

5-1-1989

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### Recommended Citation

Charles Owen Verrill Jr., *Nonmarket Economy Dumping: New Directions in Fair Value Analysis*, 1989 BYU L. Rev. 449 (1989).

Available at: <https://digitalcommons.law.byu.edu/lawreview/vol1989/iss2/5>

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## Nonmarket Economy Dumping: New Directions in Fair Value Analysis

*Charles Owen Verrill, Jr.\**

After years of debate, and a myriad of proposals and counter proposals, the Omnibus Trade and Competitiveness Act of 1988<sup>1</sup> (hereinafter the "1988 Trade Act") adopted a revised methodology for determining the fair value<sup>2</sup> of imports from nonmarket economy (NME) countries.<sup>3</sup> The revised methodology, which is based on the "factors of production," replaces the traditional approach which utilized prices charged by a surrogate producer for the same or similar product in a market economy as the fair value. Critics of the surrogate approach have argued for years that the use of another producer's prices as the proxy for the fair value of a NME product is arbitrary and unpredictable. Congress has now heeded those complaints and, after considering a variety of alternatives, settled on the factors methodology.<sup>4</sup>

The application of the antidumping law to the NME's is an ongoing issue because the traditional dumping tests, which are premised on home market prices or costs, are not considered appropriate to determine the fair value of NME imports as neither market forces nor supply and demand necessarily influence price or cost structures in those countries. For this reason, the Antidumping Act was amended in 1974 to codify a Department of Treasury (Treasury) practice that originated in 1960 during an antidumping investigation of the fair value of imported Czechoslovakian bicycles. After rejecting home market prices or costs

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\* Wiley, Rein & Fielding, Washington, D.C.

1. Pub. L. No. 100-418, 102 Stat. 1107 (1988).

2. For purposes of the Antidumping Act of 1921, "fair value" is synonymous with "foreign market value." See *Tariff Act of 1930* § 773, 19 U.S.C. § 1677b.

3. NMEs are generally communist countries whose economies do not allow for competitive pricing of goods as in the U.S.

4. See 1988 Trade Act, Section 1316 amending subsection (c) of Section 773 of the *Tariff Act of 1930*, as amended, 19 U.S.C. § 1677b. See also Omnibus Trade and Competitiveness Act of 1988, Pub. L. No. 100-418, § 1316, 102 Stat. 1107, 1186-88 (to be codified at § 1677b) (1988).

because of the state control of the Czech economy, the Treasury determined fair value based on the price of similar bicycles produced by a West German manufacturer. This surrogate fair value was then compared to the price charged by the Czech producer on sales to the United States. Dumping, or sales at less than fair value (LTFV), was found since the Czech bicycle prices in the U.S. were lower than the German home market prices.

Over time, significant problems arose in the use of the surrogate method. The Treasury and, after 1980, the Department of Commerce ("Commerce"), were often unable to locate a "surrogate" willing to provide reliable price data, a problem that escalated as the verification requirements of the 1979 Trade Agreements Act were implemented.<sup>5</sup> Even when a willing surrogate was identified, the data frequently was identified so late in the proceedings that neither the petitioner nor the NME producer had any opportunity to comment on the prices or adjustments made to achieve comparability. Moreover, NME producers often complained that this system gave them little, if any, guidance on setting U.S. market prices that would avoid an antidumping challenge. Likewise, domestic producers in the United States objected to the difficulty of assessing the likelihood of winning an antidumping action against NME products that did not have a predictable fair value.

The Senate Report on the Omnibus Trade Act of 1987 (which was finally enacted in 1988) summed up the criticisms as follows:

The current antidumping duty law and procedures as they apply to nonmarket economies do not work well. The Commerce Department is frequently unable to find surrogate producers willing to cooperate in investigations by providing data. Therefore, it has had to develop fall-back methodologies. The dumping margins for a nonmarket economy country will vary widely depending on which methodology or surrogate country is used. As a result, a nonmarket economy country typically is unable to predict whether or not a particular U.S. price will be considered a dumped price, and is unable to structure its activities accordingly. In addition, an American industry faced with low-

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5. "Experience has also shown that dumping margins may vary dramatically from case to case, depending on the country and type of data we have had to use." Administration Comments on proposed Antidumping and Countervailing Duty Amendments, submitted to the Senate Finance Committee by Commerce Under-secretary Smart and Deputy U.S.T.R. Woods, April 17, 1987, at 2. (Hereinafter "Administration Comments.")

priced competition from a nonmarket economy producer is unable to determine whether the antidumping duty law would provide a remedy.<sup>6</sup>

In short, the system required change because of perceived inadequacies in the law as administered by the Commerce Department.

