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COUNTING ONCE, COUNTING TWICE: THE PRECARIOUS STATE OF SUBSIDY REGULATION

WENTONG ZHENG*

Subsidy regulation is in a precarious state. While it has been so ever since the conception of the current subsidy regulation regime, the recent disputes between the United States and China over the “double counting” or “double remedies” of subsidies have threatened the mere functionality of the current regime. This Article argues that the double counting controversy reveals the self-contradictions of the current subsidy regulation regime as to the fundamental question of why subsidies need to be regulated. These self-contradictions make it impossible to devise a coherent solution to the double counting problem within the framework of the current subsidy regulation regime and sharpen the need for fundamental reforms of the current regime. This Article puts forward a reform proposal that will solve the double counting problem and, more importantly, will help restore the intellectual foundation of the current subsidy regulation regime.

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INTRODUCTION

In 1791, in his historic report to the U.S. Congress on the state of manufacturing in the United States, Alexander Hamilton accused Great Britain of subsidizing the exportation of certain products and proposed to impose special duties on those products to countervail the British subsidies.¹ Approximately a century later, in 1890, Congress adopted Hamilton's idea by enacting the first

¹ Among others, Hamilton recommended that Congress raise the import duties on sail cloth to ten percent because a subsidy (or what he called a "bounty") of two pence sterling per ell was allowed in Great Britain. Hamilton also recommended that Congress raise the import duties on certain linen products to seven and one-half percent because Great Britain was giving a bounty of twelve and one-half percent, on average, on the exportation of such products. These linen products included "[d]rillings, osnaburghs, ticklenburghs, dowlas, canvas, brown rolls, bagging, and all other lines the first cost of which at the place of exportation does not exceed 35 cents per yard." See ALEXANDER HAMILTON, REPORT OF THE SECRETARY OF THE TREASURY OF THE UNITED STATES ON THE SUBJECT OF MANUFACTURES, PRESENTED TO THE HOUSE OF REPRESENTATIVES ON DEC. 5, 1791, at 50 (Childs & Swaine 1791).

countervailing duty legislation in the world² to offset subsidies conferred by several continental European countries on the exportation of beet sugar.³

Fast-forwarding another century, since the early 2000s, the United States has been embroiled in a series of high-stakes disputes with China over each other's subsidy practices. Since November 2006, the United States has initiated investigations into Chinese subsidies for thirty-one categories of products, including steel, tires, paper, solar panels and wind towers, and imposed countervailing duties to offset most of them.⁴ In retaliation, China launched investigations into U.S. subsidies for four categories of products: electrical steel, chicken, automobiles, and solar-grade polysilicon, and imposed countervailing duties for three of them.⁵ On September 17, 2012, the United States and China escalated their subsidy disputes by filing a complaint against each other at the World Trade Organization (WTO).⁶

The latest subsidy disputes between the two largest economies in the world are taking place against the backdrop of heightened concerns about jobs and economic growth in the wake of the 2008–2009 global financial crises.⁷ The political significance of the issue was on vivid display when President Barack Obama, on the same day as the United States brought its WTO action against China, told a campaign rally in Ohio that “[the Chinese subsidies] are subsidies that directly harm working men and women on the assembly lines in Ohio and Michigan and across the Midwest.”⁸ Referring to the Chinese subsidies, President Obama

² See 30 CONG. REC. 2203 (1897) (remarks of Sen. Gray) (discussing the Wilson Bill of 1894). This legislation was the first countervailing duty provision in the world although the first general countervailing duty law for any and all subsidized imports would not be enacted until two years later in 1892 by Belgium. See CONG. BUDGET OFFICE, *HOW THE GATT AFFECTS U.S. ANTIDUMPING AND COUNTERVAILING-DUTY POLICY* 22 (1994).

³ These continental European countries were France, Germany, Russia, Holland, and Belgium. See Leo C. Polopolus, *World Sugar Markets and Entangled Government Programs*, in *SUGAR AND RELATED SWEETENER MARKETS: INTERNATIONAL PERSPECTIVES* 1, 7 (A. Schmitz et al. eds., 2002).

⁴ The thirty-one categories of products are coated free sheet paper, circular welded carbon quality steel pipes, light-walled rectangular pipes and tubes, laminated woven sacks, new pneumatic off-the-road tires, raw flexible magnets, lightweight thermal paper, sodium nitrite, circular welded austenitic stainless pressure pipes, circular welded carbon quality steel line pipes, citric acid and certain citrate salts, tow behind lawn groomers, kitchen appliance shelving and racks, oil country tubular goods, prestressed concrete steel wire strand, steel grating, wire decking, narrow woven ribbons with woven selvedge, magnesia carbon bricks, seamless carbon and alloy steel pipes, coated paper for print graphics, potassium phosphate salts, drill pipes, aluminum extrusions, multilayered wood flooring, steel wheels, galvanized steel wires, high pressure steel cylinders, crystalline silicon photovoltaic cells (solar panels), utility scale wind towers, and drawn stainless steel sinks. See Request for Consultations by China, *United States—Countervailing and Anti-Dumping Measures on Certain Products from China*, Apps. A & B, WT/DS449/1 (Sept. 20, 2012). These subsidy investigations were conducted in parallel with antidumping investigations aimed at combating lowly priced imports. See *id.*

⁵ See *U.S. Products Subject to Foreign Antidumping and Countervailing Duty Measures—China*, IMPORT ADMIN., <http://ia.ita.doc.gov/trcs/foreignadcvd/china.html> (last updated May 31, 2013).

⁶ See Jeff Mason & Tom Miles, *U.S. Launches Auto Case Against China, Beijing Fires Back*, REUTERS (Sept. 17, 2012), available at <http://www.reuters.com/article/2012/09/17/us-obama-trade-idUSBRE88G02420120917>.

⁷ The unemployment rate in the United States almost doubled during the so-called “Great Recession,” leaping from 5.0 percent in December 2007 to 9.5 percent in June 2009. U.S. BUREAU OF LABOR STATISTICS, *THE RECESSION OF 2007–2009*, at 2 (2012), available at http://www.bls.gov/spotlight/2012/recession/pdf/recession_bls_spotlight.pdf.

⁸ Mason & Miles, *supra* note 6.

vowed that “[w]e are going to stop it. It is not right, it is against the rules, and we will not let it stand.”⁹

Despite the clear-cut case made for subsidy regulation in the political discourse, the intellectual case for subsidy regulation has been much less clear. From an economic point of view, some subsidies are considered good and some are considered bad.¹⁰ Some subsidies affect the interest of producers in other countries and some do not.¹¹ Indeed, scholars have long debated the proper rationales for subsidy regulation and the extent to which the current subsidy regulation regime reflects those rationales.¹²

The weak intellectual foundation of the current subsidy regulation regime has resurfaced in the current U.S.-China subsidy disputes, to the point of threatening the functionality of the regime. One of the most contentious issues in the U.S.-China subsidy disputes is whether, because of the status of China as a “nonmarket economy,”¹³ the same Chinese subsidies are being counted or remedied not once, but twice, by the United States. Since 2006, in what has become a legal drama full of suspense and intrigue, the U.S. Department of Commerce, the U.S. Court of International Trade, a Dispute Settlement Panel and the Appellate Body of the WTO, the U.S. Court of Appeals for the Federal Circuit, and the U.S. Congress have each weighed in on the so-called “double counting” or “double remedies”

⁹ *Id.*

¹⁰ See *infra* Part VI.B.1.

¹¹ See *infra* Part IV.A.

