cases has a wide-ranging impact on trade (Deardorff and Stern (2005)), such that the actual prosecutions may represent only a small proportion of the trade effects.

Analytically, the chief issue concerning the CVD and AD remedies that is peculiar to simultaneous cases is whether the duties should be cumulative when cases are simultaneously prosecuted. Recent decisions by some WTO members to make the duties cumulative are contentious, leading to considerable trade friction and appeals to both WTO panels and national courts. As of this writing 14 such cases. Each of these has been accompanied by a simultaneously filed AD case. Canada had no proscription against CVD cases involving “controlled sectors”, but had not prosecuted any until 2006; since then it has pursued eight. The European Union is currently pursuing its first joint case against China. Simultaneously filed cases also continue against market-oriented economies. These latter include combined CVD / AD cases by China against U.S. chicken, by Canada against U.S. corn, and by the European Union against U.S. biodiesel.

U.S. judicial review includes primarily recent Court of International Trade decision (Court of International Trade 2009, 2010). Extensive argumentation is provided in China’s
trade involved, as well as the corrosive effect that the cases arguably are having on the WTO system, suggest the need for careful economic analysis.

Past academic research in countervailing and antidumping duties is extensive; Blonigen and Prusa (2003) provide a survey. Academic analyses have generally found CVD and AD remedies to be inefficient in theory, damaging the countries that employ them except under special circumstances. Deardoff and Stern (2005) point out that economists consider “most if not all uses of antidumping laws” and many uses of CVD laws to be unjustified. With respect to subsidies, economists point out that the importing country benefits from the foreign subsidy (Cass and Boltuck, 1995); the arrival of subsidized merchandise at the importing nation should be met with a polite thank-you note to the taxpayers of the foreign country, not with an offsetting duty. The original economic rationale for such duties, articulated by Viner (1923), reflects the concern that a competitive foreign industry, which may not be able to engage in successful private dumping, could be assisted in such an effort through the device of subsidies; over time, should subsidized imports cause irreversible harm to the competing industry in the importing country, the exporting country could cease subsidization, allowing prices to rise above the original level in the importing country, creating the potential for the importing country eventually to suffer a net welfare loss compared to the state of the world in which the subsidies had not been countervailed. But the assumptions needed to achieve this result – the irreversibility of the harm, the willingness to strategically provide and then withdraw subsidies, and a net welfare loss in the importing country even given the success of such a strategy – are strong, and have not been supported by empirical studies.

With respect to dumping, economists observe that the original rationale – predatory pricing with the intent of eventually wresting market share and greater profits – also relies on the irreversibility of harm to the importing industry, and lacks significant empirical support. Further, the blunt tool of the antidumping duty addresses pricing behavior whether or not it has predatory intent or effect. Pricing behavior that is normal among domestic competitors attracts antidumping duties when conducted across national borders (Mankiw & Swagel, 2005); the creation of an offsetting duty generally creates a net welfare loss for the importing nation (Galloway et al, 1999).

appeals of U.S. actions in simultaneous cases in WTO documents (WTO 2010), with the WTO Appellate Body report providing an analysis of the legal issues (WTO 2011). The possibilities for tit-for-tat escalation appeared in the recently concluded Chinese investigations of chicken products from the United States, in which Chinese allegations referred to the U.S. corn and soybean industries as being controlled by the government and therefore displaying pricing that does not respect market forces (Government of China 2010.)
Despite such criticism, border measures in response to subsidization or dumping are politically popular. Indeed, CVD and AD measures that match the degree of perceived transgression – the amount of the subsidy, or the amount of the price discrimination – are viewed as ways of assuring “fair” trade. This political support is often phrased in terms of "restoring the level playing field", an evocative analogy that reflects the view that duties that match the perceived transgression will offset its effects, restoring, or creating, a state of the world similar to that in which the transgression had not occurred at all.

Economists have noted the wide discretion available in the implementation of CVD and AD measures and the potential for increased inefficiencies through the exercise of this discretion (Blonigen 2006), even if one accepts _arguendo_ the offsetting duty rationale. However, to date only one analysis has developed a formal model that allows assessment of the effects of CVD and AD measures in terms of the offsetting duty norm (Kelly 2008). The lack of careful analysis of the offsetting duty norm may be the result of the generally low regard that economists have for these measures. But economic analysis can provide useful guidance, in both positive and normative senses, when taking as given a legal or institutional structure. Given the long life and political vigor of the offsetting duty norm, the need for rigorous analysis given that norm appears clear. Little research has appeared on either the theory or the implementation of the simultaneous application of both kinds of duties. Viner (1923) recognized that a particular combination of remedies, a countervailed export subsidy and an antidumping duty, required specific steps to prevent a double-count of the remedies. Kelly (2008) generalized this analysis to cases involving domestic subsidies as well. Between these two widely separated works no economic analysis had been done concerning the theoretical implementation issues inherent in simultaneous cases.

The present work extends these previous analyses to effect a more comprehensive economic understanding of this important area of trade policy. Section 2 provides a brief account of the evolution of countervailing and antidumping measures with focus on the relationship between the perceived transgressions and the consequent remedies, that is, the development of the offsetting duty norm. Section 3 provides the basic offsetting duty model, providing a formal analysis of that rationale for both types of remedies. This section follows both the Viner and Kelly analyses in considering the effects of a full pass-through of subsidies in export price, an assumption challenged in recent legal and policy arguments. The model goes beyond those earlier works through a rigorous analysis of the sense in which subsidies are assumed passed through in export price, and by broadening the analysis to include the important use of “surrogates” in antidumping calculations generally. Section 4 provides the central results, relaxing the full pass-through assumption to allow for a general theoretical
treatment of simultaneous cases. Section 5 considers the implications of simultaneous cases on the injury analysis. Section 6 extends the analysis of simultaneous CVD and AD cases to the common circumstance in which different individual products captured within the boundaries of a single case may reflect different rates of subsidization. Section 7 considers current national practices in light of the model’s results. Section 8 concludes and provides brief comments on the current policy debates.

2. **Evolution of Countervailing and Antidumping Measures**

Past work has detailed the history of anti-dumping and anti-subsidy measures, but certain elements of that history need to be highlighted for present purposes. National government practices long preceded, and underlay, the development of the relevant articles in the General Agreement on Tariffs and Trade (GATT) and the WTO agreements. The United States, for example, introduced early anti-subsidy measures with the Tariff Acts of 1890 and 1894, which set flat per-unit duties upon sugar from countries that had export bounties. The amounts of the duties were not tied to the amounts of the bounties (Viner (1923)). The Tariff Act of 1897 changed this, providing 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. Thus the 1897 Act provided for the first duty designed to **countervail**, that is, offset, a subsidy by matching its magnitude. The Tariff Act of 1922 extended the reach of the countervailing duty law to include subsidies not only upon exportation, but upon production, with the duty again set equal to the amount of the subsidy in order to offset it. Other countries followed the American lead, particularly with respect to equating the amount of the countervailing duty to the amount of the subsidy.

