CHAPTER 05

NORMAL VALUES IN A MARKET ECONOMY

The ability to inflate the dumping margin, also known as "capturing the dumping margin", could be critical in an anti-dumping investigation. An anti-dumping investigation is immediately terminated if the dumping margin is *de minimis* because it is assumed that insignificant dumping margins would not result in material injury in the importing country.[1] As explained in the previous chapter a dumping margin would, according to the URAA, be *de minimis* if it is less than 2 per cent "expressed as a percentage of the export price"(GATT Secretariat 1994:177; Rycken 1991:204). The size of the dumping margin also limits the size of any anti-dumping duty that may be imposed It would therefore be advantageous to the applicant in an anti-dumping investigation to be able to inflate the dumping margin. When the export price or the normal value have to be constructed, these values could be manipulated, which means that the dumping margin could be manipulated to ensure a positive dumping finding.

The problems related to constructing the export price have already been discussed in chapter 4. The circumstances that could affect the value of the normal value will be explored in detail in this and the following chapter. Flowcharts will be provided in both this and the next chapter after the discussion, in order to summarise the different set of circumstances in which the normal value can be manipulated. In these two chapters it will again be necessary to look at some of the legal text, because it is often the way in which the Agreement has been phrased that has created some of the loopholes that are being used to capture the dumping margin. It will become apparent that the potential to cheat in an anti-dumping investigation - by manipulating the normal value - is quite extensive.

1 The Uruguay Round Anti-dumping Agreement (URAA), PART 1, Article 5, paragraph 5.8.

5.1 THE NORMAL VALUE

According to the URAA, the normal value of a product is " the comparable price, in the ordinary course of trade, for the like product when destined for consumption in the exporting country" (GATT Secretariat 1994:168). If there are comparable sales of the "like product" in the ordinary course of trade in the domestic market of the exporter/producer, the prices of these domestic sales must be used as the normal value if the exporting country is a market economy country (Stanbrook & Bentley 1996:33; Tharakan *et al* 1998:1039). In other words, the preferred method of determining normal value is to use the actual prices of sales of the "like product" in the country of export/production. In some anti-dumping cases, however, the actual prices in the country of export/production are not used as the normal value. There are a number of circumstances under which it is allowed to use what is in effect a proxy for the normal value. These circumstances are set out in paragraph 2.2 of the URAA:

> When there are *no sales* of the like product *in the ordinary course of trade* in the domestic market of the exporting country or when, *because of the particular market situation* or the *low volume of the sales* in the domestic market of the exporting country, *such sales do not permit a proper comparison*, the margin of dumping shall be determined by comparison with a comparable price of the like product when exported to an appropriate third country, provided that this price is representative, or with the cost of production in the country of origin plus a reasonable amount for administrative, selling and general costs and for profits[2] (GATT Secretariat 1994:168, own italics).

The important consideration is that there are a number of circumstances which may result in there being no reliable prices that can be used to determine the normal value. The different sets of circumstances listed in paragraph 2.2 will be discussed in detail in this chapter under the following main headings;

- sales "not in the ordinary course of trade" (section 5.2), and
- no reliable normal value (section 5.3).

A third category, which is not clearly apparent from paragraph 2.2 and which will discussed in the next

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2 URAA, PART 1, Article 2. Paragraph, 2.2.

chapter, is if the exporter is situated in a non-market economy country.

5.2 SALES NOT IN THE ORDINARY COURSE OF TRADE

Although there may be sales of the like product in the domestic market of the exporter, the normal value based on these sales may be deemed to be unreliable if substantial quantities of these sales are made "not in the ordinary course of trade" over an extended period of time. The inclusion of such sales in the determination of the normal value (namely substantial quantities of sales of the like product made not in the ordinary course of trade over an extended period of time), would distort the normal value and so such sales may be excluded from the determination of the normal value (GATT Secretariat 1994:169). The determination of the normal value would therefore be affected if there are sales "not in the ordinary course of trade" and if such sales are included in the calculation.

There are two interpretations of "not in the ordinary course of trade". If there are sales in the domestic market of the exporter to related parties, such sales are considered to be "not in the ordinary course of trade" (Corr 1997:94; Farr 1998:11; Matsumoto & Finlayson 1990:15; Rycken 1991:195). According to Article 2(1) of the Basic Regulation[3] of the EC, the "**normal value** shall normally be based on the prices paid or payable, in the ordinary course of trade, by independent customers in the exporting country" (Farr 1998:10, emphasis in the original). The origin of this interpretation is the Interpretative Note to Paragraph 1 of Article VI of GATT, which states that "hidden dumping by associated houses ... constitutes a form of price dumping..." (GATT Secretariat 1994:545; WTO Secretariat1995:224). In the US, related party transactions are also treated as being "not in the ordinary course of trade" because, as Kaplan, Kamasck and Parker (1988:378-379) point out, transfer prices between related parties may not reflect "actual cost experience".

The other interpretation of "not in the ordinary course of trade", is the sales below cost interpretation

3 The EC anti-dumping regulations are contained in the Basic Regulation.

which originated in the US. According to US anti-dumping law, if an exporter sells products in the US at less than fair value, then that exporter is dumping (Lex Mundi 2001:38). The US anti-dumping legislation has equated fair value or normal value with the full cost of production or fully allocated costs (Kaplan *et al* 1988:359-360).

Sales at below cost were not really an issue until the Kennedy Round of Multilateral Trade negotiations (1964-1967). The US delegates to these negotiations argued that there could be instances when export sales at below cost might escape being classified as dumping. Such dumping could escape detection if sales in the domestic market of the exporter were also below cost, as there would be no or very little difference between the two values used to determine dumping, namely the export price and the normal value (Bierwagen 1990:79). In other words, normal values would be distorted if they were based on data which included sales below the cost of production and the normal value and export price could be the same even though the exporter is dumping (Johnston & Deese 1988:423).