The solution to the fair value problem originally, favored by many in Congress and the Reagan administration, would base the fair value of an NME product on the price of similar products imported into the United States from market economy producers. This methodology was argued to be more predictable since import prices are normally reflected in statistical data published monthly by the Census Bureau.<sup>7</sup> In fact, Commerce had already utilized import prices as the fair value referent where surrogates could not be located, arguing that the Act justified this departure from the usual procedures.<sup>8</sup> Controversy soon erupted, however, over which import price to use as the fair value referent. Domestic industry representatives argued for the highest import price, an average of import and U.S. prices or, at the least, the average import price of the same or similar merchandise. The Reagan administration, on the other hand, proposed the lowest import price.

Reconciliation of these positions proved difficult because of dramatically different perceptions of NME trade. On the one hand, domestic industries argued that since NME producers were known to be inefficient, it would be unfair to base the fair value of their products on the lowest import prices which presumably were charged by the most efficient foreign producer. The Reagan administration countered these arguments with the observation that any other measure of fair value would probably drive NME producers out of the U.S. market.

The Administration-proposed standard of lowest eligible country average prices is preferable because it takes into account

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6. Report of the Committee on Finance, U.S. Senate, *Omnibus Trade Act of 1987*, Report No. 100-71, June 17, 1987 at 108. S. REP. No. 71, 100th Cong., 1st Sess. 108 (1987).

7. The Census Bureau compiles monthly data on the volume and price of most imports according to the classifications in the tariff schedules of the United States.

8. For example, in Carbon Steel Wire Rod from Poland, 49 Fed. Reg. 29, 434 (1984), the fair value was derived from the U.S. import price of comparable wire rod imported from Australia. This information was readily available from statistics compiled by the Customs Service and did not require cooperation by the Australian producer.

the fact that products from NME countries usually command a lower price than products from market economy countries due to quality and supply problems. Therefore, it is a more reasonable standard and would preserve fair competition in NME products.<sup>9</sup>

Moreover, the Administration argued that the "lowest average import price will prevent an NME from being the price leader in the U.S. market, and therefore will shelter U.S. industries from market-disruptive price competition from NME suppliers."<sup>10</sup> Needless to say, this logic was unacceptable to domestic interests that feared low priced imports would disrupt the market.<sup>11</sup>

An alternative, proposed by Senator Heinz and incorporated in the Senate version of H.R. 3,<sup>12</sup> based NME fair values on the trade-weighted average price of comparable merchandise produced in the market economy accounting for the largest volume of imports of such merchandise into the United States. This proposal met less industry opposition but was still unacceptable to the Administration.

Where the imported products range in quality, the largest volume exporter may sell a medium quality product at a medium price. The NME, on the other hand, is much more likely to sell a lower quality product at a lower price in the United States in order to compete.<sup>13</sup>

Despite continuing Administration opposition, the Heinz proposal was incorporated in the Trade Bill that was passed by the Senate in 1987.

The Senate version of the Trade Bill also provided that if the goods from the largest volume exporter (the "benchmark" country) were being sold at less than fair value, then the Commerce Department would be required to construct a fair value from the "factors of production" incurred in producing the mer-

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9. Administrative Objections To and Comments on Senate Trade and Related Legislation, 133 CONG. REC. S 8733, 8734 (daily ed. June 25, 1987) [hereinafter Administration Comments II]. These "Objections" were a refinement of the April Comments *supra* note 5.

10. Administration Comments at 3.

11. It was also argued that the Administration proposal gave the NMEs a privileged status as contrasted, for example, to Mexico which had to sell at fair value derived from sales or costs in its domestic market. As a market economy, Mexico could not avoid antidumping charges by selling at the lowest import price if the home market price or costs were higher than the lowest import price.

12. S. 490, 100th Cong. 1st Sess. § 315 (1987).

13. Administration Comments *supra* note 5, at 3.

chandise. These factors would be valued according to market economy prices, plus general expenses, profit and packing costs. In the conference convened to settle differences in the House and Senate Bills, continuing objections to the use of import prices, as well as sustained controversy over the appropriate import price, led the conferees to drop the trade-weighted average import price reference altogether and establish such factors as the preferred methodology for all NME dumping investigations.