The idea of a countervailing duty was a significant change from the prior, essentially punitive, anti-subsidy tariffs. With respect to export subsidies, the amount of the duty was set so as to offset the effect of the subsidy, based on the assumption that the exporting industry was competitive and passed the subsidy on in price. With respect to production subsidies, the economic reasoning was that a competitive industry would reflect, in its pricing, the full amount by which costs are lowered due to a production subsidy. The intent of the application of

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4 Concerning export subsidies, Viner (1923) explained the prevailing view upon passage of the Tariff Act of 1922: “...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 at 126 – 7.) Concerning production subsidies, he was less clear concerning the economic rationale, but still provided a qualified
countervailing duties clearly was to restore the state of the world, absent the subsidy, in the importing nation; it was a countervailing duty. The substance of the laws was incorporated into Article VI of the original GATT in 1947 (WTO 2010), which noted that that countervailing duties were “…levied for the purpose of offsetting any bounty or subsidy bestowed, directly, or indirectly, upon the manufacture, production or export of any merchandise“. By that time, the idea of a production subsidy evolved into the broader notion of a domestic subsidy, basically referring to forms of government assistance other than export subsidies. The SCM Agreement retains the defining aspect of a countervailing duty, that it be designed to offset a subsidy rather than be a merely punitive response.

Antidumping duties have a complex history, dating at least to the mid-nineteenth century. Early antidumping measures shared the characteristics of being aimed at specific industries and of imposing a duty not directly related to any measured degree of dumping. The first general AD law, providing for methods to prosecute AD actions rather than simply setting duties by legislative fiat, was that of Canada, enacted in 1904. This provided that the dumping duty would be set equal to the difference between the export price to Canada and the fair market value of domestic market sales “in the usual and ordinary course”. (Quoted in Viner, at 193.) The somewhat briefer U.S. history also serves to highlight an important aspect of present AD laws. In 1916 the U.S. passed legislation that essentially sought to extend the reach of antitrust laws to sales by foreign companies into the U.S. market, with the chief conditions for action being that the sales were at overly low prices and were made with predatory intent. The law’s chief remedies were criminal penalties. The difficulties of extraterritorial application and proof of intent left the 1916 Act largely a dead letter. In 1921 the United States passed its first “modern” antidumping law, based on the Canadian model, in which dumping was measured by the amount by which the home market price of the exporter exceeded the purchase price of the U.S. importer, and in which the penalty was a tariff equal to the amount of dumping. This and similar national practices in Europe and British Commonwealth countries were reflected in Article VI of the original 1947 GATT and have retained their basic form in the present day WTO agreements and national practices of member nations. As with countervailing duties, early attempts at simply punitive

blessing to countervailing measure: “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.” (Viner at 170).
responses to the trade transgression were dropped in favor of a response – a tariff - calibrated to the degree of the transgression.

A second prong of a CVD or AD action, under WTO rules, is the injury determination. The investigating government must conclude that the competing domestic industry is injured, or threatened with injury, by the unfairly traded imports. In the practice of most WTO members, the degree of unfair trade - reflected in the size of the calculated CVD or AD - affects the injury determination, often through examination of price undercutting. Therefore the overall treatment of simultaneous AD / CVD cases, and in particular the question of whether the duties should be cumulative, is relevant for the injury side of the analysis as well.

Procedurally, CVD and AD proceedings can be quickly described. In most nations, a domestic industry facing import competition initiates a case, and names a product from one or more foreign countries that is allegedly benefiting from unfair trade practices, subsidization or dumping. The industry also claims injury, or threat of injury, from the named imports. The relevant trade authority in the importing country's government will initiate a case if it believes the allegations are sufficient, and the case will have separate investigations of the alleged unfair trade and of the alleged injurious effects. If there are simultaneous CVD and AD investigations, the determinations of the CVD and AD amounts generally proceed on separate tracks, often being handled by separate offices. The determination of injury, in contrast, occurs in a single proceeding that considers the combined effects of subsidization and dumping. If both unfair trade and injury are found, the case will become an order, and tariffs will be set to offset the amount of subsidization or dumping; if simultaneous CVD and AD cases have proceeded, two separate orders are issued.

3. The Offsetting Duties Model

As described above, the offsetting duties rationale represents a long-enduring expression of a social welfare function with respect to imports. The political idea that duties properly should equal the transgression, providing a “level playing field”, finds life in current international agreements in the condition that duties should not exceed the level of the transgression. This condition provides an objective means for appraising the implementation of CVD and AD remedies, a comparison of the level of the duties to the level of subsidization or dumping. Administering authorities routinely justify their decisions, and other parties routinely challenge them, based on whether the CVD matches the amount of the subsidy, and whether the dumping comparison is “fair”, that is, measures the amount of dumping correctly. Economic analysis may not support such duties as rational policies for importing countries, but the duties are a political fact, and
economic analysis can shed light on the consistency of their implementation with the social welfare function, expressed in terms of the norm of offsetting duties.

There are three distinct reactions of administering authorities to simultaneous AD and CVD cases, depending on the nature of the subsidies and of the parties investigated in the AD case. These three situations, addressed in subsections 2.1, 2.2 and 2.3 respectively, are (1) an export subsidy, combined with an AD case; (2) a domestic subsidy, combined with an AD case in which the prices or the cost of production of the investigated firm are considered reliable bases for normal value in the AD calculation; and (3), a domestic subsidy, combined with an AD case in which a respondent’s prices and costs are rejected in favor of surrogate values. An underlying assumption in the modeling of this section is that the subsidy is passed on in export pricing; this assumption is relaxed in Section 4.

3.1 Export subsidies and the basic offsetting duties model

Under the WTO’s SCM Agreement, an export subsidy may be met with a countervailing duty up to the amount of subsidy. WTO members typically implement this by setting the CVD equal to the amount of the export subsidy; in so doing, the laws (and administrative practice) continue practices established well before the WTO agreements or the relevant articles of the earlier GATT.\(^5\)

The actual calculation of export subsidies can involve various complexities of product definition, timing, and measurement, but the essential elements of the offsetting duty norm that underlies the CVD calculation, and a simultaneous AD calculation, can be captured in a simple model. Define:

\[
P_I^0: \quad \text{Initial unit price of the imported product, prior to subsidization}
\]

\[
P_I^1: \quad \text{Unit price of the imported product, after subsidization}
\]

\[
S_E: \quad \text{Per unit subsidy, contingent upon export}
\]

\[
D_C: \quad \text{The countervailing duty, set equal to the subsidy}
\]

\[
P_C*: \quad \text{Equilibrium price of the imported product following imposition of } D_C
\]

Assuming competitive conditions in the exporting industry, and constant returns to scale in the relevant range of production, the subsidy lowers the initial export price \(P_I^0\) by the amount of the subsidy, \(S_E\), so that:

\[
1a \quad P_I^1 = P_I^0 - S_E
\]

\(^5\) European Union practice sets the CVD equal to the export subsidy initially, but the amount of the remedy is capped by the degree of price undercutting experienced by the domestic E.U. industry. This injury aspect of the remedy will be evaluated in Section 5 below; the present analysis assesses the initial calculation of the CVD.
Under the same assumptions, equilibrium price $P_{C^*}$ in the importing country will reflect the countervailing duty after its imposition:

1b. $P_{C^*} = P_{I^0} + D_C = P_{I^0}$

This is the offsetting duty or "level playing field" result; the duties restore the border price that would have prevailed absent the initial subsidization. The economic assumptions of competitive conditions and constant returns are sufficient to realize this result.6

In an antidumping calculation, absent a companion CVD case, selling in the export market at a lower price than domestically is met with a duty $D_A$ equal to the amount of the amount of underselling, so that the equilibrium border price is the original price to the export market, $P_{I^0}$, plus the amount of the antidumping duty. Define the additional variables:

$P_F$ : The home price in the exporting country
$D_A$: The antidumping duty
$P_{A^*}$: Equilibrium price in the importing country following imposition of $D_A$

Underselling is defined, in the basic case, as the excess of domestic price in the foreign market $P_F$ over price in the importing country. Initially assume that the latter is the unsubsidized price $P_{I^0}$. The antidumping duty equals the amount of underselling.7

6 Competitive conditions lead firms to pass on the subsidy to customers, and constant returns to scale assure that increased production will not lead to a change in unit production costs. Changes in market or production conditions may lead to actual pass-through of subsidies greater or less than 100%. This is analyzed in Section 4, below.

