

PROPOSALS ON DETERMINATION OF NORMAL VALUE

Paper from Chile; Colombia; Costa Rica; Hong Kong, China; Japan; Korea; Norway; Singapore; Switzerland; the Separate Customs Territory of Taiwan, Penghu, Kinmen and Matsu; and Thailand

The following communication, dated 15 April 2004, is being circulated at the request of the above delegations.

This paper addresses four interrelated issues:

- 1) Definition of “sufficient quantity of sales of the like product in the domestic market for the determination of normal value”
- 2) Sales of the like product in the ordinary course of trade
- 3) The investigating authorities’ discretion to request and use respondent’s data
- 4) Constructed value

The Friends of the Antidumping Negotiations (“FANs”) feel that it is useful to address these four issues in a single paper. All four issues are fundamental to the calculation of normal value. Moreover, the interrelationship between the issues makes it worthwhile to address them together. For example, the issue of whether domestic sales of the like product are “in the ordinary course of trade” is related to the issue of below-cost sales, because Article 2.2.1 of the Anti-Dumping Agreement (ADA) provides that sales “may be treated as not being in the ordinary course of trade by reason of price” when the sales are made below cost. When there are no domestic sales “in the ordinary course of trade,” the issue arises as to the appropriate basis for normal value – constructed value or third-country prices. Any change regarding one of the issues could affect the other issues. Addressing the four issues together therefore facilitates such consideration.

This proposal indicates one way to overcome or resolve the problems relating to the four issues. The discussions in the Negotiating Group may assist in improving this proposal. Consequently, we reserve the right to modify or complement the proposal as appropriate.

In preparing and/or analyzing specific provisions, it is clear that amendment of the existing text may have an impact on other Articles of the AD Agreement, which have so far not been explicitly addressed. These links cannot be fully addressed until we have seen a comprehensive overview of proposed amendments. Consequently, we also reserve the right to make proposals on provisions which may not have been explicitly addressed so far for clarification or improvement.

Relevant Provisions: Articles 2.1, 2.2, 2.2.1, 2.2.1.1, 2.2.2, 2.4

DESCRIPTION OF THE PROBLEMS

Issue 1: Definition of “sufficient quantity of sales of the like product in the domestic market for the determination of normal value”

Article 2, footnote 2, of the ADA establishes that when the sales of the like product in the domestic market of the exporting country amount to 5 per cent or more of the sales of the product under consideration to the importing Member, those sales will normally be considered as being made in sufficient quantity for the purpose of determining the normal value.

However, Article 2.2 does not establish a clear basis for what kind of sales should be taken into account when the “sufficient quantity” test is applied.

The ADA also leaves unclear whether the test of “sufficient quantity of sales” should apply to the product as a whole or to categories or models of the product under consideration, in the event that the calculation of the dumping margin requires, for a fair comparison, the definition of such categories or models. The ADA’s lack of clarity on these issues leads to frequent use of improper methods for the calculation of the normal value (exports to a third country or cost of production plus SG&A and profit).

ADA Article 2.2 provides that, 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” or by comparison with constructed value.¹

As discussed herein, the ADA does not currently discipline key elements of authorities’ determinations regarding constructed value and third-country sales. The lack of clear, concise and unambiguous guidance in these areas leads to unpredictability and burdens on respondents.

Issue 2: Sales of the like products in the ordinary course of trade

Articles 2.1 and 2.2 of the ADA effectively permit authorities to exclude from normal value sales of the like product that are not “in the ordinary course of trade.” The ADA, however, does not provide any clear definition of this key term.

Article 2.2.1 provides that sales “may be treated as not being in the ordinary course of trade by reason of price,” and therefore disregarded, when the sales are made below cost. The methodologies to identify sales below cost, however, are ill defined. Some authorities exclude some domestic sales from the calculation of normal value even if the total sales revenue would permit the responding party eventually to recover all of its costs, depending on how “reasonable period of time” is interpreted. The test in Article 2.2.1 thus leads to anomalous determinations of normal value in which only above-cost sales – those sales that have the highest prices – are used to create an arbitrarily high normal value that no ordinary businessperson could expect.