¹² See Warren F. Schwartz & Eugene W. Harper, *The Regulation of Subsidies Affecting International Trade*, 70 MICH. L. REV. 831 (1972) (advocating a subsidy standard that would limit the use of subsidies only when they distort market and reduce economic efficiency); John J. Barcelo III, *Subsidies and Countervailing Duties—Analysis and a Proposal*, 9 LAW & POL’Y INT’L BUS. 779 (1977) (proposing a subsidy regulation scheme based on free trade and economic efficiency); Warren F. Schwartz, *Zenith Radio Corp. v. United States: Countervailing Duties and the Regulation of International Trade*, 1978 SUP. CT. REV. 297 (1978) (arguing that the imposition of countervailing duties cannot be justified on economy efficiency grounds); Charles J. Goetz, Lloyd Granet & Warren F. Schwartz, *The Meaning of “Subsidy” and “Injury” in the Countervailing Duty Law*, 6 INT’L REV. L & ECON. 17 (1986) (proposing an entitlement rationale for subsidy regulation); Richard Diamond, *Economic Foundations of Countervailing Duty Law*, 29 VA. J. INT’L L. 767, 786 (1989) [hereinafter Diamond, *Economic Foundations*] (refining the entitlement rationale for subsidy regulation and arguing that the proper purpose of subsidy regulation is to insulate domestic producers from the effects of foreign subsidies); Richard Diamond, *A Search for Economic and Financial Principles in the Administration of United States Countervailing Duty Law*, 21 LAW & POL’Y INT’L BUS. 507 (1989) [hereinafter Diamond, *Economic and Financial Principles*] (examining the extent to which U.S. statutes and case law reflect the entitlement rationale for subsidy regulation); Alan O. Sykes, *Countervailing Duty Law: An Economic Perspective*, 89 COLUM. L. REV. 199 (1989) [hereinafter Sykes, *An Economic Perspective*] (rejecting the efficiency justification for countervailing duties and advocating the abolition of countervailing duty law); Alan O. Sykes, *Second-Best Countervailing Duty Policy: A Critique of the Entitlement Approach*, 21 LAW & POL’Y INT’L BUS. 699 (1989) [hereinafter Sykes, *A Critique*] (critiquing the entitlement rationale for subsidy regulation from the perspective of economic efficiency); Wentong Zheng, *The Pitfalls of the (Perfect) Market Benchmark: The Case of Countervailing Duty Law*, 19 MINN. J. INT’L L. 1 (2010) [hereinafter Zheng, *Market Benchmark*] (critiquing the efficiency justification for the use of market benchmarks in countervailing duty law); Alan O. Sykes, *The Questionable Case for Subsidy Regulation: A Comparative Perspective*, 2 J. LEGAL ANALYSIS 473 (2010) [hereinafter Sykes, *Questionable Case*] (critiquing the economic justifications for subsidy regulation under World Trade Organization and European Union laws); Simon Lester, *The Problem of Subsidies as a Means of Protectionism: Lessons from the WTO EC—Aircraft Case*, 12 MELBOURNE J. INT’L L. 1 (2011) (arguing that a possible purpose of international regulation of subsidies is to fight protectionist subsidies).

¹³ For discussions of the designation of the nonmarket economy status, see *infra* Part II.A.

issue.¹⁴ Yet six years into the litigation, a satisfactory solution to the double counting conundrum has eluded the administrative, judicial, legislative, and dispute settlement bodies that have examined the issue. With the dispute heading into new rounds of briefings and rulings both domestically and internationally,¹⁵ a protracted legal battle over the issue appears to be only beginning.

This Article argues that the double counting issue implicates the very core of the current subsidy regulation regime and brings to the forefront long-running debates over the justifications for regulating subsidies.¹⁶ This Article contends that the double counting analyses by both sides of the dispute are misguided, as they are based on a theoretical premise that is both economically false and internally inconsistent. More importantly, this Article demonstrates that the double counting issue reveals the self-contradictions of the current subsidy regulation regime as to the behavioral impact of subsidies and adds urgency to the need for a systemic overhaul of the regime. It is as if engineers had tried all possible means to fix a crack on the walls of a building, only to find that the crack was caused by foundational problems and could not be fixed without tearing down the building altogether. This Article scrutinizes the foundational problems of the current subsidy regulation regime and proposes a blueprint for fundamental reforms of the regime.

The Article proceeds as follows. Part I provides an overview of the current subsidy regulation regime. Part II examines the origin of the double counting controversy. Part III discusses the double counting hypothesis and the different views on double counting on the part of the various bodies involved in the dispute. Part IV demonstrates that the theoretical presumption thought to give rise to the double counting issue—the subsidy pass-through presumption—is wrong from an economic point of view. Part V argues that the current subsidy regulation regime is internally inconsistent as to the behavioral and price impacts of subsidies. Part VI makes the case for fundamental reforms of the current subsidy regulation regime and proposes to replace countervailing duties with a country-specific safeguard. Part VII concludes.

I. THE BASIC FRAMEWORK OF THE CURRENT SUBSIDY REGULATION REGIME

U.S. law has taken an essentially *laissez-faire* approach to subsidies granted by domestic authorities.¹⁷ At the federal level, the U.S. Constitution grants to Congress the power to tax and spend “for the general Welfare of the United States.”¹⁸ This power has been broadly construed to allow Congress to “authorize expenditure of public moneys for public purposes not limited by the direct grant of legislative power found in the Constitution.”¹⁹ As for state subsidies, the Supreme

¹⁴ See *infra* Part III.C.

¹⁵ See *infra* Part III.C.8.

¹⁶ See sources cited in *supra* note 12.

¹⁷ See Sykes, *Questionable Case*, *supra* note 12, at 477–79.

¹⁸ U.S. CONST. art. I, § 8, cl. 1.

¹⁹ *United States v. Butler*, 297 U.S. 1, 66 (1936). In *Butler* the Supreme Court struck down a federal earmarked-tax-and-subsidy scheme, but that was because the Supreme Court believed that Congress in adopting the scheme invaded reserved state powers, not because the Supreme Court

Court has invalidated discriminatory state taxes on out-of-state products on "Dormant Commerce Clause" grounds,²⁰ but has held that state subsidies that do not resemble discriminatory taxes are permissible.²¹

In contrast to the lax regulation of domestic subsidies, the use of subsidies has been subject to stringent disciplines in international trade. The imposition of countervailing duties to offset the effect of foreign subsidies was first authorized in the United States in 1890 for one specific product—beet sugar,²² and was soon made generally available, under the Tariff Act of 1897, for all products that benefited from foreign subsidies aimed at encouraging exports.²³ The Tariff Act of 1922 further expanded the scope of countervailing duties to cover not just foreign export subsidies, but also foreign domestic subsidies, i.e., foreign subsidies aimed at encouraging the domestic production, manufacture, or distribution of merchandise in countries in which the subsidies are granted.²⁴ In 1930, the basic statutory framework of what is known today as countervailing duty law took shape under section 303 of the Tariff Act of 1930.²⁵ These early countervailing duty statutes all used the term "bounty or grant" to refer to subsidies, but left that term undefined.²⁶

In 1947, the imposition of countervailing duties was brought under multilateral discipline upon the entry into force of the General Agreements on Tariffs and Trade (GATT).²⁷ Specifically, under Article VI of GATT 1947, GATT signatory countries are allowed to impose countervailing duties on an imported product, but are not allowed to levy countervailing duties "in excess of an amount equal to the estimated bounty or subsidy determined to have been granted, directly or indirectly, on the manufacture, production or export of such product in the country of origin or exportation . . ." ²⁸ But like the earlier U.S. countervailing duty statutes, GATT 1947 still left the term "bounty or subsidy" undefined.²⁹

The fledgling subsidy regulation regime under GATT 1947 underwent significant changes in the late 1970s when GATT signatory countries negotiated

believed that Congress could not tax and spend for the general welfare. See Ruth Mason, *Federalism and the Taxing Power*, 99 CAL. L. REV. 975, 1000 (2011).

²⁰ See generally JEROME R. HELLERSTEIN & WALTER HELLERSTEIN, *STATE TAXATION* ¶¶ 4.01–26 (3d ed. 1999 & Supp. 2009) (discussing the Supreme Court's decisions under the Dormant Commerce Clause in cases involving state taxation).

²¹ See, e.g., *New Energy Co. of Ind. v. Limbach*, 486 U.S. 269, 278 (1986) ("Direct subsidization of domestic industry does not ordinarily run afoul of [the Commerce Clause]; discriminatory taxation of out-of-state commerce does."). See generally Sykes, *Questionable Case*, *supra* note 12, at 478 (describing the treatment of state subsidies under federal constitutional law); 1 LAURENCE H. TRIBE, *AMERICAN CONSTITUTIONAL LAW* 1093, 1149 (3d ed. 2000) (indicating that direct state subsidies are apparently constitutional).

²² See *supra* notes 2–3 and accompanying text.

²³ See Tariff Act of 1897, ch. 11, § 5, 30 Stat. 151, 205.

²⁴ See Tariff Act of 1922, ch. 356, § 303, 42 Stat. 858, 935. See also S. REP. NO. 67-595, 2d Sess. 250–51 (1922).

²⁵ See Tariff Act of 1930, 19 U.S.C. § 1303 (1982).

²⁶ See Zheng, *Market Benchmark*, *supra* note 12, at 8–9.

²⁷ General Agreement on Tariffs and Trade, Oct. 30, 1947, 61 Stat. A-11, 55 U.N.T.S. 194 [hereinafter GATT 1947].

²⁸ *Id.* art. VI:3. See also J. JACKSON & W. DAVEY, *LEGAL PROBLEMS OF INTERNATIONAL ECONOMIC RELATIONS* 298 (2d ed. 1986).