The 1974 US Trade Act included a provision that allowed sales at below cost, which were considered to be “not in the ordinary course of trade”, to be disregarded for determining fair value (ie normal value) (Bierwagen 1990:79; Kaplan *et al* 1988:364,369; Kolev & Prusa 2002:895-897; Macrory 1990:384; Matsumoto & Finlayson 1990:12; Vermulst 1987:351; Vermulst 1990:444-445). Sales that could be disregarded were “sales made at less than cost of production ... over an extended period of time and in substantial quantities” and, sales which were “not at prices which permit recovery of all costs within a reasonable period of time in the normal course of trade” (Bierwagen 1990:79). After the 1974 Act, sales below cost became an important aspect of US anti-dumping legislation. It has been used extensively by the US and also more recently by the EU in their anti-dumping actions (Kolev & Prusa 2002:896 ft 3; Messerlin 1991:46-51). In fact, the majority of US anti-dumping cases during the 1980s were based at least in part on allegations of goods being sold at less than fair value (Horlick 1990:133-134).

In spite of criticism against the treatment of sales at below cost, other signatories to GATT included the below-cost provision in their legislation, ostensibly to keep their anti-dumping legislation in line with the

US approach (Bierwagen 1990:79-80). Australia, Canada, the then EEC[4] and the US came to an agreement during the Tokyo Round negotiations that below-cost sales would be viewed as being "not in the ordinary course of trade"and that such sales could be excluded from normal value determination (Kufuor 1998:182; Palmeter 1995:46; Vermulst 1987:430). The URAA provisions in respect of sales below cost largely reflect what was US practice.[5]

It was made explicit in the URAA[6] that sales below cost are "not in the ordinary course of trade" and that such sales may be disregarded in determining normal value under certain circumstances (Corr 1997:92-94; Palmeter 1995:46). For example, in EC versus Brazil, Poland, Russia and the Ukraine (1994a:6)[7], more than 90 per cent of the sales of the product in Brazil were made at a loss and were therefore considered to be "not in the ordinary course of trade". As a result, the normal value in this case was established on the basis of a constructed value.

According to paragraph 2.2.1 of the URAA, if "sales of the like product in the domestic market of the exporting country or sales to a third country at prices below per unit (fixed and variable) costs of production plus administrative, selling and general costs ... are made within an extended period of time in substantial quantities and are at prices which do not provide for the recovery of all costs within a reasonable period of time", then such sales "may be treated as not being in the ordinary course of trade by reason of price and may be disregarded in determining normal value" (GATT Secretariat 1994:169).

Paragraph 2.2.1 is qualified by the following sentence: "If prices which are below per unit costs at the time of sales are above weighted average per unit costs for the period of investigation, such prices shall

4 The EC used to be known as the European Economic Community (the EEC).

5 Prior to the URAA, according to US legislation, below-cost sales had to be company specific, but now they only have to be country specific, which according to Palmeter (1995:46, 50) makes it easier to show that sales are below-costs.

6 URAA, PART 1, Article 2, Paragraph 2.2.1

7 The decision was confirmed in EC versus Brazil, Poland, Russia and the Ukraine (1994b) and imposed as a definitive anti-dumping duty.

be considered to provide for recovery of costs within a reasonable period of time" (GATT Secretariat 1994:169). According to the URAA, not in the ordinary course of trade thus means that the selling price of such sales are not high enough to recover "all costs within a reasonable period of time".

Paragraph 2.2.1 is further qualified by two footnotes, one stipulating that "The extended period of time should normally be one year but shall in no case be less than six months" (GATT Secretariat 1994:169 footnote 4). According to Palmeter (1995:45-47), the US was reluctant to increase the "extended period of time" from six months to one year during the Uruguay Round anti-dumping negotiations, which accounts for this footnote.

The other footnote states that "Sales below per unit costs are made in substantial quantities when the authorities establish that the weighted average selling price of the transactions under consideration for the determination of the normal value is below the weighted average per unit costs, or that the volume of sales below per unit costs represents not less than 20 per cent of the volume sold in transactions under consideration for the determination of the normal value"(GATT Secretariat 1994:169, ft5). Thus, if the sales below cost constitute at least 20 per cent of the total sales under consideration in the domestic market of the exporter, then these "sales below cost" are being sold in substantial quantities and may be excluded from the normal value calculation. If the sales below cost constitute less than 20 per cent of the volume of sales, then these sales below cost would be included in the determination of the normal value. In 2001, a suggestion was made during a United Nations Conference on Trade and Development (UNCTAD) Expert Meeting on the Impact of Anti-dumping and Countervailing Actions, to increase the 20 per cent threshold (UNCTAD 2001:3).

In the US, prior to the URAA, if less than 10 per cent of sales were below cost, the below cost sales were not disregarded in the determination of the normal value. If more than 10 per cent but less than 90 per cent of sales were at below-cost prices, then the below cost sales were disregarded in the calculation of normal value. An average normal value was then calculated based on the remaining sales that were not disregarded. In addition, according to Commerce's interpretation of US legislation, if more than 90 per cent of sales were at below-cost prices, then *all* the domestic sales were ignored in the calculation of normal value and the normal value was determined using the constructed value method

(Bierwagen 1990:80-81; Kaplan & Kuhbach 1990:361-363; Palmeter 1995:40, 48).

This method, which became known as the 10-90-10 test, was challenged in court a number of times. The US Court of International Trade (CIT) held that although it was reasonable to ignore sales below cost if such sales comprised 10 per cent of sales, it was unreasonable to ignore all sales if 90 per cent of sales were below cost. According to the CIT, the practice of ignoring all sales if 90 per cent of sales were below cost, was in conflict with Commerce's 5 per cent rule in respect of low volume of sales as it was then applied in the US (Bierwagen 1990:80-81; Kaplan *et al* 1988: 360-361 ft9; Kaplan & Kuhbach 1990:361-364). According to the 5 per cent rule, only if the domestic sales in the market of the exporter were less than 5 per cent of third-country (non-US) sales, would the domestic sales in the market of the exporter not constitute sufficient volume of sales to provide a proper comparison (Vermulst 1987:346). The application of the 10–90-10 test in effect meant that the percentage applicable to "a sufficient volume of sales" which are not below cost was 10 per cent and not 5 per cent.