7 The antidumping duty is assessed as a tariff, a border tax. If duties are determined retrospectively, the amount of the duty is computed on the imports to which it is applied, and so the transaction price for the import plus the dumping duty equals the total price paid by the importer at the border. Duties are often assessed prospectively, calculated based on pricing behavior in one period, but applied to imports in a later period. This introduces a source of potential inaccuracy in the application of the duty at the time it is assessed, since it may not equal the difference between normal value and export price for the imports to which it is applied. Many dumping authorities believe that the gains from predictability of the duty amounts and administrative convenience outweigh any drawbacks of prospective duties. While this creates a question concerning the degree of pass-through of antidumping duties to export pricing, it does not introduce any issues peculiar to the simultaneous application of CVD and AD remedies. With respect to retrospective duties, there is also an independent question of the degree to which exporters will adjust pricing in reaction to anticipated antidumping duties; again, this does not create any issues peculiar to the simultaneous application of CVD and AD remedies.
2a. \[ D_A = P_F - P_I^0 \]

Thus:

2b. \[ P_A^* = P_I^0 + D_A \]

This, by substitution, yields:

2c. \[ P_A^* = P_F \]

That is, the intended U.S. equilibrium price equals the price in the domestic market of the exporter.\(^8\)

Full pass-through of an export subsidy to price leads to a price of the imported product of \( P_I^1 \), per 1a above. Should prices in the home and export markets be the same initially, so that \( P_F = P_I^0 \), the price in the export market, \( P_I^1 \), will lie below that in the home market following the provision of the subsidy, creating apparent dumping in the amount \( P_F - P_I^1 \). This raises the question of the appropriate application of CVD and AD remedies, given the offsetting duty rationale.

When subsidy and antidumping cases proceed simultaneously, the 1994 General Agreement on Tariffs and Trade states, at Article VI(5), that no product “shall be subject to both anti-dumping and countervailing duties to compensate for the same situation of dumping or export subsidization.” (WTO 2009, also noted as early as Viner 1923.) The implementing laws of WTO members recognize the effect of a countervailing duty on dumping price comparability by providing that the countervailing duty be added to the export price in the dumping calculation, if the countervailing duty is imposed in response to an export subsidy. Concurrent export subsidy and antidumping proceedings thus lead to the following modifications to equations 2a and 2c above:

3a. \[ D_A = P_F - (P_I^1 + D_C) = 0 \]
3b. \[ P_A^* = P_F + D_C \]

That is, the intended export equilibrium price in the antidumping calculation is increased by the amount of any CVD imposed to correct an export

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\(^8\) This basic model abstracts from issues such as product diversity and the many oddities of the dumping calculation, which do not affect the conclusions herein. Prices should be considered to be netted back to the factory gate of the exporting country throughout the analysis. The analysis at this point applies only when the U.S. net price is below the domestic net price (the normal value) in the exporting country. Aggregate “negative” dumping duties are not paid to the exporters, but are simply set to zero.
subsidy. Since initial domestic and export prices are equal, reflecting the competitive conditions of the industry, the putative dumping margin is exactly eliminated by the addition of the countervailing duty to the export price. (Note that the revenue that the exporter receives from the subsidy itself is not an addition to the export price in the AD calculation.) The dumping margin is in effect created by the subsidy. Since the countervailing duty equals the subsidy, the CVD serves to offset it, and the addition to export price is necessary to avoid a double penalty through an antidumping duty for the same pricing behavior.

3.2 Domestic subsidies

A “domestic” subsidy is, informally, any subsidy other than an export subsidy. As such, it does not create an incentive on the part of a producer or exporter to favor the export over the domestic market. In general a 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 1b applies equally to domestic subsidies: the intended import price, that is, the price that restores the “level playing field,” is the border price to the importing nation plus the amount of the CVD, the latter equaling the subsidy rate.9

Dumping measures price differentials in the first instance, and so an export subsidy, which creates a price differential, requires an adjustment in the dumping calculation to prevent applying a second penalty if it is subject to a countervailing duty (Section 3.1, preceding). Domestic subsidies do not create such a price differential and therefore the explicit correction to the antidumping export price calculation is not necessary. Implementing legislation for the Antidumping Agreement of WTO members does not provide for an increase to export price in an antidumping calculation to reflect the amount of any countervailing duties imposed in response to a domestic subsidy.

This analysis, including equations 2 and 3, assumes that antidumping duties are calculated based on differences between domestic and export prices. But while the Antidumping Agreement recognizes domestic prices as the preferred basis for normal value, alternatives of third country prices and production costs are allowed. Third country prices, rarely used in practice, introduce no analytical issues in addition to those of domestic prices. The other alternative is production costs. Antidumping policy has long reflected the view

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9 It should be emphasized that what is being modeled is not necessarily the pass-through behavior 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 U.S. pricing; once again, the level playing field. The full pass-through assumption is relaxed in Section 4.
that production costs can be used as the basis for normal value as a second-best alternative to domestic prices; this is known as “constructed value”. Further, under broad circumstances the Antidumping Agreement permits the elimination of domestic sales made below the cost of production from normal value; this “cost test” frequently leads either to the complete elimination of sales and the resulting use of constructed value, or to the partial elimination of sales with the surviving sales used for price-based normal value. 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.

At the same time, domestic subsidies typically reduce the costs facing a firm. This forces the question: should an antidumping authority use the costs actually faced by the firm, which may have been reduced through the agency of a domestic subsidy, or use the costs that would be faced absent the subsidy? This question can be clarified by extending the offsetting duty model to domestic subsidies and corresponding CVD proceedings.