Before examining the factors method in detail, it is worth noting that the 1988 amendments define a nonmarket economy country as any country that "does not operate on market principles of cost or pricing structures, so that sales of merchandise in such country do not reflect the fair value of such merchandise."<sup>14</sup> In tacit recognition of the ambiguity of this semantically awkward definition, the Act requires Commerce, in characterizing whether a country has a nonmarket economy, "to take into account" currency convertability, the extent to which wage rates are set by bargaining between labor and management, whether (and on what terms) joint ventures and foreign investment are permitted, government ownership of the means of production and control over the allocation of resources, price and output decisions and international transactions. While some of the criteria have previously been utilized by Commerce in characterizing countries as NMEs or not,<sup>15</sup> the references to wage bargaining and foreign investment are new.

The question remains whether these criteria—now that they are spelled out in the law—portend an extension of the special NME rules beyond the "communist" countries to which they have traditionally been applied. Because the statutory criteria are not ideological, at least facially, it is conceivable that the historical tendency to categorize all "communist" countries (except Yugoslavia) as NME's and all other countries as "market economies" will now be subject to challenge.

For example, several "communist" countries with developing market characteristics—specifically Hungary and the Peoples Republic of China—have previously and unsuccessfully challenged their characterization as NMEs. These arguments

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14. Section 1316(b) amended 771 of the Tariff Act of 1930 by adding a new paragraph, 19 U.S.C. § 1677 (18)(A). Omnibus Trade and Competitiveness Act of 1988, Pub. L. No. 100-418, § 1316(b), 102 Stat. 1107, 1186 (1988).

15. See *Truck Trailer Axle-and-Brake Assemblies From the Hungarian People's Republic*, 46 Fed. Reg. 46,152 (1981).

may be renewed now that there are objective, statutory guidelines to refer to in asserting market economy status. There may be little incentive to do so, however, since the NMEs enjoy an exemption from the countervailing duty law that would be lost if Commerce agreed that a given country had "graduated" to market economy status.<sup>16</sup> Indeed, a country like Iran could well be tempted to claim it is an NME to avoid subsidy allegations.<sup>17</sup> Whether or not the new criteria will encourage these counterintuitive results will likely depend on the degree to which the factors method is considered fair or, at least, produces evenhanded results.

It should be emphasized that the "factors" method is not new. It first appeared in proposed Treasury regulations drafted in 1978 to cope with the dilemma posed when the Canadian surrogate producer used in the Polish Golf Car investigation went out of business.<sup>18</sup> Rather than use Japanese prices<sup>19</sup> or a constructed value based on U.S. costs, the Treasury proposed that

If we can obtain and verify actual, objective elements of production (e.g., hours of labor, amount of raw materials) in the state-controlled economy country, these would be valued in an economically comparable market economy country, and the figures thus obtained would be used to construct value in the market economy country where production and sale of the merchandise is occurring.<sup>20</sup>

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16. In *Georgetown Steel Corp. v. United States*, 801 F.2d 1308 (Fed. Cir. 1986), the court upheld the Commerce Department decision not to apply the countervailing duty laws to the NMEs. According to the Administration, "government intervention in an NME is so widespread that subsidies are meaningless and cannot be identified or valued." Administration Comments *supra* note 5, at 3. This rather unblinking acceptance of the dominance of the "communist" state was completely at odds with the facts developed in the *Georgetown* case.

17. Iran is not entitled to an injury test in countervailing duty investigations. As a result, producers from Iran are easy targets for countervailing duty petitions. See *Roasted In-Shell Pistachios From Iran*, 51 Fed. Reg. 35,679 (1986).

18. See *Electric Golf Cars from Poland*, 40 Fed. Reg. 25,497 (1975).

19. Japan was one of the few golf car producers that could serve as a surrogate. However, Japanese prices were much higher than U.S. prices and were, therefore, politically unacceptable as a fair value referent. See Memorandum for the Acting Secretary of State and Secretary of Commerce from the Acting Secretary of the Treasury, August 5, 1977. "Here . . . we are presently aware of golf car production in only one other country, Japan, and Japanese prices are significantly higher than U.S. prices. *Id.*"

20. Memorandum for Under Secretary Anthony M. Solomon, from Peter D. Ehrenhaft, Deputy Assistant Secretary and Special Counsel (Tariff Affairs), December 15, 1977, at 3 (Antidumping Regulations Affecting State-Controlled-Economy Countries).

According to author, the proposal seemed "fair and has been so perceived by the Poles as well."