It has been argued that the exclusion of sales below cost from the determination of normal value ignores common business practice. Although it is assumed that any enterprise must make a profit over a reasonable period of time, if an enterprise has stocks of a product that it cannot sell, it may need to reduce the selling price to rid itself of the stocks. It is also normal business practice to sell at below cost in time of recession (Bierwagen 1990:72; Deardorff 1990:30-32; Kufuor 1998:183; Macrory 1990:385; Vermulst 1987:352, 431-432; Waer 1993:70). It would seem though that this need to reduce selling prices to below per unit cost for a short period of time has been taken into consideration in the URAA. While paragraph 2.2.1 of the URAA states that below cost means "at prices below per unit (fixed and variable) costs of production plus administrative, selling and general costs", in other words below average (fully allocated) cost, it also specifies that the sales, not in the ordinary course of trade (that is, at below per unit cost), which may be ignored in the determination of normal value must not only be in substantial quantities, but also over an extended period of time. This extended period of time is usually one year, but may not be less than six months. So if an enterprise sells off obsolete stock at below cost over a short period of time, for example three months, these sales will be deemed to be *in the ordinary course of trade*.

The "sales not in the ordinary course of trade" provision forms part of the URAA and is therefore a legitimate reason for excluding certain sales from the normal value calculation, but this provision increased the potential to manipulate normal values. It is to the advantage of the applicants in an anti-dumping investigation to obtain as high a value for the normal value as possible. If the applicant is able to exclude the lowest selling prices in the domestic market of the exporter, then the possibility of capturing the dumping margin is improved. In other words, by being able to exclude "sales not in the ordinary course of trade" from the determination of the normal value, the NV part of equation (1) $DM = NV - P_X$ increases in value. In this way DM, the dumping margin, can be manipulated to ensure a positive dumping finding.

5.3 A NONEXISTENT OR AN UNRELIABLE NORMAL VALUE

The normal value used in the determination of dumping would also be influenced if there is no reliable normal value in the country of export. To repeat paragraph 2.2 of the URAA:

> When there are *no sales* of the like product *in the ordinary course of trade* in the domestic market of the exporting country or when, *because of the particular market situation* or the *low volume of the sales* in the domestic market of the exporting country, *such sales do not permit a proper comparison*, the margin of dumping shall be determined by comparison with a comparable price of the like product when exported to an appropriate third country, provided that this price is representative, or with the cost of production in the country of origin plus a reasonable amount for administrative, selling and general costs and for profits[8] (GATT Secretariat 1994:168, own italics).

There thus seem to be four circumstances under which there may be no reliable normal value:

- If there are no sales at all of the like product in the domestic market of the exporter , then the normal value is nonexistent

8 URAA, PART 1, Article 2. Paragraph, 2.2, emphasis added.

- if "there are no sales of the like product in the ordinary course of trade in the domestic market of the exporting country" (see section 5.3.1)
- "because of the particular market situation, ... such sales do not permit a proper comparison" (see section 5.3.2)
- if the low volume of the sales in the domestic market of the exporting country, ... do not permit a proper comparison (see section 5.3.3) (GATT Secretariat 1994:168)

5.3.1 No sales of the like product in the ordinary course of trade

Two of the situations are encapsulated in the words " When there are no sales of the like product in the ordinary course of trade in the domestic market of the exporting country" (GATT Secretariat 1994:168). The first situation is the most obvious. In such a situation there is no normal value against which to compare the export price. A product could be produced for export only (Waer 1993:47). For example, sometimes producers of high-priced electronic products are located in developing countries where there may be no market for the products and so production is purely export-oriented. When there are no sales *at all* of the like product in the domestic market of the exporter, there can be no sales in the ordinary course of trade and therefore there is no normal value based on domestic sales, that is, the normal value is nonexistent.

The second situation refers to the phrase *in the ordinary course of trade,* which has been discussed in the previous section of this chapter. Normal values are based on the actual prices of sales, *in the ordinary course of trade,* in the domestic market of the exporter and those sales that are *not in the ordinary course of trade* must be excluded from the determination of the normal value. If all the sales in the domestic market of the exporter are "not in the ordinary course of trade" then there are no sales of the like product *in the ordinary course of trade* in the domestic market of the exporting country. If there are sales, but all of these sales are at below costs, then these sales are *not in the ordinary course of trade*. Likewise, if all the sales in the domestic market of the exporter are to related parties, then those sales are *not in the ordinary course of trade.* In both cases there is no reliable normal value because there are no sales in the ordinary course of trade. The prices of all the sales would therefore be considered unreliable.

According to the URAA, if there are no sales of the like product, made in the ordinary course of trade, which allow for a proper comparison between the export price and the normal value, the authorities should use some other method to determine the normal value, either exports to a third country or the cost of production in the country of origin[9] (Farr 1998:10-11; Waer 1993:47). These two methods will be discussed in section 5.4 of this chapter.

Two other situations may arise where there may be no reliable normal value because the sales in the domestic market of the exporter "do not permit a proper comparison". The normal value may be deemed to be unreliable "because of the particular market situation" or because of "the low volume of the sales in the domestic market of the exporting country" (GATT Secretariat 1994:168).

5.3.2 The particular market situation

According to paragraph 2.2 of the URAA, normal values could be unreliable "when, because of the particular market situation ... such sales do not permit a proper comparison ..." (GATT Secretariat 1994:168; Stanbrook and Bentley 1996:37-38). The URAA does not elaborate on this situation. Stanbrook and Bentley (1996:37) mention that a particular market situation could prevent a proper comparison without elaborating further on what this means. Instances in which the particular market situation could prevent a proper comparison could be in a market economy country that is experiencing hyperinflation or in a market economy country where distribution channels prevent foreign competitors entering the domestic market of the exporter. According to Das (1999:209), a "particular market

9 The country of origin is assumed to be the country of production. If the products are not exported directly from the country of origin, that is the country of production, but are exported through an intermediate country, then the export price is compared to the prices in the country of export. If there are no comparable prices in the country of export then the normal value would be determined using prices in the country of origin see URAA PART 1, Article 2, paragraph 2.5.

situation" could also include the situation where "there may be strict government control on prices and prices may not be determined based on market conditions, but on several other social and political considerations". In other words the "particular market situation" could include non-market economies.

This section of paragraph 2.2 of the URAA is often simply repeated in various countries' anti-dumping legislation without any explanation of the term "particular market situation".[10] In Chile's anti-dumping legislation this paragraph is stated slightly differently as "because of special market conditions ... such sales do not allow for proper comparison..." (Compendium of antidumping and countervailing duty laws 1999:3). However, this slight rephrasing doesn't shed any light on what is meant by either of the terms, "special market conditions" or the "particular market situation".

Peru's anti-dumping legislation is more detailed, stating that "A particular market situation in the sense of Article 2.2 of the Anti-dumping Agreement shall mean the following situations:

I. Where the level of openness in the country of origin resulting from tariff or para-tariff barriers does not permit a proper comparison because it causes distortion of domestic prices.