The Antidumping Agreement defines the relevant cost measure to be “per unit (fixed and variable) costs of production plus administrative, selling and general costs” (Article 2.2.1) (WTO 2010). For cost-based normal value (constructed value), profits are also added to costs to reach the normal value used in the antidumping calculation. For simplicity, the profit rate is assumed to be zero in the following analysis. Define:

\[ NVO = \text{Normal value based on constructed value, assumed equal to cost of production, including administrative, selling and general costs} \]

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

\[ D_A = NVO - P_I^0 \]

Domestic subsidies are rarely paid as a simple bounty per unit upon sale, as is frequently the case with export subsidies. Consequently, a calculation usually is necessary to express the subsidy in per unit terms. For CVD purposes, typically the total amount of a domestic subsidy received by a firm during some time period is computed, then allocated over total production or sales value or

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10 Subsidies may include the direct payment of a benefit by a government, or the provision of an input at below-market prices. The input may be a good or a service, the latter including debt financing at below-market interest rates. Key to measuring the benefit to the recipient is the identification of a market benchmark, the amount that the recipient would have paid absent the government intervention.
quantity. The analysis that follows will assume a quantity allocation basis; a value allocation basis would complicate the algebra of the model slightly but introduce no new substantive considerations. (The SCM Agreement also provides that the CVD cap the subsidy amount in per unit terms.) This yields a subsidy per unit of output:

\[ S_D : \text{ Domestic subsidy per unit of output, equal to total subsidy received divided by quantity} \]

Consider two alternative policies in the face of simultaneous antidumping and domestic subsidy cases. Assume that the firm receives a unit subsidy \( S_D \); for example, this might be due to subsidized electricity rates. The unit costs faced by the company decrease by \( S_D \) 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. With cost-based normal value and the simplifying zero profit condition, introduction of the subsidy lowers the normal value by the unit amount of the subsidy; observed costs are now \( C_U - S_D \). Further, with the pass-through of the subsidy to pricing, export price also declines by the same amount as costs, so that the overall dumping margin is unchanged by the subsidy:

\[ D_A = (NVO - S_D) - (P_I^0 - S_D) = NVO - P_I^0 \]

the same result as equation 4. A parallel anti-subsidy action would result in a CVD rate of \( S_D \); the introduction of a subsidy introduces the potential for an increased trade response equal to the subsidy, but it does not affect the dumping calculation.

Simultaneous AD and CVD proceedings would result in the original AD rate \( D_A \) being imposed, as well as the CVD rate \( D_C = S_D \). The combined duties would be the original antidumping duty plus the countervailing duty, the latter set equal to the subsidy. If there were no dumping to begin with, the remedies imposed by simultaneous cases would simply be \( D_C \), since \( D_A \) would equal zero.

Alternatively, assume that the costs used in the dumping calculation are not those faced by the company, but are unsubsidized costs, perhaps the market benchmark costs that would be used in a subsidy calculation. In that case, the dumping margin would be increased by the amount of the subsidy relative to the unsubsidized case shown in equation 4:

\[ D_A = NV_O - (P_I^0 - S_D) = NV_O - P_I^0 + S_D \]
If a subsidy case proceeded simultaneously and resulted in a countervailing duty equal to the subsidy, the combined remedial duties would create a doubled response to the subsidy: per equation 6, the dumping duties would increase by the amount of the subsidy relative to the unsubsidized case, and the CVD would equal the amount of the subsidy. In the simplest case, if there were no dumping (positive or negative) to begin with, the AD would equal the subsidy rate, and combined AD and CVD proceedings would result in an exactly doubled response to the subsidy:

7 \[ D_A + D_C = (NVO - P_I^0 + S_D) + S_D = 2*SD \]

The doubled penalty of equation 7, based in turn on equation 6, arises because the subsidy creates apparent dumping by lowering export prices below cost. But the subsidy also lowers normal value by the same amount and in fact no dumping remedy should be applied. The offsetting duty norm underlying the trade remedies, expressed in the WTO agreements in the requirement that countervailing duties not exceed the amount of subsidization and dumping duties not exceed the dumping margin, would reject the result of equation 7, which reflects both CVD and AD reactions to the same act of subsidization.

As noted above, the WTO agreements and national legislation are silent on the topic of any additional adjustments when AD and CVD cases target the same products, with the CVD case involving domestic subsidies. The reason is clear with respect to price-to-price calculation in antidumping: a domestic subsidy does not create price discrimination between markets, and therefore does not require an adjustment to prevent a doubled remedy in response to the subsidy. With respect to cost-based normal value, the doubled remedy can be avoided through the use of the company’s actual costs, as demonstrated above. When not using a surrogate for a company’s normal value, the practice of trade authorities is in fact to use a company’s actual costs, therefore preventing the doubled remedy and obviating the need for a separate adjustment such as that applied in the presence of export subsidies.

3.3 Domestic subsidies and the use of normal value surrogates

The domestic subsidy model above reflects the case in which a normal value reflects the domestic prices or the subsidized costs actually experienced by a company investigated in an AD investigation. However, under some circumstances trade authorities use surrogates for the domestic prices and costs of antidumping respondents, rather than the companies' own costs. Such circumstances require care in the analysis of trade remedies.
The leading example of the use of surrogates occurs when a trade authority considers an economy, or the relevant sector of an economy, to be so influenced by government control that its domestic costs and prices cannot be used for antidumping calculations. Normally, antidumping and countervailing duty actions are 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 calculations rely on market prices to determine the degree of dumping or subsidization. In this context, economies or sectors in which prices are not good measures of value due to pervasive government involvement in the economy create difficulties. In such cases, WTO members have the option of using surrogate values in calculating dumping duties, an option which the United States, Canada, and the European Union, at least, have frequently exercised. In each jurisdiction, a special AD surrogate economy methodology is available for such cases.

This surrogate economy dumping calculation uses production costs for normal value. These costs use the quantities of materials, labor, and other inputs from the industry under investigation, but set unit costs for these inputs based largely on input prices from a surrogate, market economy at a similar level of economic development. For example, costs of industries in India are frequently used as surrogates for Chinese input costs. Consequently, the cost calculations are designed to replicate market outcomes at the physical efficiencies of the respondent firms. Some overhead items, and administrative, selling and general expenses, and profit are calculated as ratios against manufacturing costs based on surrogate economy ratios.

Normal value thus is based on costs, not sales prices\footnote{There are circumstances in which a price-based surrogate is used due to the particular information needs of a case. For example, responses considered inadequate or late by the antidumping authority may be rejected in part or whole, leading the authority to use a surrogate for normal value rather than the company’s own data. In some cases this may lead to a situation similar to that analyzed in the text; see Section 7 for further discussion. The analysis of the text applies equally to price surrogates.}, with the dumping calculation the same basic equation as (4d) above:

\[ D_A = NV_T - P^*_T \]

where the subscript on the NV (normal value) term indicates that input prices are taken from a third party not subject to the particular trade proceeding.

The modeling applicable to market economies can be extended readily to AD cases involving the surrogate methodology. Leaving aside the measurement problems inherent in quantifying a subsidy in a sector in which prices and
commercial rates are held suspect, consider a subsidy with total value $S$, as in the market economy case. Assume an initial export price $P_i^0$ and a successful CVD action that results in the imposition of a CVD of $D_C = S_D$. On the dumping side, the zero dumping base case, given the surrogate economy methodology, is that a competitively set export price equals the costs derived by that methodology. (This is the same result as in market economies; factory gate normal values are equalized across markets.) In the presence of a domestic subsidy, the export price would be reduced by the amount of the subsidy. In the latter case, the observed export price $P_i^0$ would be below imputed domestic costs by $S_D$, leading to a calculated dumping margin of:

$$D_A = NV_T - P_i^0 - S_D$$

for the same imports that face a potential countervailing duty of $S_D$. This is identical to equation 6, and 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 surrogate case, the costs faced by the firm are not used due to the surrogate economy methodology, being replaced by costs from another country. Therefore the automatic correction does not occur. With the CVD offsetting the effects of the subsidy, using the surrogate unsubsidized costs in the AD calculation penalizes the company for the same subsidy. Were the dumping rate exactly zero to begin with, and a subsidy were introduced that was passed on in pricing, simultaneous AD and CVD proceedings would lead to joint AD and CVD remedies that would double-count the effects of the subsidy, as in equation 7. In fact this has occurred extensively in recent practice, as described in Section 7 below.