¹ Where domestic sales fail the “sufficient quantity” test, Article 2.2 does not address the circumstances in which authorities shall choose third-country sales as the basis for normal value, and those in which authorities shall choose constructed value. Nor does Article 2.2 address the choice of the “appropriate” third country. These issues will be discussed in future negotiations.

Issue 3: The investigating authorities' discretion to request and use cost data

Article 2.2.1.1 of the ADA provides that production costs shall normally be calculated on the basis of the producer's own accounting records, if these records are in accordance with GAAP of the exporting country. This principle, however, is restricted by the condition that such cost information must reasonably reflect the costs associated with the production and sale of the product under consideration.

Investigating authorities, however, have frequently applied this condition in a manner that requires respondents to reinvent their costs. Indeed, a typical practice appears to be that the authorities require respondents to recalculate their per-unit costs of production based on completely different assumptions from those on which their normal accounting records are based.

Many respondents have been unable to accommodate requests for cost data at a level of detail not used in their normal accounting. The inability to provide such detailed information has frequently resulted in application of adverse facts available, and prohibitively high dumping margins. In other cases, the authorities' cost calculation methodologies increase the cost of production for the product under consideration, which artificially creates or increases dumping margins.

Issue 4: Constructed value

The chapeau of Article 2.2.2 provides that the amounts for administrative, selling and general costs and for profits shall be based on actual data pertaining to production and sales of the like products by the exporter or producer under consideration. It underlines the object and purpose of this Article, which is to base the calculation on actual data of the exporter or producer in question.

However, the existing Article 2.2.2 allows investigating authorities substantial discretion to resort to the three alternative methodologies for calculating constructed value, two of which would involve the use of data that are outside the actual experience and control of the exporter or producer under consideration. Also, owing to the lack of guidance in various aspects of this article, investigating authorities could "construct" arbitrarily high dumping margins to the detriment of exporters and domestic users. Moreover, the ADA's lack of clarity with regard to profits allows authorities to ignore the business reality that firms do, in the ordinary course of their operations, sometimes operate at a loss or no profit. Tighter disciplines in this article would deter abuses and enhance the legitimate trade interests of all parties concerned.

ELEMENTS OF A SOLUTION**Issue 1: Definition of "sufficient quantity of sales of the like product in the domestic market for the determination of normal value"**

Relevant Provisions: Article 2.2 and footnote 2

1-1. Proposal: The "sufficient quantity" test

- Amend footnote 2 to clarify that the sufficient quantity test is conducted for the volume of sales of each respondent, based on all sales, including sales later determined to be outside the ordinary course of trade, for the entire period of the investigation.
- Further clarify the phrase, "sales of the like product destined for consumption in the domestic market," by defining the term "domestic sales" as follows:

Domestic sales are all sales of the like product as a whole by a respondent to domestic purchasers in the exporting country, except sales where objective and concrete evidence demonstrates that the respondent knew at the time of his sale that the product would be exported to another country.

Explanation

The sufficient quantity test is a benchmark or litmus test at the very beginning of investigation. The test enables a respondent to know in advance the kind of data it will be required to submit in the subsequent stages of the investigation.

The ADA should clearly establish that the sufficient quantity test will be applied to sales of the like product as a whole in the domestic market of the exporting country. The test should not be applied only to sales that are made in the ordinary course of trade. The purpose of the sufficient quantity test, or so called “viability test,” is to determine whether the domestic market is sufficiently large to enable domestic sales prices to serve as a legitimate measure of normal value. Markets typically consist of various channels and types of sales, including those that might not qualify as sales in the ordinary course of trade. Thus, all sales, not just those deemed to be in the ordinary course of trade, contribute to the “viability” of the domestic market.

The fact that home market sales are “viable” in terms of quantity does not, by itself, constitute a sufficient condition to use all these sales for the calculation of normal value. The authorities thus should first conduct the test of sufficient quantity with regard to all sales of the like product; then, if domestic market sales quantities are found sufficient, the authorities may examine whether those sales are made in the ordinary course of trade.