II. Where other special factors exist in the domestic market of the country of origin which, in the opinion of the Commission, do not permit a proper comparison because they cause distortion of domestic prices" (Compendium of antidumping and countervailing duty laws 1999:9-10).

So it seems that the term "particular market situation" could include situations in market economies as well as in non-market economies.

5.3.3 Low volume of sales

10 Examples are Brazil, Ecuador and Uruguay (Compendium of antidumping and countervailing duty laws 1999:2,7,14).

Normal values based on actual selling prices in a market economy, could also be deemed unreliable "when, because of the ... low volume of the sales in the domestic market of the exporting country, such sales do not permit a proper comparison" (GATT Secretariat 1994:168). In other words, the quantity or volume of domestic sales of a product in the country of export may not be sufficient to provide a reliable normal value.

According to the footnote to paragraph 2.2 of the URAA, a sufficient quantity or volume of domestic sales would "constitute 5 per cent or more of the sales of the product under consideration to the importing Member" (GATT Secretariat 1994:168). So the domestic sales in the country of export must be sufficient in relation to the quantity or volume of the like product that is being imported into the investigating country and that is being investigated under the anti-dumping action. This 5 per cent rule is, however, qualified in the same footnote. Provision is made for a lower ratio than 5 per cent if it can be shown that such a lower ratio is "of sufficient magnitude to provide for a proper comparison" (GATT Secretariat 1994:168).

The way the 5 per cent low-volume rule has been implemented in the URAA is more reflective of previous EC rather than US regulation (Waer 1993:71). There was no specific reference to low volumes of sales in the domestic market of the exporter in the Tokyo Code[11]. In the EC, prior to URAA, low volume was taken to be less than 5 per cent - but 5 per cent of exports to the Community. In the US, on the other hand, if the domestic sales in the market of the exporter were less than 5 per cent of third-country (non-US) sales, the domestic sales in the market of the exporter would not constitute sufficient volume of sales to provide a proper comparison (Palmeter 1995:50; Vermulst

11 In the previous anti-dumping agreement, the Tokyo Code (1979), the paragraph referring to the use of alternative methods to determine normal value was phrased slightly differently to the later URAA. According to the Tokyo Code;

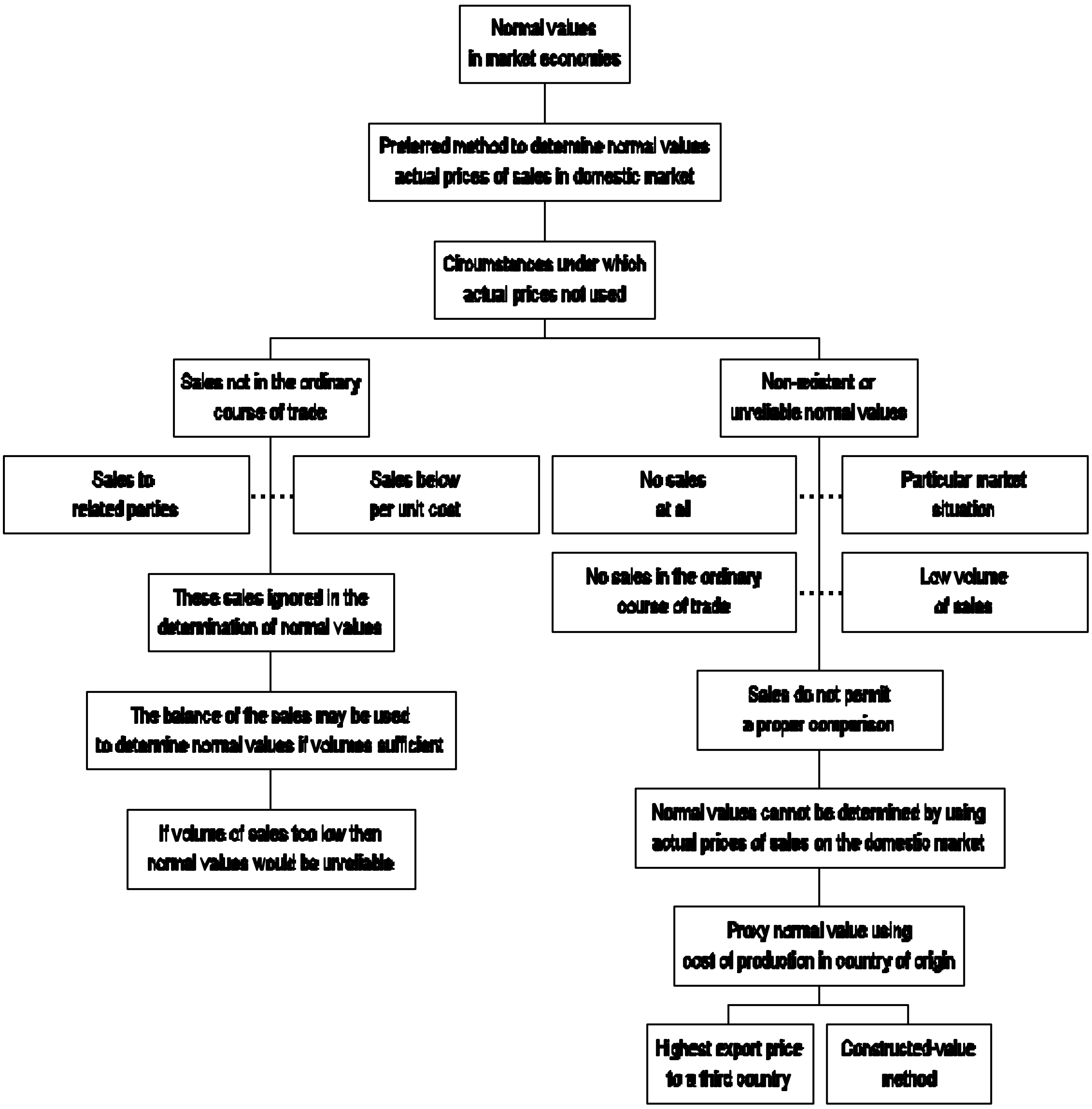
> When there are no sales of the like product in the ordinary course of trade in the domestic market of the exporting country or when, because of the particular market situation, such sales do not permit a proper comparison, the margin of dumping shall be determined by comparison with a comparable price of the like product when exported to any third country which may be the highest such export price but should be a representative price, or with the cost of production in the country of origin plus a reasonable amount for administrative, selling and any other costs and for profits. As a general rule, the addition for profit shall not exceed the profit normally realized on sales of products of the same general category in te domestic market of the country of origin (Bierwagen 1990:224).