The use of a surrogate indicates that the trade authority does not consider the firm’s subsidized costs to be reliable measures of normal value. To avoid the double count, therefore, a trade authority must either take an additional step, such as adding the CVD to export price, or not impose the countervailing duty. If the countervailing duty is imposed in response to an export subsidy, WTO members are required to follow the former solution, regardless of the nature of the AD proceeding. So the rule modeled in Section 3.1 above applies equally to surrogate cases: the double count is avoided by adding the countervailing duty to export price in the antidumping calculation. For domestic subsidies, possible corrective measures are considered in the more general cases of Section 4.3, below, which allows for varying degrees of subsidy pass-through to price.
4. **Evaluation of the role of pass-through**

The above modeling reflects the assumptions implicit in the offsetting duty rationale for both countervailing and antidumping duties: competitive and production conditions such that a duty will restore the state of the world that would have prevailed, absent the subsidization or dumping. An antidumping duty, which is an additional border payment (tariff) equal to the difference between the normal value and export price, does this by its nature, subject to the elaboration provided in Footnote 7. However, market conditions other than perfect competition may lead to a smaller or greater price effect from a subsidy than that implied by 100% pass-through to export price, as might decreasing or increasing returns to scale. This section evaluates the implications of less than perfect pass-through of a subsidy to price in the presence of simultaneous CVD and AD proceedings. Strikingly, while imperfect pass-through may undermine the level playing field rationale for countervailing duties considered alone, the addition of a simultaneous AD proceeding can restore the basis for that rationale – that is, the trade remedies equaling the price effects of subsidies and dumping - when the surrogate normal value methodology is not used. In the latter case, the potential for a double-count of the remedies remains, and absent proper analysis the simultaneous application of remedies could easily over-correct for the impact of subsidies and dumping.

4.1 **Export subsidies under partial pass-through**

Consider first an export subsidy. If an industry in the exporting country receives an export subsidy and faces downward sloping demand curves in its export market, production will increase. As has long been recognized (Viner 1923), if the industry has increasing returns to scale, due perhaps to external economies, increasing production will lower marginal production costs, which, under competitive conditions, will lead to a price effect greater than the subsidy amount. If the industry has decreasing returns to scale, increasing production will increase marginal production costs, which, under competitive conditions, will lead to a price effect less than the subsidy amount. This has two implications for our analysis. First, the CVD still equals the subsidy rate, but no longer matches the price effect in the export market, and so no longer restores a “level playing field”. Second, should an AD proceeding occur, the AD, equal to the price differential between the markets, will no longer equal the subsidy or the CVD.

---

12 We first note again that in administrative practice the CVD is set equal to the amount of the subsidy, regardless of actual evidence concerning pass-through. So if pass-through of an export subsidy, for example, is less than 100%, the CVD will exceed the price effects of that export subsidy. The offsetting duty norm would seemingly require that the degree of pass-through
Assume that the pass-through of the subsidy to price is \( r \cdot S_E, r \neq 1 \). This leads to the following modifications in the earlier equations:

1a' \[
\begin{align*}
P_I^1 & < P_I^0 - S_E, \text{ if } r > 1 \text{ (pass-through greater than 100\%)} \\
P_I^1 & > P_I^0 - S_E, \text{ if } r < 1 \text{ (pass-through less than 100\%)}
\end{align*}
\]

The export price does not exactly reflect the export subsidy, leading the CVD to under-correct for the price effects of the subsidy if pass-through is greater than 100\%, or over-correct if pass-through is less than 100\%:

1b'. \[
\begin{align*}
P_C^* &= P_I^1 + D_C < P_I^0, \text{ if } r > 1 \\
P_C^* &= P_I^1 + D_C > P_I^0, \text{ if } r < 1
\end{align*}
\]

Turning to the AD side of simultaneous cases, consider the simple circumstance in which the initial home market price \( P_F \) equals the initial export price. In this circumstance, the subsidy creates price discrimination of \( P_F - P_I^1 \). Adding the CVD to export price, the dumping calculation has the same structure as in equation 3, but with the result that the dumping margins are no longer zero:

3a' \[
\begin{align*}
D_A &= P_F - (P_I^1 + D_C) > 0, \text{ if } r > 1 \\
D_A &= P_F - (P_I^1 + D_C) < 0, \text{ if } r < 1
\end{align*}
\]

That is, a positive dumping margin results if pass-through exceeds 100\%, even with the addition of the CVD to export price, while a negative dumping margin results if pass-through is less than 100\%.

Equations 3a' indicate that the overstated or understated CVD in turn affects the AD. Rearranging terms, we have:

be determined accurately, and the CVD adjusted accordingly. To this author’s knowledge, no national trade authority does this; in U.S. practice, this possibility is explicitly rejected, presumably due to its difficulty or to political considerations. The information requirements to determine the duties that actually offset the price effects are extremely high, so a consistent rule, neutral in expectations, can be seen as recourse adopted for administrative practicality. An interesting line of research would be to determine whether in fact pass-through is neutral in expectation (that is, actual pass-through averages to roughly 100\%), and whether exporting countries game the system by granting subsidies relatively more to increasing returns industries, for which the CVDs would under-correct the effects of the subsidies.

Equation 3a’ allows for a negative antidumping rate. In fact no nation pays negative antidumping duties; a negative rate would normally be set equal to zero. This prevents the correction of the excessive CVD rate. However, a negative rate on a particular transaction may well have its full impact felt if it is averaged with positive rates on other margins, a common step in the AD calculation.
That is, the AD and CVD duties together equal the price discrimination created by the export subsidy, and thus restore the original price, prior to subsidization. Interestingly, the simultaneous AD case restores the offsetting duty outcome that the CVD case alone cannot achieve when the subsidy pass-through is not exact. Further, the addition of the CVD to export price in the AD calculation provides remedies consistent with the social welfare goal of restoring pricing to its level before subsidization regardless of the pass-through situation.

4.2 Domestic subsidies under partial pass-through

For a domestic subsidy in a market economy situation, the decrease in cost created by a subsidy has no effect on antidumping margins in a pure price-to-price comparison, since there is no differential created between export and domestic pricing. This remains true if pass-through of the subsidy to price is more or less than 100%, as long as the pass-through is the same in both markets. As with export subsidies, in such a case the CVD, set equal to the subsidy, no longer matches the price effects of the subsidy, but this goes to the appropriateness of the subsidy relief alone, not to the complexities introduced by an accompanying AD case. Consequently, no additional analysis for simultaneous AD / CVD proceedings is necessary for price-to-price AD comparisons with domestic subsidies.

As analyzed in Section 3.2 above, when production costs are used in the dumping calculation, the use of the actual company costs in the AD calculation, reflecting the subsidies, leads to consistent use of the CVD and AD remedies when there is complete pass-through of the subsidy to pricing, and no further correction is required under the offsetting duty rationale. When there is not complete pass-through of the subsidy to pricing, our analysis requires some modification.