Furthermore, the ADA should provide a clear definition of the term “sales of the like product destined for consumption in the domestic market” in footnote 2. If a respondent knew, at the time of sale, that the product sold to domestic purchasers would be exported to another country, such sales should be treated as export sales to that country. Otherwise, the sales to domestic purchasers should be treated as domestic sales even if they are subsequently exported into the investigating country. Such determination of knowledge of a respondent should be based on objective and concrete evidence.

1-2. Proposal: “Particular market situation”

Delete the clause regarding the “particular market situation” from Article 2.2.

Explanation

Article 2.2 states in relevant part: “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. . .” (emphasis added.) The term “particular market situation” is undefined, and might be interpreted to apply to almost any set of circumstances. This creates an uncertain situation for exporters and for authorities. It is impossible for exporters to predict how authorities will interpret and apply this term. Authorities who invoke the term to justify disregarding home market sales could not be certain whether their decision would be upheld in the event of a challenge before the WTO dispute settlement body. Moreover, the term is unnecessary. Our proposal regarding sales of the like product in the ordinary course of trade (issue 2 below) provides an exhaustive list of all situations in which domestic sales of the like product could be disregarded as “outside the ordinary course of trade.” This list obviates the need for Article 2.2’s reference to a “particular market situation.” We therefore propose that the clause be deleted from Article 2.2.

Issue 2: Sales of the like products in the ordinary course of trade

Relevant Provisions: Articles 2.1, 2.2, 2.2.1 and 2.2.2.

2-1. Proposal: Definition of sales of the like product in the ordinary course of trade

- Clarify that sales of the like product “in the ordinary course of trade” means all sales made by a responding party in the exporting country or to a third country; provided that sales falling in any of the following categories shall not be considered to be made in the ordinary course of trade:

sales of samples

sales to employees

barter sales;

sales of the like products to a toller or subcontractor for further-manufacture, upon the condition that the further-manufactured product will be returned to the responding party;

all home market sales of the like product, in the circumstances described in the second proposal below, “Proposal: Sales below cost”; and

certain sales to affiliated parties.²

Explanation

This proposal clarifies that sales by a responding party of the like product are “in the ordinary course of trade,” unless these sales fall into any one of several specifically identified exceptions. These specific exceptions provide clear guidance to all exporters and the investigating authorities whether a sale would be excluded from normal value. Our experience tells us that these exceptions sufficiently cover all sales that in common business understanding would not be “in the ordinary course of trade.”³

2-2. Proposal: Sales below cost

- To clarify that sales at prices that are below costs at the time of sales shall still be in the ordinary course of trade if the aggregate value of sales of the like product, including sales at such prices, is not less than the aggregate cost of production for the period of investigation, amend Article 2.2.1 as follows:

“All sales of the like product for the period of investigation in the domestic market of the exporting country or sales to a third country may be treated as not being in the ordinary course of trade and may be disregarded as a whole from the determination of normal value, only if the aggregate value of all sales of the like product during the period of investigation is less than the aggregate costs of production plus selling costs corresponding to these sales. Otherwise, sales of the like product in the domestic

² Detailed proposals on “Sales to affiliated parties” are presented in document TN/RL/W/146.

³ For the same reason as the calculation of normal value, all of the following categories of sales should be excluded from the calculation of export price: (a) Sales of samples, (b) sales of employees, (c) barter sales, and (d) sales of the like products to a toller or subcontractor for further-manufacture, upon the condition that the further-manufactured product will be returned to the responding party.

market of the exporting country or sales to a third country may not be disregarded by reason of price from the determination of normal value.”

- Delete footnotes 4 and 5.
- Furthermore, add a provision or footnote to clarify that the below-cost test must be performed for all sales of the like product as a whole, and not any sub-group of these sales.
- Further clarify that the authorities shall be permitted to seek from respondent’s information on costs of production for purposes of the below-cost test only if sufficient evidence at the time of initiation of an investigation demonstrates that the respondent made a substantial portion of its sales below cost. A “substantial portion” shall mean that more than [Y] per cent of sales in volume.