1987:346). The principle involved here is that the quantity or volume of sales of the like product in the domestic market of the exporter must be sufficient to provide a proper comparison between the normal value based on those sales and the export price.

And according to paragraph 2.2 of the URAA, if the particular market situation or the low volume of sales do not permit a proper comparison, then the authorities may use either exports to a third country or the cost of production in the country of origin to determine a proxy normal value. The circumstances described in paragraph 2.2 of the URAA are summarised in the following flowchart.

Figure 5.1 Flowchart showing the circumstances under which proxy normal values would be calculated.

Source: Own compilation



5.4 METHODS TO DETERMINE THE NORMAL VALUE

According to the URAA, there are two alternative methods that can be used to determine normal value if the sales in the domestic market are unreliable or non-existent and if the exporter is situated in a market economy: exports to a third country or the cost of production in the country of origin, which is also known as the constructed value method. These two methods will be discussed in this chapter. The intention of the methods is to determine normal values that would reflect the cost of production in the country of origin. If the exporter is situated in a non-market economy (see ch 6), not only will the selling prices of the product in the domestic market of the exporter be unreliable, export prices to other countries and prices of any products produced in that country will also be unreliable. The determination of a normal value for a non-market economy in an anti-dumping action is not usually based on the two methods prescribed in the URAA for market economies. A different method, known as the analogue or surrogate method, is usually used. This method will be discussed in chapter 6.

5.4.1 Exports to a third country

One method used to determine normal value for a market economy if the normal value based on actual prices of sales is unreliable, is the export price to a third country. Article VI of GATT stipulates that the export price of the product under investigation should be compared to "the highest comparable price for the like product for export to any third country in the ordinary course of trade"[12] (GATT Secretariat 1994:493). The URAA qualifies Article VI by stating that the comparable price should be representative and that the exports should be to an appropriate third country[13] (GATT Secretariat

12 The General Agreement on Tariffs and Trade, Article VI, paragraph 1(b) (i).

13 The Tokyo Anti-dumping Code (1979) stipulates that "the margin of dumping shall be determined by comparison with a comparable price of the like product when exported to any third country which may be the highest such export price but should be a representative price ..." whereas the URAA states that "the margin of dumping shall be determined by comparison with a comparable price of the like product when exported to an appropriate third country, provided that this price is representative ..." (Bierwagen 1990: 224;

1994:168). So the export price of the like product sold to another importing country - other than the country in which the product is allegedly being dumped - by the exporter (the alleged dumper) can be used as a proxy for the domestic price of the exporter (Messerlin 1991:47). For example, if country X is accused of dumping a product in country Y and there are no domestic sales of that product in country X, the export price of sales of the like product from country X to (say) country Z could be used as the normal value in the dumping case between X and Y.

The exports-to-a-third-country method [also called the third-country test by Bierwagen (1990:77)] has not often been used to determine normal value in the EC. In fact the EC Commission has a clear preference for the constructed-value method over the third-country method because the export country could be dumping in the third country as well (Farr 1998:10-11; Hindley 1988:448; Messerlin 1991:47; Stanbrook & Bentley 1996:38-39; Vermulst 1987:422; Waer 1993:47-48). In the above-mentioned example, country X could be dumping in both countries Y and Z. Using the export price to country Z could result in a negative dumping finding when dumping could in fact exist.

On the other hand, in the US, the exports-to-a-third-country method was and still seems to be preferred to the constructed-value method, in spite of the possibility that the exporter could be dumping in more than one export market (Compendium of antidumping and countervailing duty laws1999:12; Kaplan *et al* 1988:364 fts35-36; Vermulst 1987:346-347; Vermulst 1990:444; White 1997:118). According to Vermulst (1987:347), the third-country method is easier to administer than the constructed-value method. Vermulst (1987:348-349) suggested that another reason why the US authorities preferred the third-country method to the constructed-value method was because of an unrealistic 8 per cent profit rule in the constructed-value method under the previous US anti-dumping legislation. This 8 per cent profit rule sometimes resulted in prices that were "in conflict with commercial realities in the industry under consideration" (Vermulst 1987:348-349). In other words, the investigative authorities thought that the third-country method was a fairer method than the constructed-value method, as well as being the easier method to administer. Prior to URAA, US legislation allowed the use of multiple third countries in order to determine a normal value. If one third country did not provide an adequate sample,

GATT Secretariat 1994:168).

export sales to several third countries could be aggregated - although this was not often done in practice (Palmeter 1995:51; Vermulst 1987:347-348).

5.4.2 The constructed-value method/the cost of production

A method used in many cases in which the normal value of a market-economy exporter was unreliable or non-existent, is the second method provided for in paragraph 2.2 of Article 2 of the URAA, which is based upon the cost of production. This method became known, initially in the US, as the constructed-value method (Palmeter 1995:51; Stanbrook & Bentley 1996:39). The export price is to be compared "with the cost of production in the country of origin plus a reasonable amount for administrative, selling and general costs and for profits"[14] (GATT Secretariat 1994:168). According to paragraph 2.2.1.1 of the URAA, it seems that the first line of approach is to use actual data from the exporter or producer under investigation:

> For the purpose of paragraph 2, costs shall normally be calculated on the basis of records kept by the exporter or producer under investigation, provided that such records are in accordance with the generally accepted accounting principles of the exporting country and reasonably reflect the costs associated with the production and sale of the product under consideration (GATT Secretariat 1994:169).

However, the reference to the cost of production in the country of origin in paragraph 2.2,[15] seems to imply that data from other producers in the same country may be used to calculate the entire normal value under certain circumstances, and this is the interpretation that seems to have been included in the new EC Anti-dumping Regulation[16] (Stanbrook & Bentley 1996:283; Vermulst & Waer 1995:54-55).

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14 Anti-dumping Agreement, PART I, Article 2, paragraph 2.2.

15 The export price is to be compared "with the cost of production in the country of origin plus a reasonable amount for administrative, selling and general costs and for profits" (GATT Secretariat 1994:168).