Let the pass-through of the subsidy to price be \( r \cdot S_D \), \( r \neq 1 \). Allow the antidumping duty, in the absence of a subsidy, be as defined in equation (4), and substitute \( r \cdot S_D \) for \( S_D \) in equation 5, yielding:

\[
D_A = (NV_O - S_D) - (P_I^0 - r \cdot S_D) = NV_O - P_I^0 - S_D (1 - r)
\]

The original normal value has fallen by the amount of the subsidy, but export price has fallen by a smaller or larger amount, reflected in the pass-through multiplier \( r \). Relative to \( NV_O - P_I^0 \), this creates an additional dumping margin if \( r \)
> 1 (pass-through greater than 100%) and a reduced dumping margin if r < 1. If r = 1, the subsidy has no effect on antidumping duties, consistent with Section 3.2.

Should there be a simultaneous subsidy investigation, the CVD will equal the subsidy $S_D$. Under the same imperfect pass-through assumption, this will not match the export price effect of the subsidy, which is $rS_D$. A stand-alone subsidy case therefore violates the offsetting duty rationale if pass-through is not exact. However, the cumulative effect of the CVD and AD remedies would be:

\[ D_A + D_C = NV_O - P_I^0 - S_D (1 - r) + S_D = NV_O - P_I^0 + rS_D \]

The combined remedy equals the combined effect on export price, that is, the combined remedy yields the offsetting duty result. In the presence of a domestic subsidy and imperfect pass-through of that subsidy to price, the AD and CVD margins, taken alone, depart from the offsetting duty norm of replicating a state of the world without dumping or without subsidization, respectively. However, these departures from the offsetting duty result cancel each other out when the AD and CVD margins are combined. Thus in the presence of a combined case, and the use of the company’s own costs reflecting the effects of the subsidy, the degree of pass-through does not affect the consistency of the outcome with the offsetting duty rationale.  

\[ 4.3 \quad \text{Pass-through and normal value surrogates} \]

In the case of normal value surrogates, the domestic prices or costs used in the AD case no longer reflect the subsidies, so the CVD and the AD potentially double-count the price effect of the subsidy. This remains true if pass-through is other than 100%. Consider equation 11 from the previous subsection, but with the element $(NV_O - SD)$ replaced by the normal value based on third party costs, $NV_T$. This yields the equation for the AD with surrogate normal value and other than pure pass-through of the subsidy to export price:

\[ DA = NV_T - (P_I^0 - rS_D) = NV_T - P_I^0 + rS_D \]

14 In the extreme case of zero pass-through of the subsidy to price, $r = 0$, the combined effect of the antidumping and countervailing duties is $D_A = NV_T - (P_I^0 - rS_D) = NV_T - P_I^0$. This is the same result as equation 5, 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 – antidumping plus countervailing duty – unchanged. The reduction in cost due to the subsidy decreases the countervailing duties; 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.
The AD is increased or decreased by the amount by which the subsidy is passed through; if pass-through is perfect, this reduces to equation 9. The AD thus reflects the impact of the subsidy to the extent that it is passed through in export price.

Should there be a simultaneous CVD imposed, this will equal $S_D$. By assumption, this will incorrectly state the effect on export pricing, which is $r*S_D$, $r \neq 1$. The cumulative effect of the remedies will be:

$$DA + DC = NVT - (P_1^0 - r*S_D) + S_D = NVT - P_1^0 + r*S_D + S_D$$

The additional export price impact of the subsidy, over and above any independent amount of dumping $NVT - P_1^0$, is $r*S_D$, and so by the offsetting duty rationale – restoring the state of the world in the importing country to its status prior to the act of subsidization – the border remedy for the subsidy should be $r*S_D$. In fact the CVD equals $S_D$. As shown in equation 13, the AD itself reflects the amount of dumping, $NVT - P_1^0$, independent of the subsidy amount, as well as $r*S_D$. Therefore, the simultaneous AD and CVD cases create an excess remedy equal to the amount of the subsidy itself. The AD margin represents the export price impact of the subsidy, as well as any independent dumping, and the CVD imposes an entirely redundant remedy $DC$ equal to the full amount of the subsidy, $S_D$. Thus, notably, not imposing the CVD remedy serves to restore the level playing field in surrogate cases when the pass-through of the subsidy to price is other than 100%.

This analysis, and in particular the observation that not imposing the CVD remedy serves to offset the amount of the unfair practices, places no restriction on the value that the antidumping duties can take. In practice there is a common restriction on such duties, which is that, in aggregate, over an investigated or reviewed period, they cannot be negative. Rather than paying the exporter the absolute value of any negative dumping duty, the importing government simply treats a negative duty as if it were zero. Imposing this restriction requires further analysis of potential approaches to the double-count issue.

Consider the possibility that the subsidy effect $r*S_D$ exceeds the AD margin, due perhaps to some degree of negative dumping (normal value < export price) prior to the provision of $S$. In this case, if one does not consider negative dumping to be an appropriate offset to a CVD measure, the AD margin by itself does not fully correct the unfair trade, since it is smaller than $r*S_D$. The CVD margin, by itself, does correct the unfair trade; since there was negative dumping in the absence of the subsidy; consistency with the offsetting duty norm would require that no antidumping duty be imposed in addition to the countervailing duty.
Consider the other possibility, that the subsidy effect \( r^*S_D \) is less than the AD margin, say due to some positive dumping (normal value > export price) prior to the provision of \( r^*S_D \). In this case, the AD margin, by itself, does fully correct the unfair trade, since it includes the original dumping amount plus the export price effect due to the subsidy. The CVD margin does not fully correct the unfair trade, since it does not capture the original amount of the dumping.

Thus simply eliminating the CVD may not lead to the level playing field result in certain circumstances. From the above, taking only the higher of the two margins in a given case would eliminate the excess duty while fully offsetting the unfair trade. This option, attractive in its simplicity, may be difficult to square with national legislation among some WTO members. (It does not contradict WTO texts, which state that CVD and AD remedies shall not exceed the amount of subsidization or dumping, but do not restrict a member’s use of a duty less than the amount of subsidization or dumping.) The identical result can be achieved by an adjustment in the AD calculation, either a “due allowance” adjustment for the difference between the AD and CVD duty amounts, or an addition to export price for the amount of the countervailing duty, similar to that used in export subsidy situations. The “due allowance” reference is to a provision in the Antidumping Agreement (Paragraph 2.4) that a fair comparison requires that due allowance shall be made for differences between export price and normal value that affect price comparability. In the surrogate case, the normal value is based on prices or costs that do not reflect the subsidy, leading to the subsidy being addressed in both the CVD and AD remedies. A downwards adjustment to normal value equal to the amount of the countervailed subsidy would remedy the problem, whether there existed dumping without the subsidy, or not. Alternatively, an addition to export price of the amount of the countervailing duty would also resolve the problem. Any dumping that existed independently of the subsidy would remain and be subject to the AD remedy; any “dumping” created by the subsidy would be eliminated, reflecting the fact that this is addressed by the countervailing duty.15

The analysis of domestic subsidies has a clear result. Domestic subsidies affect normal value, and thus affect the antidumping calculation. Recognizing this effect on normal value in calculating antidumping duties prevents a double

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15 The logic and arithmetic of this option are identical to those reflected in the addition to export price for a countervailed export subsidy. This fact has led to some objection to this possibility on the grounds that the absence of such an adjustment, given its presence in the case of export subsidies, indicate that the framers of the WTO agreements and the national implementing legislations considered and rejected it as an option. In fact this situation – the double-count of remedies in surrogate cases – likely simply has never been considered prior to the explosion of cases over the last three years. Parallel AD and CVD cases that do not involve the AD surrogate methodology do not create the double-count. Parallel AD and CVD cases that did involve the AD surrogate methodology were not, to this author’s knowledge, pursued prior to 2006 or 2007 among at least the most active nations in the prosecution of AD and CVD cases.
remedy. By moving from normal values that reflect subsidies to those that do not in the *antidumping* calculation, a surrogate methodology essentially passes the subsidy through to U.S. pricing in the form of the antidumping duty. This is true regardless of the level of subsidy pass-through to export price. However, remedies to the overlapping remedies are easy to calculate and apply.