Explanation

This proposal clarifies that the investigating authorities must perform the below-cost test with respect to the aggregate costs for all sales of the like product in the exporting country or to a third country. This test reflects the basic principle of the ADA. The objective of an anti-dumping investigation is to determine whether one kind of product, as compared to the like product sold in the domestic market of the exporting country, was dumped, while companies typically do not determine or manage profitability on a transaction-specific basis but rather on a product-line basis. This basic principle tells us that the recovery of the full costs shall be measured with respect to sales of the like product as a whole, and not a part of these sales.

We are also proposing that the current 20 per cent volume test of footnote 5 be repealed. The current Article 2.2.1 provides a multi-pronged test, the two principle elements of which are (1) whether prices allow for the recovery of costs within a “reasonable period of time”; and (2) whether 20 per cent of the volume is sold below cost within an extended period of time. Our experience shows that responding parties recover the full costs of production of all sales even when more than 20 per cent of the total sales in volume within the period of investigation were below cost. Furthermore, the interaction of these criteria has created wide variation of Members’ practice in application of the below-cost test, making the AD regime complicated and less predictable. In addition, a company normally measures its profitability within a certain period of time by the amount of profit as a whole, and not by the volume of profitable sales. These facts and our past experience under the current ADA lead us to conclude that the 20 per cent volume test in Article 2.2.1 is inappropriate.

Finally, to avoid unnecessary cost investigations, the ADA should be amended to require that the authorities may initiate a cost investigation only when the domestic industry has made substantiated claims that responding parties have sold the like product below cost. An anti-dumping investigation imposes heavy burdens on responding parties. Inquiries by the authorities thus must be limited to the extent necessary. Unnecessary inquiries work only to increase the burdens on a responding party.

Issues regarding the calculation of production costs are discussed at issue 3 below.

Issue 3: The investigating authorities' discretion to request and use respondent's data

Relevant Provisions: Articles 2.2.1.1, 2.2.2, and 2.4

3-1. Proposal: Period of data collection and period of investigation

- Clarify that the period for which the investigating authorities may request production and sales data (i.e., sales, sales expenses and costs data) shall be the respondent's fiscal year that most closely corresponds to the period of investigation for which the authorities have requested information to determine normal value and export price. Where the fiscal year does not coincide with the period of investigation for which information to calculate normal value and export price has been requested, such data may be requested for fiscal periods (e.g., semi-annual reporting periods) that more closely correspond to the period for which normal value and export price information has been requested.
- Further clarify that the period of investigation shall be one year.
- Further clarify that, at the respondent's option, the respondent may submit production and sales data regarding an entire cycle of the product under consideration in case of cyclical markets. Should the respondent choose this option, the authorities must use these data to calculate the aggregate cost of production for the like products under the proposal 2-2 above and conduct the below-cost test based on such aggregate cost as well as use such data in case it constructs the normal value.

Explanation

This proposal is intended to reduce the burden on respondents while also ensuring that the most accurate data are provided. It is extremely burdensome for respondents to provide cost information that does not correspond to their fiscal year or other fiscal periods. Reporting information that does not correspond to fiscal periods requires, for example, that the respondents provide adjustments of interim costs that are not normally adjusted until the end of a fiscal period, and that would be made only for the purposes of meeting an authority's request in an investigation or review. Such adjustments made outside of the normal accounting system often do not accurately reflect actual costs.

In order to minimize the burdens on respondents and ensure that the most reliable data are used for determinations by authorities, the information requested should correspond to the fiscal year of the respondent or, in limited instances, with another fiscal period that coincides most closely with the period of investigation for determining normal value and export price.

In cases of cyclical markets, it may be appropriate for the period of data collection to be longer than one year. The rationale for this proposal is that companies often make their decisions about the sales price of the like products in such a way as to recover the total costs over a period that extends beyond the current fiscal year. We therefore suggest that respondents be given the option of demonstrating that they recovered costs over a longer period of time upon the request of the respondent. This does not mean that the authorities can request sales information beyond the period of investigation.