²⁹ See GARY CLYDE HUFBAUER & JOANNA SHELTON ERB, *SUBSIDIES IN INTERNATIONAL TRADE* 12–13 (1984).

and concluded a Subsidies Code as part of the GATT Tokyo round negotiations.³⁰ The Subsidies Code placed additional limitations on the ability of GATT signatory countries to levy countervailing duties by requiring a demonstration of the “injury” of subsidized imports before countervailing duties could be applied.³¹ The Subsidies Code also took a significant step forward in the direct regulation of subsidies: It prohibited the use of export subsidies for all products other than certain primary products,³² and authorized GATT signatory countries to initiate dispute settlement proceedings against export subsidies before the GATT.³³ Recognizing the social and economic goals that domestic subsidies may promote,³⁴ the Subsidies Code stopped short of placing an outright ban on the use of domestic subsidies as it did in the case of export subsidies.³⁵ It did, however, authorize a GATT signatory country to challenge a domestic subsidy directly before the GATT if the subsidy causes “injury to its domestic industry, nullification or impairment of benefits accruing to it under the General Agreement, or serious prejudice to its interests.”³⁶ But like GATT 1947, the Subsidies Code did not define the term “subsidy,”³⁷ other than providing illustrative examples of both export subsidies³⁸ and domestic subsidies.³⁹

The watershed moment in subsidy regulation came in 1994, when the GATT Uruguay round negotiations led to the establishment of the WTO.⁴⁰ The

³⁰ Agreement on Interpretation and Application of Articles VI, XVI, and XVIII of the General Agreement on Tariffs and Trade, Apr. 12, 1979, 1186 U.N.T.S. 204 [hereinafter Subsidies Code].

³¹ *Id.* art. 4.4.

³² *Id.* art. 9.1.

³³ See *id.* art. 12.1 (providing that GATT signatory countries may request consultations with other signatory countries that grant or maintain export subsidies); *id.* art. 13.1 (providing that GATT signatory countries may refer disputes over export subsidies to the GATT Committee on Subsidies and Countervailing Measures if a mutually acceptable solution has not been reached within thirty days of a request for consultations); *id.* art. 13.3 (providing that the GATT Committee on Subsidies and Countervailing Measures shall review, upon request, a dispute over subsidies in accordance with the GATT dispute settlement procedures if it is not resolved as a result of consultations or conciliations).

³⁴ See *id.* art. 11.1. Note that the Subsidies Code did not use the term “domestic subsidies”; instead, it referred to “subsidies other than export subsidies.” See *id.*

³⁵ The Subsidies Code only urged GATT signatories to “seek” to avoid causing adverse effects to trading partners when using domestic subsidies. See *id.* art. 11.2.

³⁶ *Id.* art. 12.3. (providing that GATT signatory countries may request consultations with other signatory countries that grant or maintain domestic subsidies); see also *id.* art. 13.2 (providing that GATT signatory countries may refer to the GATT Committee on Subsidies and Countervailing Measures disputes over domestic subsidies if a mutually acceptable solution has not been reached within sixty days of a request for consultations); *id.* art. 13.3 (providing that the GATT Committee on Subsidies and Countervailing Measures shall review, upon request, a dispute over subsidies in accordance with the GATT dispute settlement procedures if it is not resolved as a result of consultations or conciliations).

³⁷ See Zheng, *Market Benchmark*, *supra* note 12, at 9–10.

³⁸ See Subsidies Code, *supra* note 30, Annex: Illustrative List of Export Subsidies. For examples of domestic subsidies, see *id.* arts. 11.1, 11.3.

³⁹ *Id.* art. 11(3). The examples of domestic subsidies listed in Article 11(3) of the Subsidies Code include government financing of commercial enterprises, including grants, loans or guarantees; government provision or government financed provision of utility, supply distribution and other operational or support services or facilities; government financing of research and development programs; fiscal incentives; and government subscription to, or provision of, equity capital. *Id.*

⁴⁰ See Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations, Apr. 15, 1994, 33 I.L.M. 1125 (1994).

WTO Agreement on Subsidies and Countervailing Measures (SCM Agreement),⁴¹ one of the agreements concluded upon the establishment of the WTO, laid out the framework of the current multilateral subsidy regulation regime. One of the most significant developments under the SCM Agreement is that it provides, for the first time, a definition of the term “subsidy.”⁴² Under the SCM Agreement, a subsidy exists if three criteria are met: First, there is a “financial contribution” by a government or public body;⁴³ second, a benefit is thereby conferred;⁴⁴ and third, the subsidy is “specific to an enterprise or industry or a group of enterprises or industries.”⁴⁵

As for the mechanisms for subsidy regulation, the SCM Agreement inherited the Subsidies Code’s two-pronged approach. The first prong allows WTO members to levy countervailing duties on subsidized imports, subject to restrictions imposed by the SCM Agreement.⁴⁶ As in the case of the Subsidies Code, the SCM Agreement requires a demonstration of “injury” before countervailing duties could be applied.⁴⁷ This prong, which relies on the unilateral imposition of countervailing duties, will be referred to as the “unilateral prong” or the “countervailing duty prong” in this Article. The second prong of the subsidy regulation regime under the SCM Agreement is the direct regulation of certain subsidies. In this regard, the SCM Agreement distinguishes export subsidies, which are subject to an outright ban,⁴⁸ from domestic subsidies, which are impermissible only if they cause “adverse effects” to the interests of other WTO members through “injury to the domestic industry of another [WTO] Member, nullification or impairment of benefits accruing directly or indirectly to other [WTO] members under GATT 1994 . . . , [or] serious prejudice to the interests of another [WTO] member.”⁴⁹ For both export and domestic subsidies, the SCM Agreement authorizes WTO members to initiate dispute settlement proceedings before the WTO Dispute Settlement Body.⁵⁰ This prong will be referred to in this Article as the “multilateral prong” or the “WTO prong.”

⁴¹ Agreement on Subsidies and Countervailing Measures, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1A, 33 I.L.M. 1125 (1994) [hereinafter SCM Agreement].

⁴² PETROS C. MAVROIDIS, *TRADE IN GOODS* 532 (2d ed. 2012).

⁴³ SCM Agreement art. 1.1(a)(1).

⁴⁴ *Id.* art. 1.1(b).

⁴⁵ *Id.* art. 2.1.

⁴⁶ *See id.* pt. V.

⁴⁷ *See id.* art. 15. The term “injury” under the SCM Agreement means “material injury to a domestic industry, threat of material injury to a domestic industry or material retardation of the establishment of such an industry.” *Id.* art. 15 n.45.

⁴⁸ *See id.* art. 3.1(a).

⁴⁹ *Id.* art. 5.

⁵⁰ *See id.* art. 4 (providing for dispute settlement procedures for disputes regarding export subsidies); *id.* art. 7 (providing for dispute settlement procedures for disputes regarding actionable subsidies).

II. GENESIS: THE CONCURRENT APPLICATION OF ANTIDUMPING AND COUNTERVAILING DUTY LAWS TO NONMARKET ECONOMIES

To understand what the double counting issue is and why it reveals the fundamental vulnerabilities of the current subsidy regulation regime, a discussion of the developments leading up to the emergence of the issue is in order. As this Article will explain, the root cause of the double counting controversy can be traced back to the concurrent application of antidumping and countervailing duties to imports from the so-called “nonmarket economies.”

A. Nonmarket Economies

Under U.S. law, a nonmarket economy (NME)⁵¹ is defined as “any foreign country that the administering authority determines 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 the merchandise.”⁵² U.S. law authorizes the U.S. Department of Commerce (DOC) to conduct NME determinations.⁵³ U.S. law requires consideration of several factors in determining whether a country should be designated as an NME, including the convertibility of currency, the determination of wages by free bargaining, government restrictions on foreign investment, government ownership or control of the means of production, and government control over the allocation of resources and over the price and output decisions of the enterprises.⁵⁴ Once a country is designated as an NME, that designation remains in effect until revoked by the DOC.⁵⁵

B. Antidumping Duties and NMEs

The question of how the United States should handle cheap imports from NMEs was first addressed under antidumping law. By way of background, U.S. antidumping law subjects imports from foreign countries to potential antidumping duties if they are being sold or are likely to be sold in the United States at less than their “fair value”⁵⁶ and if they cause or threaten to cause material injury to a domestic industry or materially retard the establishment of a domestic industry.⁵⁷ In determining whether imports are being sold or are likely to be sold at less than their

⁵¹ The U.S. government, in various contexts, has used several terms to refer to nonmarket economies. These terms include “nonmarket economies,” “state controlled economies,” and “countries dominated or controlled by communism.” See William P. Alford, *When is China Paraguay? An Examination of the Application of the Antidumping and Countervailing Duty Laws of the United States to China and Other “Nonmarket Economy” Nations*, 61 S. CAL. L. REV. 79, 80 n.9 (1987).

⁵² 19 U.S.C. § 1677(18)(A)(2011).