16 According to the EC Basic Regulation, Council Regulation (EC) No. 384/96 Article 2(1), "where the exporter in the exporting country does not produce or does not sell the like product, the normal value may be established on the basis of prices of other sellers or producers" (Stanbrook & Bentley 1996:283).

However, it is not clearly stated in the URAA that data from other producers may or should be used to calculate the entire normal value. The URAA specifically allows data from other producers to be used for administrative, selling and general costs and profits, but no more than that. Emphasis is placed on the requirement to use data from the country of origin, that is, the country of export and/or production. Presumably the intention is to ensure that any comparative advantage that the exporting country may have over the country that is importing its products should be reflected in the constructed normal value or, as Kufuor (1998:183) phrases it, due regard should be given to the normal commercial situation in the exporting country.

The value of the constructed normal value will also depend partly on the accounting methodology chosen by the investigative authorities (White 1997:119). According to the URAA, the generally accepted accounting principles (GAAP) of the exporting country or foreign producer should be used to determine constructed value (GATT Secretariat 1994:169 ; White 1997:119). But if the GAAP of the exporting country does "not assign all the appropriate costs to the product", or when "the principles distort the financial results", then the investigative authorities may deviate from the GAAP of the exporting country (White 1997:118-120).

Paragraph 2.2.1.1 of the URAA also refers specifically to the provision of appropriate amortisation[17] and depreciation periods and appropriate allowances for capital expenditure and other development costs. Costs have to be adjusted appropriately for non-recurring costs, for example research and development costs, which benefit future and/or current production. According to this paragraph of the URAA:

> Authorities shall consider all available evidence on the proper allocation of costs, including that which is made available by the exporter or producer in the course of the investigation provided that such allocations have been historically utilized by the exporter or producer, in particular in

17 Although the term *amortisation* is commonly understood to mean the writing off of a loan over a period of time, *amortisation* also means "to allocate a capitalized cost to several time periods." In this sense *amortisation* is similar to *depreciation*, except that *amortisation* is usually used in reference to an intangible asset, for example the investment needed to develop a new product, whereas the term *depreciation* is usually applicable to a tangible fixed asset, for example the purchase of plant and equipment (Hulten 1992:39-40).

> relation to establishing appropriate amortization and depreciation periods and allowances for capital expenditures and other development costs. Unless already reflected in the cost allocations under this sub-paragraph, costs shall be adjusted appropriately for those non-recurring items of cost which benefit future and/or current production, or for circumstances in which costs during the period of investigation are affected by start-up operations (GATT Secretariat 1994:169-170).

A footnote further qualifies the reference to start-up costs:

> The adjustment made for start-up operations shall reflect the costs at the end of the start-up period or, if that period extends beyond the period of investigation, the most recent costs which can reasonably be taken into account by the authorities during the investigation. (GATT Secretariat 1994:170, ft6).

The way in which these type of non-recurring costs are treated can make a substantial difference to the final decision in an anti-dumping investigation. It would be quite easy to manipulate normal values at this stage in order to inflate the dumping margin. As indicated in paragraph 2.2.1.1 of the URAA, the type of costs involved are capital expenditure and development costs, like research and development and start-up costs. The main issue is the time period over which a company should be allowed to write off such a cost, as the length of time would impact significantly on the per unit cost of production used as the normal value for the product (Corr 1997:91-92; Stanbrook & Bentley 1996:42).

The reason why it is important to use the correct time period over which to write off such costs, is to prevent arbitrary findings of dumping (Corr 1997:91; Horlick & Shea 1995:26; Leebron 1997:235; Palmeter 1996:50). For example, start-up operations are capital intensive and are often initially accompanied by low production quantities which would distort the per unit production cost during such a start-up period. If start-up or other such non-recurring costs are included in normal value calculations over an anti-dumping investigation period without making adjustments for a start-up period or other relevant periods, which may be longer than the investigation period, the resultant high normal value will not reflect the normal production situation and will result in inaccurate positive dumping decisions (Corr 1997:91-92; Farr 1998:13; Kufuor 1998:187). But how long should such a time period be? As long as the business cycle, the production cycle or the anti-dumping investigation cycle? Does the length of a start-up phase or the period over which, for example, research and development cost should be written off, depend on the circumstances of the exporter or producer under investigation? Certain types of cost, for example depreciation, are not such a problem when it comes to apportioning the expenses as there are a number of generally accepted accounting practices which are common to most countries. But it seems that the period over which certain non-recurring costs, especially start-up costs, may be written off when the normal value is being constructed is largely left to the discretion of the investigative authorities (Corr 1997:91; Kufuor 1998:187; Vermulst & Waer 1995:56-58).

The start-up period is not defined in the URAA and this issue could be a bone of contention in anti-dumping actions (Kufuor 1998:187; Stanbrook & Bentley 1996:43). Corr (1997:91) suggests that the start-up period ends "when commercial production reaches a level that is characteristic of the merchandise, producer or industry, and not necessarily when production is at optimum capacity utilization". It is therefore not just a simple exercise of deciding on a certain period over which all enterprises may write off capital expenses. The write-off period often depends on the type of enterprise or industry.

This problem of a write-off period becomes an issue only when the constructed-value method is being used. If the actual prices of the exporter are accepted as being reliable, there is no problem. It is when the normal value is being constructed and the accounting methods of the producer come under scrutiny by the investigative authorities, or when the investigative authorities use accounting technics which the exporters object to, that problems arise. When the constructed-value method is used to determine normal values, the type of costs that could have a significant affect on the normal value used to determine dumping and which could be a area of dispute, are capital expenses like the amortisation of start-up and research and development costs.

It is alleged that developed countries have adopted a narrow or restrictive approach to the adjustment of start-up costs. Expenses like advertising or improvements to existing facilities are not considered to be start-up costs (Corr 1997:91; Kufuor 1998:187; Leebron 1997:236). US anti-dumping legislation specifies the way start-up costs should be treated in much more detail than the URAA (Palmeter 1995:49-50). According to US legislation, the US Department of Commerce (USDOC or the

Department) may only make adjustments for start-up costs if

- the investigated company is using new production facilities or is producing a new product that requires substantial additional investment, and
- production levels are limited by technical factors associated with the initial phase of commercial production (Leebron 1997:235-236; Palmeter 1995:49).