5. **Assessment when injury determinations take account of the level of unfair trade.**

In nearly all circumstances, the imposition of antidumping or countervailing duties under the WTO requires a finding of injury to the domestic industry as well as the finding of dumping or subsidization of imports. The SCM Agreement requires positive evidence “of both (a) the volume of the subsidized imports and the effect of the subsidized imports on prices in the domestic market for like products and (b) the consequent impact of these imports on the domestic producers of such products.” *(World Trade Organization (2010), SCM Agreement, Article 15.1, footnote omitted.)* The Antidumping Agreement uses nearly identical language, referring to dumped rather than subsidized merchandise. *(World Trade Organization (2010), Antidumping Agreement, Article 3.1.)* With respect to the effect on prices, the investigating authorities are directed to look for price undercutting by imports or other evidence of price suppression. In terms of causation, the member governments must demonstrate that the subsidized or dumped imports are, through the effects of subsidies or dumping, causing injury to the domestic industry.

Implementation of the Agreements varies somewhat among WTO members. In European Union practice, the countervailing or antidumping duty cannot exceed the degree of price undercutting by imports within the Union, and the amount of the countervailing duties and antidumping duties is considered in determining whether injury exists *(European Commission (2009)).* 16 Canadian law, typical of many WTO members, directs that the injury determination shall take into account “the magnitude of the margin of dumping or amount of subsidy in respect of the dumped or subsidized goods” *(Government of Canada (2010), Article 37.1 (1) (c) (ii.1)).*

If price undercutting in the importing nation enters into the injury determination the importance of a correct calculation of CVD and AD margins is

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16 Under this “lesser duty” rule, the duties cannot exceed the “injury margin”, the amount of under-pricing by imports. The official point of view was given by then-E.C. Trade Commissioner Peter Mandelson: “Europe’s "lesser duty" anti-dumping rule clearly ensures that anti-dumping measures cannot be used to make imports more expensive than the equivalent EU product - and they can and often do leave the competing export much cheaper than the European equivalent.” *(European Commission (2006)).*
clear. Should the duties be overstated, the effect on the domestic industry in the
importing country will be exaggerated unless the cross-price elasticity of imports
for domestically produced goods is non-positive, in which case an affirmative
injury determination is presumably unwarranted. In the situation summarized by
equation 14, the combined level of subsidization and dumping is overstated by
\( r \times S_D \), where \( S_D \) is the level of subsidization and \( r \) represents the proportion of the
subsidy passed through in pricing. The injury determination is an on/off
decision; if the domestic industry is considered not injured, the case ends, whereas
if it is injured, the case continues. Consequently, the impact of the combined
duties that exceed the combined amount of subsidization and dumping could be to
permit a case to go forward that would otherwise end.

Less dramatically, the incorrectly stated margins can also have a numeric
effect on the final duty under the lesser duty rule. As noted above, the European
Commission caps its final duty at the lesser of the actual duties calculated or the
degree of price undercutting by imports, the latter being the injury margin. This is
consistent with the Antidumping Agreement, which states (Article 9.1) (WTO
2010), “It is desirable that the imposition [of antidumping duties] be permissive in
the territory of all Members, and that the duty be less than the margin if such
lesser duty would be adequate to remove the injury to the domestic industry.”

Define:

\[
P_I: \quad \text{Price of the imported product, reflecting any dumping or subsidization, prior to the imposition of duties}
\]

\[
P_D: \quad \text{Price of the comparable domestically produced product in the importing country, again prior to the imposition of duties.}
\]

The injury margin \( IM \) is the excess of the \( P_D \) over \( P_I \):

\[
IM = P_D - P_I
\]

In the presence of combined cases with potential duties \( D_A \) and \( D_C \), the overall
duty \( D \) would be:

\[
D = \min (D_A + D_C, P_D - P_I)
\]

As above, consider the simultaneous application of antidumping and
countervailing duties. Under the export subsidy and domestic subsidy outcomes
of equations 10 and 12, with no restrictions on the degree of pass-through, total
duties equal the amount of under-pricing created by the subsidization and
dumping. Equation 16 thus operates as intended, limiting remedy to the lower of
the amount of unfair trade or of price undercutting.
However, under the uncorrected surrogate methodology of equation 14, there is an excess duty calculated of $r^* S_D$. With $D_A + D_C$ increased by $r^* S_D$, examination of equation 16 shows that the lesser duty $D$ will be affected if the (correctly calculated) $D_A + D_C$ is less than $P_D - P_I - r^* S_D$; otherwise, the $P_D - P_I$ condition is binding. Thus the lesser duty rule provides no certain relief from the incorrectly calculated combined duties.

6. **Product variety and differing subsidization levels.**

To this point we have assumed that the exported product, and the domestic product to which it is compared, are equally subsidized if subject to a domestic subsidy. Typically, the merchandise subject to an AD proceeding may be divided into many particular products reflecting product characteristics. The dumping comparison gives priority to choosing identical products for comparison purposes, but often this is not possible. A particular exported product may lack an identical domestic comparison for a number of reasons: the equivalent product may not be sold domestically, or its sales may not meet a quantitative threshold for adequacy for comparison purposes, or its sales may be judged not to be in the ordinary course of trade. If sales of identical products are not available, sales of an alternative, similar product are used for the price comparison, or the constructed value of the exported product is used. (A third possibility, that sales of an identical product to a third country be used for only the particular product in question, is rarely applied, and would simply correspond to the comparison of identical products already considered in the text.) If an alternative product is used, it must fall within the definition of the more general “like product” subject to the proceeding. (World Trade Organization 2010, Antidumping Agreement, Article 2.1.)

Given this, it is possible that an exported product will be subject to a different subsidy rate than the domestic product to which it is being compared. As a simple example, it may occur that an exported product benefits from domestic subsidies and is countervailed, but is compared in the dumping calculation to a product that is not subsidized. The apparent price discrimination in the AD calculation would then be due in whole or part to the comparison of a subsidized exported product to an unsubsidized product sold in the home market.