⁵³ *Id.* § 1677(1) (defining “administering authority” as “the Secretary of Commerce, or any other officer of the United States to whom the responsibility for carrying out the duties of the administering authority under [the countervailing and antidumping duty statutes] are transferred by law”).

⁵⁴ *Id.* § 1677(18)(B). In addition to these factors, the Tariff Act of 1930 also authorizes the consideration of “other factors as the administering authority considers appropriate.” *Id.*

⁵⁵ *Id.* § 1677(18)(C)(i).

⁵⁶ *Id.* § 1673(1).

⁵⁷ *Id.* § 1673(2).

fair value, the DOC, the agency charged with antidumping determinations,⁵⁸ makes a “fair comparison” between the prices at which imports are sold in the United States and their “normal value.”⁵⁹ In cases involving imports from market economies, the “normal value” of imported merchandise is the sale price of the foreign like product in the exporting country or in third countries,⁶⁰ or the “constructed value” of the imported merchandise defined as the sum of the costs, expenses, and profits in producing the imported merchandise.⁶¹

For imports from NMEs, however, U.S. antidumping law uses prices from third countries instead of prices from NMEs to determine normal value. Codifying DOC practices in the 1960s in antidumping cases concerning imports from certain Eastern European countries, the Trade Act of 1974 enacted a special surrogate country method for determining the “normal value” (or “foreign market value,” the statutory term then used for “normal value”) of imports from NMEs.⁶² Under the Trade Act of 1974, the DOC was authorized to substitute either the prices of the same or similar merchandise sold in a “non-state-controlled economy” or the constructed value of the same or similar merchandise in a non-state-controlled economy for the home or third-country market price of the NME merchandise.⁶³ The rationale for the surrogate country method, as stated in the legislative history of the Trade Act of 1974, was that in state-controlled economies, “the supply and demand forces do not operate to produce prices, either in the home market or in third countries, which can be relied upon for comparison.”⁶⁴ The 1988 Omnibus Trade and Competitiveness Act modified the surrogate country method, requiring the foreign market value of NME merchandise to be calculated solely on the basis of the value in a surrogate market economy of the factors of production utilized in producing the merchandise, plus expenses and profits.⁶⁵ Those factors of production include, but are not limited to, labor, raw materials, energy and other utilities, and capital.⁶⁶

C. *The Applicability of U.S. Countervailing Duty Law to NMEs*

While providing a special methodology for imports from NMEs under the antidumping law, Congress did not enact any special legislation on the application of the countervailing duty law to NMEs. In the early 1980s, domestic industries in the United States began petitioning for the imposition of countervailing duties on

⁵⁸ The Trade Agreements Act of 1979 transferred the responsibility for administering antidumping and countervailing duty laws from the Treasury Department to the Department of Commerce. See Pietro S. Nivola, *Trade Policy: Refereeing the Playing Field*, in A QUESTION OF BALANCE: THE PRESIDENT, THE CONGRESS, AND FOREIGN POLICY 201, 230 (Thomas E. Mann ed., 1990).

⁵⁹ 19 U.S.C. § 1677b(a) (2011).

⁶⁰ *Id.* § 1677b(a)(1).

⁶¹ *Id.* § 1677b(a)(4), (e).

⁶² See Comment, *Dumping by State-Controlled-Economy Countries: The Polish Golf Cart Case and the New Treasury Regulations*, 128 U. PA. L. REV. 217, 223–24 (1979).

⁶³ Trade Act of 1974, Pub. L. No. 93-618, tit. III, § 321(d), 88 Stat. 1978, 2046–48 (1975) (codified as 19 U.S.C. § 1677(b)(c)(1982)).

⁶⁴ S. Rep. No. 93-1298 § 174 (1974), reprinted in 1974 U.S.C.C.A.N. 7186, 7311.

⁶⁵ 19 U.S.C. § 1677(b)(c)(1) (1988).

⁶⁶ *Id.* § 1677(b)(c)(3).

imports from NMEs.⁶⁷ The DOC, the agency also charged with countervailing duty determinations,⁶⁸ blocked these initial efforts. In a decision issued in the first batch of countervailing duty investigations on NME imports, the DOC determined that the countervailing duty law did not apply to NMEs because bounties or grants—the statutory terms then used for subsidies—could not be identified in such economies.⁶⁹ In the course of making this determination, the DOC defined a subsidy as “any action that distorts or subverts the market process and results in a misallocation of resources, encouraging inefficient production and lessening world wealth.”⁷⁰ Because allocation of resources is achieved in an NME by central planning, not by supply and demand, there is “no market process to distort or subvert” in such economy.⁷¹ This distinction led the DOC to conclude that “subsidies have no meaning outside of the context of a market economy.”⁷²

In a landmark opinion, *Georgetown Steel Corp. v. United States*,⁷³ the U.S. Court of Appeals for the Federal Circuit affirmed the DOC’s refusal to apply the countervailing duty law to imports from NMEs. According to the court, there was a fundamental difference between the nature of a subsidy in a market economy and the nature of economic incentives provided by the state to exporting entities in an NME. Since the state controlled the pricing decisions of the exporting entities in an NME, “unlike the situation in a competitive market economy, the economic incentives the state provided to the exporting entities did not enable those entities to make sales to the United States that they otherwise might not have made.”⁷⁴ The governments of NMEs, therefore, could not provide exporters with the kind of bounty or grant for which Congress prescribed the imposition of countervailing duties.⁷⁵

Despite the Federal Circuit’s opinion in *Georgetown Steel*, petitioners continued their efforts to reverse the DOC’s policy of not applying the countervailing duty law to imports from NMEs. In November 2006, petitioners filed a request for countervailing duty investigation on imports of coated free sheet

⁶⁷ In 1983, the DOC initiated the first countervailing duty investigation against imports from a nonmarket economy in a case involving textiles and apparel products from China. See Textiles, Apparel, and Related Products from the People’s Republic of China, 48 Fed. Reg. 46,600 (Dep’t of Commerce Oct. 13, 1983) (initiation of countervailing duty investigation). The petitioners in that case later withdrew their petition. See Industry, Commerce Agree to Delay Decision on Chinese Textiles CVD Case, 9 U.S. Import Weekly (BNA) No. 10, at 373 (Dec. 7, 1983). In the same year, the DOC initiated countervailing duty investigations against certain steel products from Poland and Czechoslovakia. See Carbon Steel Wire Rod from Poland, 48 Fed. Reg. 56,419 (Dep’t of Commerce Dec. 21, 1983) (initiation of countervailing duty investigation); Carbon Steel Wire Rod from Czechoslovakia, 48 Fed. Reg. 56,419 (Dep’t of Commerce Dec. 21, 1983) (initiation of countervailing duty investigation).

⁶⁸ See *supra* note 58 and accompanying text.

⁶⁹ Carbon Steel Wire Rod from Poland, 49 Fed. Reg. 19,374, 19,374 (Dep’t of Commerce May 7, 1984) (final negative countervailing duty determination) [hereinafter *Carbon Steel Wire Rod from Poland*].

⁷⁰ *Id.* at 19,375.

⁷¹ *Id.*

⁷² *Id.*

⁷³ 801 F.2d 1308 (Fed. Cir. 1986).

⁷⁴ *Id.* at 1315–16.

⁷⁵ *Id.* at 1316.

(CFS) paper from China.⁷⁶ In March 2007, the DOC published a memorandum discussing whether the analytical elements of the Federal Circuit's *Georgetown Steel* opinion are still applicable to China's present-day economy.⁷⁷ The DOC pointed out in the memorandum, referred to as the *Georgetown Steel Memo* below, that China's economy today is "significantly different" from the "Soviet-style" economies of the early 1980s that were at issue in *Georgetown Steel*.⁷⁸ The DOC noted that unlike the Soviet-style economies, China's economy today shares many of the characteristics of a market economy.⁷⁹ It is now possible, therefore, to determine whether the Chinese government "has bestowed a benefit upon a Chinese producer (i.e., the subsidy can be identified and measured) and whether any such benefit is specific."⁸⁰ Following its analyses set out in the *Georgetown Steel Memo*, the DOC determined that the Chinese CFS paper producers were subsidized by the Chinese government within the meaning of the countervailing duty law.⁸¹

While stating that market forces in China are sufficiently developed to permit the identification and measurement of subsidies, the DOC also held that "market forces in China are not yet sufficiently developed to permit the use of prices and costs in that country for the Department's dumping analysis."⁸² As a result, the DOC still designates China as an NME for antidumping purposes and still employs its NME methodology for determining normal value in antidumping proceedings involving imports from China.⁸³

⁷⁶ See Coated Free Sheet Paper from the People's Republic of China, Indonesia and the Republic of Korea, 71 Fed. Reg. 68,546 (Dep't of Commerce Nov. 27, 2006) (initiation of countervailing duty investigations).