The USDOC may also not consider "the expansion of an existing production line's capacity to be a start-up operation unless the expansion constitutes such a major undertaking that it requires the construction of a new facility". Improvements to an existing facility do not qualify as start-up costs. The US legislation also limits the type of costs that may be adjusted to production costs, for example, sales and marketing costs are excluded from any adjustment, even though the URAA does not specify such exclusions (Leebron 1997:236; Palmeter 1995:49-50).

According to the EC Basic Regulation, maintenance expenditure is excluded from start-up costs (Stanbrook & Bentley 1996:42). The EC Basic Regulation[18] defines start-up operations as when

- new production facilities started during the investigation period
- these facilities required substantial additional investment and
- the new facilities operated at low capacity utilisation during the same period (Stanbrook & Bentley 1996:42, 283).

Administrative, selling and general expenses and the rate of profit were a major area of dispute prior to the URAA. According to previous US anti-dumping legislation, the constructed normal value had to include at least 10 per cent mark-up for selling and general expenses and 8 per cent mark-up on the sum of costs plus general expenses for profit. General expenses included selling, administrative and general expenses plus the cost of containers, coverings and expenses related to placing merchandise ready for shipment to the US (Bierwagen 1990:82; Vermulst 1987:348-349). In the EC, the normal value was constructed based on the cost of production (both fixed and variable costs) in the country of origin plus a reasonable/appropriate amount for selling, general and administrative costs and profit (Vermulst 1987:422-427; Waer 1993:48). According to Rycken (1991:196) and Waer (1993:48-49,

18 Article 2(5), third sub-paragraph, of the Council Regulation (EC) No 384/96 in Stanbrook & Bentley (1996:283).

77), the way in which administrative, selling and general costs and profits were treated in EC law and practice prior to the Uruguay Round was consistent with the then Tokyo Round Anti-dumping Code and the current URAA incorporates previous EC legislation and practice. However, it seems that the EC authorities were not always consistent in their treatment of profit rates when the constructed-value method was used to determine normal values (Horlick & Shea 1995:26; Waer 1993:67-68,71-74).

According to paragraph 2.2.2 of the URAA, “the amounts for administrative, selling and general costs and for profits shall be based on actual data pertaining to production and sales in the ordinary course of trade of the like product by the exporter or producer under investigation” (GATT Secretariat 1994:170). Thus while the normal value may be estimated by adding up production costs observed in the exporting country, amounts for administrative, selling and general costs and for profits should be based on actual data from the exporter or producer under investigation, if at all possible (Messerlin 1991:47; Palmeter 1995:51; Thailand v Poland 2000:34).

Only if the data for administrative, selling and general costs and for profits cannot be obtained from the producer or exporter, may the authorities then determine these amounts using other sources of data in the exporting country (Kufuor 1998:188) and then, according to paragraph 2.2.2 (i) to (iii) of the URAA, the amounts used in the constructed value method for administrative, selling and general costs and for profits

> ... may be determined on the basis of:
>
> (i) the actual amounts incurred and realized by the exporter or producer in question in respect of production and sales in the domestic market of the country of origin of the same general category of products;
>
> (ii) the weighted average of the actual amounts incurred and realized by other exporter or producers subject to investigation in respect of production and sales of the like product in the domestic market of the country of origin;
>
> (iii) any other reasonable method, provided that the amount for profit so established shall not exceed the profit normally realized by other exporters or producers on sales of products of the same general category in the domestic market of the country of origin (GATT Secretariat 1994:170).

The authorities may only use these methods if "such amounts cannot be determined on" the basis as set out in paragraph 2.2.2 of Article 2.2 of the URAA (GATT Secretariat 1994:170). In other words, the authorities must first use the actual data of the exporter or producer under investigation to determine administrative, selling and general costs and the rate of profit, before other sources of data may be used. According to Waer (1993:77-78), the options listed as subparagraphs to paragraph 2.2.2 are in a specific order of preference. In other words, if the authorities cannot use the actual data for the like product from the exporter or producer under investigation, then they may use option 2.2.2(i), the data from the exporter or producer for the same general category of products. If the data from 2.2.2(i) are not available, then the authorities may use data from other exporters or producers subject to investigation of the like product but from the same country, that is, the country of origin. If these data are not available, only then may the authorities use any other reasonable method. Moreover, even this method stipulates that the profit figure should not exceed that realised by exporters or producers of the same general category of products in the country of origin.

The panel in Thailand versus Poland (2000:36) noted, that in their view, there is no specified order of preference or established hierarchy among the subparagraphs of 2.2.2. In fact, the EC Regulation has switched the order of sub-paragraphs 2.2.2 (i) and 2.2.2 (ii) around (Farr 1998: 13; Stanbrook & Bentley 1996:43; Vermulst & Waer 1995:58). It is clear, though, that the intention of the URAA is that the preferred methodology " is to use *actual* data of the exporter or producer under investigation for the *like product* where possible, because the use of actual data would ensure results that are reasonable, which is the requirement of Article 2.2 of the URAA (Thailand v Poland 2000:34-37). So it would seem that the methods prescribed in paragraphs 2.2.2 (i) and 2.2.2(ii) are preferred to the method prescribed in paragraph 2.2.2 (iii) (Vermulst & Waer 1995:58). However, some experts feel that article 2.2.2 of the URAA "allows too much discretion and may lead to unreasonable selling, general and administrative expenses and profit calculations" and that the current provision should be clarified (UNCTAD 2001:3).

Even so, the section of the URAA dealing with the cost of production is a lot more detailed than in previous anti-dumping agreements. In the past, certain costs were inappropriately treated in some anti-dumping cases. The Tokyo Round Anti-dumping Code, which authorised the use of constructed estimates, only imposed a standard of reasonableness on administrative, selling and other costs and for profits, nor was it mandatory according to this Code, to use domestic costs, that is, costs from the country of origin (Messerlin 1991;47; Waer 1993:48-49). The investigative authorities and lawyers were allowed a fair amount of discretion under the previous anti-dumping agreement with regard to the interpretation and application of the rules and different countries applied various sections of the Anti-dumping Agreements in slightly different ways (Bierwagen 1990:224; Hindley 1988; Horlick & Shea 1995:18-23,26; Johnson & Deese 1988; Kaplan *et al* 1988; Messerlin 1991; Palmeter 1995:39-40, 51; Waer 1993:48).