3-2. Proposal: Acceptance of respondent's data in accordance with GAAP

- Clarify that the authorities must accept a respondent's production and sales information, including per-unit costs, for the product under consideration, as maintained in the respondent's accounting system in accordance with GAAP in the exporting country. In this case, a certificate of audit as issued by a certified public accountant or the auditors' letter accompanying the financial statement shall be conclusive evidence that the accounting system is consistent with GAAP in the exporting country. With respect to unaudited respondents, their production and sales information

shall be treated in the same manner as audited companies unless it is demonstrated that the unaudited company's accounts are not consistent with GAAP in the exporting country.

- Further clarify that the authorities may not require a respondent to submit per-unit cost information at a level of specificity for product types different from the level of specificity, which the respondent maintains in its cost accounting system, and may not penalize respondents for failure to do so. However, respondents may, at their option, submit per-unit cost information at a more specific level.

Explanation

The primary objective of this proposal is to prevent investigating authorities from substituting their judgment as to how costs should be maintained, valued or allocated for that of the exporting country's GAAP. A particular concern is the manipulation of a respondent's costs by authorities. Authorities sometimes reject the methods of allocating or valuing certain costs that a respondent maintains in its cost accounting system, and instead use another method preferred by the authorities. As a result, the authorities use calculation methods, which depart from the cost accounting known to and relied upon by the exporter in the normal course of business.

This proposal also seeks to prevent authorities from placing unreasonable burdens on respondents in the guise of requesting detailed information. Authorities' current practice, for example, often requires respondents to create complex cost allocations for an investigation or review, based on product distinctions or methodologies dictated by the authorities, which are not used by the respondent in its normal accounting system. This proposal would put a stop to such burdensome practices. Even with some unaudited companies, such as privately held companies, the fact that such respondents do not have audited financial statements should not permit the authorities to request special information on a basis that would not be permitted if the respondents had audited financial statements.

To balance the burdens and the necessity to conduct a precise investigation, we also propose that it be a respondent's option to submit cost information at a level of specificity more detailed than is maintained in its cost accounting system. A respondent may do so for any purpose – e.g., in support of requests for due allowance for differences in product characteristics, for purposes of responding to a below-cost questionnaire, and for constructed value.

Issue 4: Constructed value

Relevant Provisions: Article 2.2.2

4-1. Proposal: Use of actual data for determining constructed value and alternative methodologies

- Clarify that the methodology as set out under the chapeau of Article 2.2.2 (i.e., actual data pertaining to production and sales of the like product by the exporter or producer under investigation) should be used for determining the amounts for selling costs and profits. When such amounts cannot be determined on this basis, the amounts may be determined only on the basis of the alternative methodology provided for under Article 2.2.2 (i). In addition, to ensure that only actual data pertaining to the production and sales of the exporter or producer concerned will be used, the two alternative methodologies as provided under Articles 2.2.2 (ii) & (iii) should be deleted.
- Further clarify that the term "same general category of products" in Article 2.2.2(i) refers to the narrowest category of products for which data can be obtained from the records kept by the respondent in the ordinary course of business.

- Add a new Article 2.2.2(ii), which would apply when the respondent has no sales of any product in its domestic market. In such a case, the authorities must use the selling costs and profit from the respondent's unconsolidated financial statement. Where the respondent maintains in the ordinary course of business internal financial statements that cover the "same general category of products" as the like product, the authorities should use those internal financial statements.

Explanation

A finding of dumping should require knowledge on the part of the exporter or producer. The knowledge criterion is implicit in GATT Article VI:1, which states that injurious dumping "is to be condemned." This normative judgment about "dumping" would be inappropriate if the exporter were merely an unknowing conduit of market forces. Thus, a finding of dumping based on anything outside the exporter's knowledge – i.e., its actual data and experience – is inappropriate. This is also consistent with the principle that procedural fairness should be enshrined in all WTO agreements, including the Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994. This principle leads to the conclusion that in determining constructed value, the investigating authorities, in all circumstances, should use actual data pertaining to the production and sales of the exporter or producer under investigation. The current ADA already establishes that priority should be given to actual data pertaining to production and sales in the ordinary course of trade of the like product by such exporter or producer. In line with the above-mentioned principle, in a case in which such data cannot be a basis, the primary option in order to make the best approximation of the "reasonable" amount for selling costs and profits should be actual amounts of the such exporter or producer pertaining to the same general category of products. The two alternative methodologies as provided for under the existing Articles 2.2.2 (ii) & (iii) should be deleted as they involve the use of data that are outside the actual knowledge and control of the exporter or producer under investigation.