⁷⁷ See Memorandum from Shauna Lee-Alaia & Lawrence Norton, Office of Policy, Import Admin., to David M. Spooner, Asst. Sec'y, Import Admin., Countervailing Duty Investigation of Coated Free Sheet Paper from the People's Republic of China—Whether the Analytical Elements of the *Georgetown Steel* Opinion are Applicable to China's Present-Day Economy (Mar. 29, 2007) [hereafter *Georgetown Steel Memo*].

⁷⁸ *Id.* at 4.

⁷⁹ In support of this finding the DOC stated:

[P]rivate industry now dominates many sectors of the Chinese economy, and entrepreneurship is flourishing. Foreign trading rights have been given to over 200,000 firms. Many business entities in present-day China are generally free to direct most aspects of their operations, and to respond to (albeit limited) market forces. The role of central planners is vastly smaller.

Id. at 10.

⁸⁰ *Id.*

⁸¹ See Coated Free Sheet Paper from the People's Republic of China: Final Affirmative Countervailing Duty Determination, 72 Fed. Reg. 60,645 (Dep't of Commerce Oct. 25, 2007). However, the countervailing duty investigation in the CFS paper case did not lead to the imposition of countervailing duties because the International Trade Commission made a negative final determination as to injury. See U.S. INT'L TRADE COMM'N, PUBLICATION 3695, COATED FREE-SHEET PAPER FROM CHINA, INDONESIA, AND KOREA (FINAL) (Dec. 2007).

⁸² SHAUNA LEE-ALAIA ET AL., IMP. ADMIN., ANTIDUMPING DUTY INVESTIGATION OF CERTAIN LINED PAPER PRODUCTS FROM THE PEOPLE'S REPUBLIC OF CHINA ("CHINA")—CHINA'S STATUS AS A NON-MARKET ECONOMY ("NME") 4 (2006), available at <http://ia.ita.doc.gov/download/prc-nme-status/prc-lined-paper-memo-08302006.pdf>.

⁸³ See *id.*

III. DOUBLE COUNTING: A COMPLEX LEGAL LANDSCAPE

The U.S. decision to apply the countervailing duty law in conjunction with the antidumping law to imports from China “opened the Pandora’s box” in world trade.⁸⁴ Since the CFS paper case, the DOC initiated concurrent antidumping and countervailing duty investigations concerning thirty Chinese products and made positive antidumping and countervailing duty determinations for most of them.⁸⁵

One legal issue that has proven particularly enigmatic is the potential double counting or double remedies of subsidies when imports are simultaneously subject to countervailing duties and antidumping duties calculated using an NME surrogate country methodology. As this Article will discuss, the current subsidy regulation regime provides scant guidance on how to analyze the double counting issue, and the administrative, judicial, legislative, and dispute settlement bodies involved in the dispute have offered conflicting views on the issue.

A. The Double Counting Hypothesis

Although there are divergent views as to whether subsidies are indeed being double-counted in concurrent NME antidumping and countervailing duty cases, there appears to be a consensus on why the double counting of subsidies in such cases might occur. According to what could be referred to as the “double counting hypothesis,” a subsidy will be counted twice when the DOC imposes countervailing duties to offset the subsidy, and then compares a subsidy-free normal value derived from a surrogate country with the subsidized export price to calculate the amount of antidumping duties. Figure 1 below illustrates the potential double counting of subsidies in such scenario.

In Figure 1, N represents the normal value of the merchandise subject to concurrent antidumping and countervailing duty investigations. P is the export price of the merchandise. The dumping margin for the merchandise, therefore, is $a = N - P$. Now the government of the exporting country confers a subsidy in the amount of s on the merchandise. According to the double counting hypothesis, the exporter will reduce the export price *pro rata* as a result of the subsidy. For the sake of simplicity, suppose that the export price decreases by the same amount as the subsidy, s , from P to P' . In market economy cases, the decrease in the export price will not lead to a corresponding increase in the dumping margin, because the normal value of the merchandise will also decrease by s , from N to N' . That is because the normal value in market economy cases is based on the actual prices or costs prevailing in the exporting country,⁸⁶ and those prices and costs will decrease by the same amount as the amount of the subsidy. After the conferral of the subsidy, the dumping margin in market economy cases is $b = N' - P'$, which is the same as a , the dumping margin before the conferral of the subsidy.

In NME cases, however, the decrease in the export price of the merchandise presumably leads to a corresponding increase in the dumping margin,

⁸⁴ Dukgeun Ahn & Jieun Lee, *Countervailing Duty Against China: Opening a Pandora’s Box in the WTO System?*, 14 J. INT’L ECON. L. 1, 18 (2011).

⁸⁵ See *supra* note 4 and accompanying text.

⁸⁶ See *supra* notes 60–61 and accompanying text.

as the normal value in NME cases is based on unsubsidized prices or costs from a surrogate country and will not decrease as a result of the subsidy. In NME cases, the dumping margin after the conferral of the subsidy will be $c = N - P'$, which is the sum of a , the dumping margin before the conferral of the subsidy, and s , the amount of the subsidy. If the importing country imposes countervailing duties in the amount of s in addition to antidumping duties in the amount of c , the subsidy will be counted twice, as the amount of antidumping duties already includes the amount of the subsidy.

Figure 1. The Double Counting Hypothesis

B. The Scant Legal Framework Regarding Double Counting

Despite the potential for the double counting of subsidies in concurrent NME antidumping and countervailing duty cases, the current subsidy regulation regime provides scant guidance as to how to approach this issue. Article VI:5 of GATT 1994, the only WTO rule directly on point, provides that “[n]o product of the territory of any contracting party imported into the territory of any other contracting party shall be subject to both anti-dumping and countervailing duties to compensate for the same situation of dumping or export subsidization.”⁸⁷ This requirement, however, only applies to export subsidies, i.e., subsidies contingent on export performance.⁸⁸ GATT 1994 and other WTO agreements do not specifically

⁸⁷ See General Agreement on Tariffs and Trade 1994, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1A, 33 I.L.M. 1153 (1994) [hereinafter GATT 1994], art. VI:5.

⁸⁸ GATT 1994 does not define the term “export subsidy.” The SCM Agreement, however, uses the phrase “subsidies contingent . . . upon export performance” to refer to export subsidies. See SCM Agreement, *supra* note 41, art. 3.1(a). Consistent with the SCM Agreement, U.S. countervailing duty law defines an export subsidy as “a subsidy that is, in law or in fact, contingent upon export performance, alone or as 1 of 2 or more conditions.” 19 U.S.C. § 1677(5A)(B) (2011).

address the question of whether and how double counting should be accounted for in scenarios involving domestic subsidies.⁸⁹

Consistent with the GATT's prohibition on the double counting of export subsidies, U.S. antidumping law requires the DOC to adjust the amount of antidumping duties when countervailing duties are applied simultaneously to offset an export subsidy on the same merchandise.⁹⁰ But like GATT 1994, U.S. antidumping law is silent on the handling of the double counting of domestic subsidies, in both market economy and NME cases. In cases involving market economies, the DOC's standard practice is not to make adjustments to the U.S. price for domestic subsidies, on the theory that in such cases, "[d]omestic subsidies presumably lower the price of the subject merchandise both in the home and the U.S. markets, and therefore have no effect on the measurement of any dumping that might also occur."⁹¹ But prior to the application of the countervailing law to China, the DOC had not had the occasion to address the question of whether the U.S. price should be adjusted to avoid double counting domestic subsidies in NME cases.

C. Different Views on Double Counting

The lack of specific rules on the double counting issue under relevant WTO agreements and U.S. statutes leaves a legal void as to whether and how double counting should be accounted for in NME cases. Since the inception of the current round of subsidy disputes, various administrative, judicial, legislative, and dispute settlement bodies have ventured to provide their own views of the issue. This Article outlines these views below.

1. The Department of Commerce

In the CFS paper case⁹² and a number of subsequent parallel antidumping and countervailing duty cases concerning imports from China,⁹³ the government of China argued that double counting will always be a possibility whenever a product is simultaneously subject to countervailing duties and antidumping duties calculated using the DOC's NME methodology.⁹⁴ The Chinese government's argument

⁸⁹ Neither GATT 1994 nor the SCM Agreement provides a definition of domestic subsidies. U.S. countervailing duty law, however, defines a domestic subsidy as "a specific subsidy [other than an export subsidy or import substitution subsidy], in law or in fact, to an enterprise or industry within the jurisdiction of the authority providing the subsidy." 19 U.S.C. § 1677(5A)(D)(2011).

⁹⁰ *See id.* § 1677a(c)(1)(C).

⁹¹ *Low Enriched Uranium from France*, 69 Fed. Reg. 46,501, 46,506 (Dep't of Commerce Aug. 3, 2004) (notice of final results of antidumping duty administrative review).