Such differences in approach sometimes affected not only the determination of dumping but also the size of the dumping margin, which in turn affected the calculation of any anti-dumping duties that were imposed (Matsumoto & Finlayson 1990; White 1997). For example, the US method of applying arbitrary statutory minimum percentages for administrative, selling and general expense and for profit rates sometimes resulted in incorrect positive anti-dumping decisions. But the US had to change their legislation to conform with the URAA. There are no longer arbitrary statutory minimums for selling, general and administrative expenses and profits in the US and this change may render the constructed-value method more favourable to exporters to the US than it was in the past (Palmeter 1995:48, 51).

Paragraph 2.2.1.1 of URAA has also been included in US legislation, so that "costs normally shall be based on the records of the exporter or producer" and existing US Department of Commerce practice has been codified in respect of non-recurring costs so that costs have to be associated with all production that benefits from those costs (Palmeter 1995:49). For example, research and development expenses are allocated over both current and future production.

A further complicating factor when constructing normal values is the existence of sales not in the ordinary course of trade. According to paragraph 2.2.2 of the URAA, "the amounts for administrative, selling and general costs and for profits shall be based on actual data pertaining to production and sales in the ordinary course of trade of the like product by the exporter or producer under investigation" (GATT Secretariat 1994:170). As already explained in section 5.2 of this chapter, sales not in the ordinary course of trade can be either sales to related parties or sales at below cost. The inclusion of related-party transactions or sales below cost would distort any constructed normal value. Sales not in the ordinary course of trade are therefore excluded from constructed-value calculations (Johnston & Deese 1988:421-425; Matsumoto & Finlayson 1990:15; Palmeter 1995:57; Stanbrook & Bentley 1996:41). Sometimes "not in the ordinary course of trade" has also been interpreted to mean that low profit margins or losses may be excluded from constructed-value calculations (Horlick & Shea 1995:18; Waer 1993:68-69).

In a recent dispute, it was argued that sales "not in the ordinary course of trade" were not to be excluded when calculations were made in terms of paragraphs 2.2.2 (i) to (iii) of the URAA. The EC Commission was criticised by the Appellate Body in EC versus India (2001:26) for excluding sales not in the ordinary course of trade when using the method provided for in paragraph 2.2.2 (ii). According to the findings by the Appellate Body, sales "not in the ordinary course of trade" may only be excluded when the method prescribed in paragraph 2.2.2 is used, because the phrase "not in the ordinary course of trade appears only in paragraph 2.2.2 and not in (sub-) paragraphs 2.2.2 (i) to (iii).

5.4.3 Criticisms of the constructed-value method

The above discussion of the constructed-value method served to illustrate how complicated it can become to construct normal values. The *administrative burden* behind the calculations needed to construct a normal value is much greater than the work required to obtain the actual selling price of the like product in the domestic market of the exporter or the export price to a third country (Kaplan *et al* 1988:418). The investigative authorities have to obtain the necessary data from the exporter/producer in order to construct a normal value. If the information is not available from the exporter/producer because, for example, the enterprise is a small company and does not have detailed cost records, then the investigative authorities have to find other producers which produce the like product, that are willing and able to supply the necessary information (Macrory 1990:387). As a last resort, the investigative authorities sometimes use the prices used in previous anti-dumping cases. While these prices may result in dumping margins that seem unfair, the authorities have the right to use the best information available.

The constructed-value method has been criticised as being *biased in favour of the applicants* of anti-dumping cases (Corr 1997:93-94; Hindley 1988; Matsumoto & Finlayson 1990:6; Waer 1993:48; White 1997:127). The potential to manipulate normal values and capture the dumping margin is inherent in the constructed-value method. There are a number of ways in which data could be manipulated to the advantage of the applicants. However, if the exporters provide the necessary information, the chances of manipulation are minimised. Problem areas include the valuation of materials bought from related parties, the amortisation of research and development and start-up costs, and the calculation of depreciation and financial expenses, in other words the allocation of overheads (Macrory 1990:387). Waer (1993:64) also points out that even though constructed normal values could be largely hypothetical or guesstimates, the resultant figures are almost impossible to be proved wrong by the exporter/producer under investigation, which could place an exporter at a disadvantage.

The use of the constructed-value method often means that another producer's production costs are used to construct the normal value for an exporter. This is the same as assuming that all producers/exporters act and distribute their products in the same way (Waer 1993:65). If an exporter has a *comparative advantage* over its domestic competitors, this advantage *will not be reflected* in the constructed normal value, which is based on cost data from the other producers in the same country. However, any comparative advantage that the *country* of export may have over the country of import will be reflected in the constructed normal values.

Another problem is that the result of the dumping decision depends on the value of the constructed normal value, which is unknown before the anti-dumping action is initiated. So the outcome of such cases is often unpredictable and this unpredictability creates *uncertainty for exporters* in general (Waer 1993:60-1: White 1997:117). In addition, as was explained in chapter 2, the mere initiation of an anti-dumping investigation has an *harassment effect* on exporters. Such an harassment effect would be exacerbated by the fact that the constructed-value method is used to determine normal values in these anti-dumping investigations.

The ability to cast doubt on prices in the exporting country often results in the constructed-value method being used to construct normal values for the exporter, and the use of this method enhances the potential to manipulate the determination of dumping. Developing countries, countries in transition and countries that are new to the anti-dumping game are particularly vulnerable to any manipulation tactics employed in anti-dumping cases.

5.5 CONCLUSION

When the normal value and the export price of the exporter or producer are acceptable and are used in the determination of dumping, then the results of the calculation are usually clear and predictable. When the actual prices of the product under investigation are not reliable and alternative methods are used to determine the normal value, then the results of the determination of dumping may be questioned. The exports-to-a-third-country method, while not satisfactory from the importing countries point of view, is based on the exporter's price data and as such reflects the exporter's comparative advantage. The constructed-value method, which is meant to result in a fair and reasonable determination of the normal value of the product under investigation, can be used to capture the dumping margin.

The constructed-value method has been criticised for a number of reasons, but it is the potential to manipulate "determination of dumping" results, inherent in this method, that is of concern to many members of the WTO and which is of interest here. In spite of the apparent intention of the anti-dumping agreement, namely the encouragement of free and fair international trade, the way in which various members of the WTO are abusing the agreement indicates that the agreement is being intentionally dishonoured. The next chapter underscores this message.