This results in the problem identified in the comparison of equations 8 and 9 with respect to the use of surrogates for normal value; indeed, the use of a similar product in some ways is simply another method of surrogate selection. In equation 9, the double-count of the subsidy occurs because the subsidy addressed by a countervailing duty is also addressed by the antidumping duty, due to the subsidy being reflected in export price but not normal value. Equations 13 and 14 present the equivalent problem if pass-through of the subsidy is not perfect. The
correction is straightforward, as outlined in Section 4.3 above. The Antidumping Agreement provides for adjustments to reflect differences between markets and products that affect price. As demonstrated in Section 4.3, an upwards adjustment to export price for the amount of the countervailing duty, or a downwards adjustment to normal value for the amount of the subsidy, corrects the double-count of the remedies and leaves the total remedy at the level anticipated by the WTO requirement that the remedies not exceed the transgressions. Equivalently, the CVD could be added to the export price in the AD calculation.

7. Recent practice

The WTO agreements leave considerable room for discretion in the implementation and CVD and AD measures. To some extent, this discretion extends to the treatment of duties in simultaneously filed cases. Yet the WTO does proscribe the application of duties in excess of the underlying action, subsidization for CVD or selling at less than normal value for AD. Clearly, if the combined duties exceed the measurement of the combined underlying actions, either the countervailing duty or the antidumping duty, or both, are excessive under WTO rules.

The recent record is mixed with respect to simultaneous cases prosecuted by national trade authorities. With respect to the case considered in Section 3.1 above, WTO members appear to adhere consistently to the addition to export price for countervailing duties imposed in response to export subsidies, preventing overlapping countervailing and antidumping duties. Similarly, with respect to the case considered in Section 3.2, the signatories most active in CVD and AD prosecutions adhere to the use of a company's own costs, again avoiding an excessive collection of duties through a doubled remedy.

The situation in which surrogates are used for normal value, analyzed in sections 3.3 and 4.3 above, has had a varied recent history in at least European Union, American and Canadian practice. EU practice has departed from the offsetting duty norm in a context similar to that described in part 6 above. In a recent case concerning biodiesel from the United States, the European Commission imposed countervailing duties in response to U.S. subsidies on exported merchandise (European Commission 2009). For one firm, the Commission used a surrogate product in the dumping comparison that was not subsidized, with the result that the dumping margin was calculated by comparing a subsidized exported product with an unsubsidized product sold domestically. Since the nature of the subsidy and competitive conditions in the industry led to the pass-through of the subsidy in pricing, this created a dumping margin due to the subsidy. The export price, lowered through the mechanism of the subsidy, attracted both a CVD, set equal to the amount of the subsidy, and an AD, as a
result. The Commission did not dispute the fact of the double-count, but it claimed a lack of authority either to make a different AD comparison - to domestic sales of an equally subsidized product - or to make a circumstance of sale adjustment reflecting the different nature of the export and domestic sales. The Commission rejected the possibility of adding the subsidy or CVD amount to export price in the dumping calculation, reading the authority to do so in the case of export subsidies as exclusionary, preventing its application in the case of a domestic subsidy (European Commission 2009, Official Journal of the European Union, 7 July 2009: L 179/33). The case has considerable importance in light of the above analysis, for comparisons of different products, which may well have different rates of subsidization, is common in AD cases.

The more extensive use of surrogates, which has created the greater controversy, has arisen in (at least) American and Canadian practice concerning non-market economies. In antidumping proceedings, U.S. practice has been to classify countries as market-oriented or non-market economies (NMEs). The U.S. applies surrogate values for normal value to industries in NMEs, although in theory – never applied - a firm or industry may be viewed as “market oriented” within an NME. China is the leading example of an NME in current U.S. practice. Canadian practice has been to consider claims by Canadian domestic interests that industries in a limited number of countries should be subject to surrogate normal values due to their domestic prices being substantially determined by the government and differing from competitive prices; such claims have been frequently successful against Chinese industries in recent Canadian practice. The European Union provides that surrogate values shall automatically be used for non-market economies that are not WTO members, and will be used for other non-market economies, subject to the possibility that particular producers may argue that they face market conditions.

The United States long refused to initiate CVDs against NME economies, not necessarily because of the potential double-count issue, but because of the apparent impracticality of determining subsidization in a market considered state controlled. However, this changed in March 2007 with a deliberate break with past practice, and since then the United States has actively pursued simultaneous CVD and AD cases using the surrogate methodology for the latter. In these cases, the U.S. had made no adjustment for the potential double-count analyzed in Sections 3.3 and 4.3, above, until a recent and ongoing remand proceeding from the court of review for the proceedings. Consequently, cases involving some billions of dollars in imports have led to overlapping duties, often at very high rates. U.S. practice has led to court and WTO appeals by those affected and has created considerable trade friction with China (WTO 2010). Canadian practice did not have an explicit break with past practice as did the United States in 2007, but at about the same time Canada began prosecuting CVD cases against Article
20 AD respondents. Canada has made no adjustment for the potential double-count analyzed in Sections 3.3 and 4.3. Finally, the EU has initiated its first countervailing duty case against a non-market economy, which is paired with a slightly earlier dumping case; the joint cases have reached affirmative final determinations that awaits member state approval (European Commission 2010).

Canadian practice may also include cases of doubled remedies through the use of surrogates even when shipments from prescribed countries or government monopolies are not involved. In March 2006, the Canadian Border Services Agency (CBSA) issued its final determinations of dumping and subsidization with respect to unprocessed grain corn from the United States (CBSA 2006). On the subsidy side of the case, the CBSA explicitly assumed that subsidies were passed on in full to the purchasers of American corn. On the dumping side, the CBSA concluded that certain respondents had not provided complete, timely responses and so used U.S. Department of Agriculture estimates of the actual cost of producing corn. These actual costs were not net of at least some of the countervailed subsidy amounts, particularly counter-cyclical payments. Consequently a potential double-count resulted, in much the same way as in a non-market economy case: the costs used in the dumping calculation were not net of (all of) the subsidies that were subject to the countervailing duties. The potential double-count was not recognized as an issue in the case and is an illustration that the problem of overlapping remedies is a problem of using surrogates for normal value generally, not of surrogates in non-market economy cases alone.

8. Conclusion

The modeling exercise demonstrates that the simultaneous prosecution of CVD and AD cases requires care to prevent an excess assessment of duties. The excess assessment is not an artifact of the full pass-through assumption of the offsetting duty norm. Rather, to the extent that the border price effect of the subsidy is addressed by the countervailing duty, the antidumping duty will lead to an excess assessment if the subsidy’s impact on export price, or on normal value, is ignored. Strikingly, correctly done, simultaneous CVD and AD proceedings can lead to duties that offset the level of trade transgression exactly when either the CVD or AD, taken alone, does not do so.

Recent national practices have markedly increased the application of excessive duties in cases involving surrogates for normal value, notably, but not exclusively, markets or sectors considered not to be subject to normal market forces. As shown by equation 14, simultaneous CVD and AD proceedings in such cases can lead to a doubled penalty for subsidies, violating the Antidumping
and SMC Agreements’ requirement that duties in response to dumping and subsidies not exceed the amount of the dumping or subsidization.

The analysis of this paper is based on the offsetting duty norm, that countervailing and antidumping measure are intended to offset certain behaviors. Institutionally, countervailing duties are computed based on the amount of subsidy measured by the benefit to the recipient and indeed are capped at this amount by the SCM Agreement; the alternative of tracing the actual effects of the subsidy in general has played little role in the practice of WTO members. However, the analysis of Part 4 above, which contemplates pass-through of other than 100%, accommodates this alternative as well.

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