⁹² *See supra* Part II.C.3.

⁹³ *See supra* note 4 and accompanying text.

⁹⁴ STEPHEN J. CLAEYS, IMP. ADMIN., ISSUES AND DECISION MEMORANDUM FOR THE FINAL DETERMINATION IN THE LESS-THAN-FAIR-VALUE INVESTIGATION OF COATED FREE SHEET PAPER FROM THE PEOPLE'S REPUBLIC OF CHINA (PRC) 11 (2007) [hereinafter CFS PAPER AD I&D MEMO], available at <http://ia.ita.doc.gov/frn/summary/prc/E7-21041-1.pdf>. Although the CFS paper case did not result in the imposition of antidumping and countervailing duties due to the negative final injury determination by the ITC, all of the subsequent parallel antidumping and countervailing duty investigations concerning imports from China refer to the analyses of the double counting issue in the CFS paper case. *See, e.g.*, STEPHEN J. CLAEYS, IMP. ADMIN., ISSUES AND DECISION MEMORANDUM FOR THE FINAL DETERMINATION OF SALES AT LESS THAN FAIR VALUE IN CIRCULAR WELDED

echoed the double counting hypothesis illustrated in Figure 1 above: When a non-subsidized surrogate value is used for normal value, double counting will arise because, while the U.S. price is reduced due to the cost savings from the subsidy, the effect of the subsidy will not be reflected in the normal value.⁹⁵ The Chinese government argued that U.S. antidumping law implicitly embodies the presumption that subsidies automatically “pass through” to export prices, as seen from the statutory provision requiring adjustments to the U.S. price for export subsidies and the DOC’s practice of not granting adjustments for domestic subsidies in market economy cases.⁹⁶ This subsidy pass-through presumption, the Chinese government argued, requires the DOC to adjust the U.S. prices for domestic subsidies in NME cases because domestic subsidies automatically pass through to export prices but do not reduce normal values.⁹⁷ Furthermore, the Chinese government argued that the presumption that domestic subsidies lower export prices is the whole basis of imposing countervailing duties on such subsidies.⁹⁸

The DOC rejected all of the Chinese government’s key arguments. Citing the “typically direct connection between export subsidies and exports,” the DOC agreed with the Chinese government that the statutory requirement for adjustments to antidumping duties for export subsidies rests on the presumption that export subsidies automatically lower export prices, *pro rata*.⁹⁹ The DOC, however, dismissed as “speculative” the proposition that domestic subsidies automatically lower export prices.¹⁰⁰ Rejecting the Chinese government’s argument that the presumption that domestic subsidies lower prices is the whole basis for imposing countervailing duties on such subsidies, the DOC argued that “[w]hile subsidies unquestionably benefit their recipients, it is by no means certain that those recipients automatically respond to subsidies by lowering their prices, *pro rata*, as opposed to investing in capital improvements, retiring debt, or any number of other uses.”¹⁰¹ Nor did the DOC find any indication in the statute or legislative history that Congress harbored any presumption about the effect of domestic subsidies on export prices.¹⁰² Finally, the DOC denied the Chinese government’s assertion that it had previously assumed that domestic subsidies fully pass through to home-market and export prices. According to the DOC, a more accurate description of its practice is that the DOC had “sometimes presumed that, whatever the effect, if any, of domestic subsidies upon the prices subsequently charged by their recipients, that effect would be the same for domestic prices and export prices.”¹⁰³ Since the presumption of a subsidy pass-through was the only basis on which the Chinese government requested duty adjustments to avoid double counting, the DOC denied the request.¹⁰⁴

CARBON QUALITY STEEL PIPE FROM THE PEOPLE’S REPUBLIC OF CHINA 19–22 (2008), *available at* <http://ia.ita.doc.gov/ftn/summary/prc/E8-12606-1.pdf>.

⁹⁵ See CFS PAPER AD I&D MEMO, *supra* note 94, at 10.

⁹⁶ See *id.* at 11.

⁹⁷ *Id.*

⁹⁸ See *id.* at 14.

⁹⁹ *Id.*

¹⁰⁰ *Id.*

¹⁰¹ *Id.*

¹⁰² See *id.*

¹⁰³ *Id.* at 15.

¹⁰⁴ See *id.*

2. The Court of International Trade

In September 2008, in the opening salvo of a protracted legal battle, a Chinese respondent in one of the concurrent antidumping and countervailing duty investigations initiated subsequent to the CFS paper case brought a lawsuit before the U.S. Court of International Trade (CIT), challenging the DOC's antidumping and countervailing duty determinations in that case. In September 2009, the CIT issued its opinion in *GPX International Tire Corp. v. United States (GPX I)*,¹⁰⁵ in which it rejected the DOC's double counting analyses in the agency proceedings below.

Before turning to the double counting issue, the CIT first examined whether it was lawful for the DOC to apply the countervailing duty law to China in the first place. Noting the ambiguity of both the Federal Circuit's *Georgetown Steel* ruling and the countervailing duty law itself as to the applicability of the countervailing duty law to NMEs,¹⁰⁶ the CIT stated that it "cannot say from the statutory language alone that Commerce does not have the authority to impose [countervailing duties] on products from an NME-designated country."¹⁰⁷

After concluding that the DOC may have the authority to apply the countervailing duty law to NMEs, the CIT went on to hold that the DOC's interpretation and methodologies as to the concurrent application of antidumping and countervailing duties to imports from China were nonetheless "unreasonable."¹⁰⁸ The CIT agreed with the double counting hypothesis illustrated in Figure 1 above, stating that comparing the subsidized export price with the unsubsidized constructed normal value in calculating antidumping duties "could very well result in a double remedy."¹⁰⁹

If there is substantial potential for the double counting of subsidies, as the CIT held there is in the concurrent application of NME antidumping and countervailing duties to imports from China,¹¹⁰ the issue then becomes, according to the CIT, an issue about the allocation of the burden of proof. The CIT held that it was unreasonable for the DOC to require respondents to submit specific evidence to demonstrate the existence of double counting,¹¹¹ because "there is likely no way for any respondent to accurately prove what may very well be occurring."¹¹² The CIT held that "if it is too difficult for Commerce to determine whether, and to what degree double counting is occurring, Commerce should refrain from imposing

¹⁰⁵ *GPX Int'l Tire Corp. v. United States*, 645 F. Supp. 2d 1231 (Ct. Int'l Trade 2009) [hereinafter *GPX I*].

¹⁰⁶ See *id.* at 1237–39.

¹⁰⁷ *Id.* at 1239.

¹⁰⁸ *Id.* at 1240. The CIT's approach is based on the *Chevron* doctrine, which requires a court to "defer to the agency's interpretation of its own statute as long as that interpretation is reasonable." *Id.* (citing *Koyo Seiko Co. v. United States*, 36 F.3d 1565, 1573 (Fed. Cir. 1994)).

¹⁰⁹ *Id.* at 1242.

¹¹⁰ In support of this holding, the CIT cited a report by the Government Accountability Office that arrived at the same conclusion. See *id.* at 1243 n.11.

¹¹¹ *Id.* at 1243.

¹¹² *Id.* The CIT believed that the difficulty of demonstrating the effect of subsidies on price is recognized by the countervailing duty law, which does not require the measurement of the price effect in the calculation of countervailing duties. *Id.*

[countervailing duties] on NME goods until it is prepared to address this problem through improved methodologies or new statutory tools.”¹¹³

The CIT remanded the case for the DOC to either forego the imposition of countervailing duties on the merchandise at issue or adopt additional policies and procedures to adapt its NME antidumping and countervailing methodologies to account for the double counting issue.¹¹⁴ In its remand determination, the DOC followed the latter route. It considered itself to have only three options left regarding the parallel application of countervailing duties and NME antidumping duties: (1) not to apply the countervailing duty law to the subject merchandise; (2) apply the market economy antidumping methodology to the subject merchandise; or (3) offset the countervailing duties against the NME antidumping cash deposit rate.¹¹⁵ The DOC chose the third option, reasoning that it was the “least objectionable” one.¹¹⁶

Respondents challenged the DOC’s remand determination before the CIT again. In August 2010, the CIT rejected the DOC’s double counting analyses in its remand determination. In *GPX International Corp. v. United States (GPX II)*, the CIT noted that with the DOC’s offset, the combination of the countervailing duty margin and the NME antidumping cash deposit rate “will always equal the unaltered NME AD margin,” making the countervailing duty investigation superfluous.¹¹⁷ The CIT agreed with the respondents that it is not reasonable to force them to spend time and resources to go through a countervailing duty investigation, and then to eliminate the countervailing duty margin because it has been offset by the parallel antidumping margin.¹¹⁸ The CIT further held that besides being unreasonable, the offset is also inconsistent with the antidumping law, as an offset for domestic subsidies is not among permissible offsets to the U.S. price in the calculation of antidumping duties.¹¹⁹ The CIT held that given the DOC’s inability to determine whether and to what degree double counting is occurring, and in the absence of new statutory tools, the only option left for the DOC is *not* to apply the countervailing duty law to imports from China.¹²⁰

3. WTO Dispute Settlement Panel

Around the same time when the plaintiffs in the *GPX I* case filed their suit before the CIT, the government of China requested consultations with the United States at the WTO regarding the imposition of antidumping and countervailing duties by the United States on imports of four products from China in DS379.¹²¹

¹¹³ *Id.*

¹¹⁴ *Id.* at 1251.