In recent years, the factors methodology has in fact been used whenever the surrogate or import price approach was deemed inappropriate. For example, in *Urea From the Union of Soviet Socialist Republics*,<sup>21</sup> Commerce was unable to obtain surrogate data because of the refusal of the market economy producers to cooperate. Accordingly, Commerce "calculated the constructed value [of Soviet urea] based on the factors of production of the Soviet producers."<sup>22</sup> The *Urea* decision later became an important consideration in the decision of the conferees to use the factors method as the required methodology in all NME antidumping investigations where adequate information is available.<sup>23</sup>

The factors method values the actual NME production factors based on prices determined in a country that operates on market principles, to which is added an amount for general expenses (at least ten percent and profit of at least eight percent). The relevant factors for any given product include the hours of labor required, as well as unit raw material, energy, utility and representative capital costs (including depreciation). The specific reference to "representative capital cost, including depreciation" ensures that this factor is to be considered as a separate item in the construction of foreign market value, thus ending a debate whether capital cost and depreciation were included in "general expenses."

The factor values are to be derived from actual production experience of the NME manufacturer and will obviously vary from producer to producer depending on the efficiencies (or lack thereof) achieved in each manufacturing facility. This method, therefore, rewards efficiency since the NME producer with the *lowest* unit factors will also have the lowest fair value which lessens the risk of a dumping finding while the less efficient producers will be more vulnerable.

The recognition of different efficiency achievements by the revised methodology is a significant and valuable step toward ra-

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21. 52 Fed. Reg. 19,557 (1987).

22. *Id.*

23. Where there is inadequate information to develop a fair value based on factors, the import price is the required alternative. See Omnibus Trade and Competitiveness Act of 1988, Pub. L. No. 100 - 418, 102 Stat. 1107, 1186 (to be codified at 19 U.S.C. § 1677b(c)) (1988).



tional application of the antidumping law to NMEs. Both the surrogate method and the use of (average/lowest/other) import prices result in fair values that are entirely divorced from actual production factors; the same fair value applies to an NME producer with a productivity of two-man hours per unit as to a producer that requires ten man-hours to make the same product. This singularity of result is intellectually objectionable and inconsistent with the general principle that antidumping duties are intended to prevent price discrimination. The factors methodology, because it is producer specific, is consistent with this principle.

While the factors are determined from the actual operating records of the NME producer, the monetary value of each factor is based on prices or costs of the same factors in one or more market economy countries that are (i) at a level of economic development comparable to that of the nonmarket economy country, and (ii) significant producers of comparable merchandise. For example, to determine the unit price of coal for purposes of valuing that factor in the case of an NME producer, Commerce is required, if possible, to use the coal price in a country of comparable economic development to that in which the NME product is made, and where there are "significant" producers of the merchandise in question.

The criteria for selection of surrogate prices or costs for NME factors are intended to yield prices or costs that bear a reasonable relationship to what would be the price or cost levels in the NME were it to operate according to market principles. For example, it could be argued that countries at the same level of economic development would have comparable wage costs. While this assumption is questionable,<sup>24</sup> comparable economy criteria does give some measure of predictability to the calculation required to establish fair value. For example, a Polish producer could presumably value a new product by determining factors, which are in its possession, and pricing those factors in a country likely to be the surrogate should a dumping action be filed.

The emphasis on "significant producer" also suggests that Congress was trying to replicate the costs and prices that would

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24. Assuming that the principal measure of comparability is gross national product per capita, it is clear that the cost of growing grain in Canada would not be comparable to that in Denmark although the relative incomes per capita in both countries are nearly the same.

be realized by a NME producer that operates in a market economy. The conference report, for example, states that "Commerce should seek to use, if possible, data based on production of the same general class or kind of merchandise using similar levels of technology and at similar levels of volume as the producers subject to investigation."<sup>25</sup>

While one can quarrel about the intricacies of these comparisons, it seems clear that what has emerged is a methodology that is relatively predictable and is based to the extent feasible on the actual experience of the NME producer. This is a commendable achievement.<sup>26</sup>

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25. Conference Report, at 591.

26. An additional feature of the 1988 Act is a provision authorizing the Commerce Department to suspend, *i.e.*, "settle," antidumping investigations based upon quantitative restraint agreements. This is a significant departure from the antidumping law applicable to market economies, which generally permits suspension of an investigation based solely on price considerations (*i.e.*, elimination of dumping margins) and will be applicable only to NME antidumping investigations. While the Act does require that public interest considerations be taken into account, a more significant requirement is that the suspension agreement must be found to "prevent the suppression or undercutting of price levels of domestic products." This is a new direction for the law and one which ought to be considered in other contexts.