Due to the lack of precise guidelines, investigating authorities have considerable discretion to define "same general category of products." This high degree of discretion makes it possible for the authorities to define the term in a way that leads to arbitrary constructed values. It is therefore necessary to establish a more precise definition for "same general category of products."

4-2. Proposal: Inclusion of below-cost sales; and the profit for constructed value

Add a provision to clarify that in cases where the aggregate sales value of all sales in the exporting country is less than the aggregate costs for the corresponding sales, the profit applied in constructed value shall be zero.

Explanation

Both GATT Article VI and ADA Article 2.2 require a "reasonable" adjustment to cost of production, selling costs and profits. It is not "reasonable" to add a profit that is contrary to the exporter's actual sales experience. Nor is it reasonable to base profit only on a limited number of sales that are found to be above cost. Although accounting and economic usage distinguish among many formulations of "profit" (gross profit, net profit, operating profit and so forth), we are not aware of any definition of profit that is not based on the aggregate of all sales, both above-cost and below-cost sales, in the determination of profit.

It follows from the above that the calculation of constructed value should reflect domestic market conditions. This includes the business reality that firms sometimes operate at a loss or no profit. For example, during economic recessions companies may show losses for a full fiscal year.

Companies may introduce products that do not achieve the market acceptance that the company had predicted, and therefore are not profitable.

The CV calculation seeks to construct the price at which the product would have been sold, if the respondent sold the product in the domestic market. Since the actual profit level, which is a negative figure in this case, cannot be taken as it is in the calculation of the constructed value,⁴ the authorities have to determine the “reasonable” profit level as an approximation using the best source to base such approximation. Unlike in a situation in which there are no sales in the domestic market of the like product, the authorities still can and should reflect the current domestic market condition that the respondent faces regarding for its sales of the like product, which is the best source as a basis for such approximation. Hence, a zero profit is the best approximation regarding the profit at which the respondent would have sold the product – i.e., the closest amount that is not a “loss.”

This approach is more appropriate as the best source of approximation than, as discussed in proposal 4-1 above, a finding of dumping based on anything outside the exporter's knowledge. Companies normally treat their detailed cost and profit information as highly confidential. Therefore, a respondent will not normally know the profits of its competitors in the domestic market. For this reason, the ADA should not permit authorities to use other producers' profits as CV profit for a respondent.

4-3. Proposal: General and administrative costs

Clarify that "general" and "administrative" costs should not be included in determining constructed value.

Explanation

The ADA creates the room to expand the scope of the elements of constructed value, by adding the terms “general” and “administrative,” beyond what normal business practice takes into account in pricing export products. Specifically, the term “selling” cost refers to expenses that are related to sales, whether directly or indirectly relating to sales of the like product. In contrast, the terms “general” and “administrative” costs have specific and commonly understood meanings in accounting parlance. They are distinct from and not a subset of selling costs. They include general overhead and administrative costs that are not related to expenses for sales of the like product. For example, when a multinational company introduces a product to a foreign country, the company does not normally price its product to cover all of its global “general” and “administrative” costs. The “general” and “administrative” costs thus should be deleted from the ADA to clarify that expenses related only to sales of the like products may be added to the cost of production for the purposes of the below-cost test and the constructed value.

This basic principle is reflected in GATT Article VI. Article VI provides that constructed value shall include “a reasonable addition for selling cost and profit.” However, Article 2.2 of the ADA provides for “a reasonable amount for administrative, selling and general costs and for profits”. It includes two elements - “general” and “administrative” expenses - which do not appear in GATT Article VI.

⁴ Some may argue that negative profits should be a “reasonable” profit within the meaning of GATT Article VI. However, this argument is not consistent with the generally accepted definition of “profit,” which does not include negative figures (normally called a “loss.”)