¹¹⁵ DEP’T OF COMMERCE, FINAL RESULTS OF REDETERMINATION PURSUANT TO REMAND 8 (2010), available at <http://ia.ita.doc.gov/remands/09-103.pdf>.

¹¹⁶ *Id.*

¹¹⁷ *GPX Int’l Corp. v. United States*, 715 F. Supp. 2d 1337, 1345 (Ct. Int’l Trade 2010) [hereinafter *GPX II*].

¹¹⁸ *Id.*

¹¹⁹ *Id.*

¹²⁰ *Id.* at 1346.

¹²¹ See Request for Consultations by China, *United States—Definitive Anti-Dumping and Countervailing Duties on Certain Products from China*, WT/DS379/1 (Sept. 22, 2008). The four

Among others, China challenged the DOC's treatment of the double counting issue as being inconsistent with the United States' obligations under various WTO provisions.¹²²

In its final report issued in October 2010, the WTO dispute settlement panel established to hear China's challenges (Panel) explained what it understood to be the reason for double counting.¹²³ In its explanations, the Panel stated the double counting hypothesis illustrated in Figure 1 above, noting that the use of an NME methodology leads to "an asymmetric dumping margin comparison between an *unsubsidized* normal value and *subsidized* export price."¹²⁴ In other words, the Panel recognized that the double counting of subsidies in concurrent NME antidumping and countervailing duty cases is at least a theoretical possibility.¹²⁵

But after suggesting that double counting is theoretically possible, the Panel went on to hold that even if it does occur, it is not inconsistent with the relevant WTO provisions cited by China.¹²⁶ The Panel concluded that since double counting poses no concerns under WTO law, it was not necessary for it to examine whether double counting did result from the concurrent imposition of NME antidumping duties and countervailing duties in the four sets of DOC investigations at issue.¹²⁷

4. WTO Appellate Body

China appealed the Panel's double counting analyses in DS379 to the Appellate Body of the WTO. In its final report issued in March 2011, the Appellate Body accepted the Panel's understanding of why double counting might occur.¹²⁸ However, the Appellate Body reversed the Panel's findings as to whether relevant WTO provisions prohibit double counting. Specifically, the Appellate Body held that the Panel failed to give meaning and effect to all the terms of Article 19.3 of the SCM Agreement, which requires a countervailing duty to be imposed "in the

products at issue were circular welded carbon quality steel pipe, new pneumatic off-the-road tires, light-walled rectangular pipe and tube, and laminated woven sacks. *See id.* at 1–3.

¹²² *See* Report of the Panel, *United States—Definitive Anti-Dumping and Countervailing Duties on Certain Products from China*, ¶¶ 14.8–.10, WT/DS379/R (Oct. 22, 2010) [hereinafter DS379 Panel Report].

¹²³ *See id.* ¶¶ 14.67–.76.

¹²⁴ *Id.* ¶ 14.72 (emphasis in original).

¹²⁵ Before the Panel, China argued that "a double remedy arises in *all* instances of concurrent application of countervailing duties and of anti-dumping duties calculated pursuant to a methodology relying on surrogate values." *Id.* ¶ 14.50 (emphasis in original). That is because, in China's view, "the rationale for using an NME methodology in an antidumping investigation subsumes the rationale for imposing countervailing duties . . ." *Id.* China argued that when the DOC uses its NME methodology to calculate the amount of antidumping duties, it "necessarily" captures any trade-distorting effects of alleged subsidies in the antidumping margin. *Id.* This argument was an apparent effort to avoid the burden of proof problem the Chinese respondents encountered in the DOC proceedings below. The Panel, however, did not address this argument.

¹²⁶ For the Panel's analyses regarding these WTO provisions, *see* DS379 Panel Report, *supra* note 122, ¶¶ 14.104–.140.

¹²⁷ *See id.* ¶ 14.76.

¹²⁸ *See* Report of the Appellate Body, *United States—Definitive Anti-Dumping and Countervailing Duties on Certain Products from China*, ¶¶ 542–43, WT/DS379/AB/R (Mar. 11, 2011) [hereinafter DS379 AB Report].

appropriate amounts in each case.”¹²⁹ The Appellate Body reasoned that under Article 19.3 of the SCM Agreement, “the amount of a countervailing duty cannot be ‘appropriate’ in situations where that duty represents the full amount of the subsidy and where antidumping duties, calculated at least to some extent on the basis of the same subsidization, are imposed concurrently to remove the same injury to the domestic industry.”¹³⁰

The Appellate Body next considered whether the DOC’s handling of the double counting issue in the four sets of investigations at issue was consistent with Article 19.3 of the SCM Agreement. The Appellate Body first determined that the occurrence of double counting depends on “whether and to what extent domestic subsidies have lowered the export price of a product, and on whether the investigating authority has taken the necessary corrective steps to adjust its methodology to take account of this factual situation.”¹³¹ The Appellate Body then noted that in the four sets of DOC investigations at dispute, the DOC “did not initiate any examination of whether double remedies would arise in the four investigations at issue and refused outright to afford any consideration to the issue or to the submissions pertaining to the issue that were presented to it.”¹³² According to the Appellate Body, the DOC’s failure to conduct any factual inquiries regarding double counting was inconsistent with Article 19.3 of the SCM Agreement, as the obligation to determine the appropriate amount of countervailing duties under Article 19.3 encompasses the obligation to affirmatively determine whether double counting is occurring.¹³³

5. Federal Circuit

On the domestic litigation front, the United States appealed to the Federal Circuit the CIT’s ruling in *GPX II*, which, as discussed earlier, ordered the DOC not to apply the countervailing duty law to NMEs.¹³⁴ In December 2011, in *GPX International Corp. v. United States (GPX III)*, a three-judge panel of the Federal Circuit affirmed the CIT’s *GPX II* ruling, albeit on a different ground than that relied on by the CIT.¹³⁵ In *GPX III*, while upholding the CIT’s ruling that the DOC was not allowed to apply the countervailing duty law to NMEs, the Federal Circuit considered it “problematic” for the CIT to predicate its ruling on the possible occurrence of double counting, because it was unclear to what extent the statute prohibits double counting, and because the DOC had determined that “it is far from clear that double counting has in fact occurred.”¹³⁶ Rather, the Federal Circuit held that the DOC was barred by the countervailing duty statute from imposing countervailing duties on imports from NMEs.¹³⁷ Citing the principle of legislative

¹²⁹ *Id.* ¶ 582.

¹³⁰ *Id.*

¹³¹ *Id.* ¶ 599.

¹³² *Id.*

¹³³ *Id.* ¶¶ 605–06.

¹³⁴ See *supra* note 120 and accompanying text.

¹³⁵ 666 F.3d 732 (Fed. Cir. 2011) [hereinafter *GPX III*].

¹³⁶ *GPX III*, 666 F.3d at 737.

¹³⁷ *Id.*

ratification, the Federal Circuit concluded that Congress ratified the DOC's policy of not applying the countervailing duty law to NMEs when it enacted amendments to U.S. trade law statutes in 1984, 1988, and 1994 without making any changes that would have altered that policy.¹³⁸

6. Congress

By basing its decision in *GPX III* on its construction of congressional intent as to the application of the countervailing duty law to NMEs, the Federal Circuit essentially threw the ball to Congress. Indeed, at the end of its *GPX III* opinion, the Federal Circuit invited Congress to act, stating that "if [DOC] believes that the law should be changed, the appropriate approach is to seek legislative change."¹³⁹

Congress took up the Federal Circuit's invitation. Legislation in response to the Federal Circuit's *GPX III* decision was quickly passed by both chambers of Congress and was signed by President Obama into law as P.L. 112-99 on March 13, 2012.¹⁴⁰ In an outright repeal of the Federal Circuit's ruling in *GPX III*, section 1(a) of P.L. 112-99 amended U.S. countervailing duty law by adding a provision stating that, generally, "the merchandise on which countervailing duties shall be imposed under [section 701(a) of the Tariff Act of 1930] includes a class or kind of merchandise imported, or sold (or likely to be sold) for importation, into the United States from a nonmarket economy country."¹⁴¹ This new provision applies retroactively to all countervailing duty proceedings initiated on or after November 20, 2006, the date the DOC's *Georgetown Steel Memo* was issued.¹⁴²

Congress was mindful that by reinstating the applicability of the countervailing duty law to NMEs, it was bringing the double counting issue back into the fray. To provide the statutory authority for dealing with the double counting issue, section 2(a) of P.L. 112-99 amended the countervailing duty statute by adding a new provision that gives the DOC the authority to adjust the antidumping duty amount to take account of the double counting of subsidies if a countervailable subsidy "has been demonstrated" to lower the export price of the subject merchandise, and if the DOC "can reasonably estimate" the magnitude of the double counting of subsidies.¹⁴³ This provision applies to all countervailing duty investigations and reviews initiated on or after the enactment of the law, as well as all section 129 determinations issued on or after the enactment of the law.¹⁴⁴

What section 2(a) of P.L. 112-99 is not clear about, however, is who has the burden of proof regarding double counting. P.L. 112-99 states that double

¹³⁸ See *id.* at 740–43.

¹³⁹ *Id.*

¹⁴⁰ See Act of Mar. 13, 2012, Pub. L. No. 112-99, 126 Stat. 265 [hereinafter P.L. 112-99]. Section 129 determinations are determinations issued by the DOC in accordance with section 129 of the Uruguay Round Agreements Act (URAA) to render the DOC's action in a specific trade remedy proceeding "not inconsistent" with the findings of the WTO Dispute Settlement Panel or the Appellate Body. See URAA, Pub. L. No. 103-465, § 129(b)(2), 108 Stat. 4809, 4837 (codified at 19 U.S.C. § 3538(b)(2)(2011)).

¹⁴¹ P.L. 112-99, *supra* note 140, § 1(a).

¹⁴² *Id.* § 1(b).

¹⁴³ *Id.* § 2(a).

¹⁴⁴ *Id.* § 2(b).

counting must be accounted for if a subsidy “has been demonstrated” to lower the export price of the subject merchandise. But demonstrated by whom—the petitioner, the respondent, or the DOC? Moreover, even if the party that is required to have the burden of proof does demonstrate that a subsidy has lowered the export price of the subject merchandise, double counting will be accounted for under section 2(a) of P.L. 112-99 only if the DOC “can reasonably estimate” the extent to which the subsidy is being double counted. It appears that under this provision, the DOC does not have to account for double counting if it somehow could not reasonably estimate the magnitude of double counting. This stands in contrast with the Appellate Body’s finding in DS379 that an investigating authority has an affirmative obligation to demonstrate that double counting is not occurring before it imposes countervailing duties concurrent with NME antidumping duties.¹⁴⁵

7. The Department of Commerce on Remand

On the international front, on July 31, 2012, the DOC issued its revised determinations for the four sets of investigations challenged in DS379 pursuant to the procedures set forth in section 129 of the Uruguay Round Agreements Act for implementing adverse WTO rulings.¹⁴⁶ On August 21, 2012, the DOC officially implemented these section 129 determinations as instructed by the United States Trade Representative.¹⁴⁷

In its section 129 determinations, the DOC first addressed the question of who has the burden to prove whether double counting is occurring. The DOC determined that “the burden is on a respondent to demonstrate its entitlement to a particular adjustment [to its antidumping cash deposit rate].”¹⁴⁸ The wording of this conclusion appears to be intentional: The DOC considered the burden of proof at issue here not the burden of proof for double counting, but the burden of proof for adjustments to the export price in antidumping proceedings.¹⁴⁹ In so doing, the DOC avoided directly stating that respondents have the burden to prove the

¹⁴⁵ See *supra* note 133 and accompanying text.

¹⁴⁶ See Circular Welded Carbon Quality Steel Pipe from the People’s Republic of China (Dep’t of Commerce July 31, 2012) (final section 129 determination) [hereinafter CWP Section 129 Determination], available at <http://ia.ita.doc.gov/download/section129/prc-cwcq-steel-pipe-Final-129-Determination-20120830.pdf>; Certain New Pneumatic Off-the-Road Tires from the People’s Republic of China (Dep’t of Commerce July 31, 2012) (final section 129 determination), available at <http://ia.ita.doc.gov/download/section129/prc-otr-tires-Final-129-Determination-20120830.pdf>; Laminated Woven Sacks from the People’s Republic of China (Dep’t of Commerce July 31, 2012) (final section 129 determination), available at <http://ia.ita.doc.gov/download/section129/prc-lw-sacks-Final-129-Determination-20120830.pdf>.

¹⁴⁷ See Certain New Pneumatic Off-the-Road Tires: Circular Welded Carbon Quality Steel Pipe; Laminated Woven Sacks; and Light-Walled Rectangular Pipe and Tube from the People’s Republic of China, 77 Fed. Reg. 52,683, 52,683 (Dep’t of Commerce Aug. 30, 2012) (implementation of determinations).

¹⁴⁸ See CWP Section 129 Determination, *supra* note 146, at 14. Since the DOC’s discussions of the double counting issue are verbatim identical across the four proposed section 129 determinations, the other three determinations will not be separately cited.

¹⁴⁹ Among others, the DOC cited the Statement of Administrative Action for the URAA and a DOC rule providing that in making adjustments to the export price in antidumping proceedings, “[t]he interested party that is in possession of the relevant information has the burden of establishing to the satisfaction of the Secretary the amount and nature of a particular adjustment.” See *id.* n.41.

existence of double counting—a stance that would be contrary to the Appellate Body’s finding in DS379—while achieving practically the same outcome.

Then, after recounting the difficulties it encountered in conducting the factual inquiries required by the Appellate Body for the double counting analysis, the DOC determined that, with respect to input subsidies, i.e., subsidies on the inputs for manufacturing the subject merchandise, the Chinese respondents met their burden of proof to receive an adjustment to their antidumping cash deposit rates.¹⁵⁰ The DOC then compared the ratio of change between an aggregate-level China purchasing price index and an aggregate-level China production price index,¹⁵¹ and found that sixty-three percent of the alleged input subsidies passed through to the export price of the subject merchandise.¹⁵² As a result, the DOC subtracted sixty-three percent of the input subsidies from the export prices of the subject merchandise in calculating the respondent firms’ new antidumping cash deposit rates.¹⁵³

8. The Saga Continues

Six years after the DOC first applied the countervailing duty law to China, and after the DOC, the CIT, a WTO Dispute Settlement Panel, the Appellate Body, the Federal Circuit, and United States Congress each weighed in on the double counting controversy, an end to the dispute is still nowhere in sight. Domestically, litigation in the GPX case continues over the constitutionality of the retroactive application of P.L. 112-99.¹⁵⁴ International litigation over the double counting issue also continues. At the WTO Dispute Settlement Body (DSB) meeting on August 31, 2012, the United States claimed that it had brought the measures challenged in DS379 into full compliance with the DSB recommendations and rulings,¹⁵⁵ in apparent reference to the DOC’s section 129 determinations implemented on August 21, 2012.¹⁵⁶ On September 28, 2012, however, China made a statement to the DSB that it did not agree with the U.S. claim that it had fully complied with the DSB recommendations and rulings in DS379.¹⁵⁷ Additionally, on September 17, 2012, China initiated a new WTO dispute settlement proceeding against the United

¹⁵⁰ *Id.* at 14.

¹⁵¹ *Id.* The datasets relied on by the DOC were China Purchasing Price YoY (CNPPIY) and China PPI YoY (CHEFTYOY), both of which are compiled by Bloomberg. *Id.*

¹⁵² CWP Section 129 Determination, *supra* note 146, at 19 (“The GOC alleges that the Department’s finding that only 63 percent of the alleged input subsidies passed through to the price of subject merchandise is contrary to the rationale for imposing countervailing duties in the full amount of the subsidy.”).

¹⁵³ *See, e.g., id.* at 35–36.

¹⁵⁴ Plaintiffs in the GPX case argued that P.L. 112-99 violates the Ex Post Facto Clause of the U.S. Constitution, as well as Due Process and Equal Protection Clauses of the Fifth Amendment. *See* GPX Int’l Tire Corp. v. United States, No. 08-00285, slip op. 13-2 at 8 (Ct. Int’l Trade Jan. 7, 2013). The CIT ruled against the plaintiffs on their constitutional claims. *See id.* at 62.

¹⁵⁵ *See Dispute Settlement: Dispute DS379, United States—Definitive Anti-Dumping and Countervailing Duties on Certain Products from China*, WTO, http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds379_e.htm (last updated Oct. 12, 2012).

¹⁵⁶ *See supra* note 147 and accompanying text.

¹⁵⁷ *Id.*

States, DS449, challenging the newly enacted P.L. 112-99.¹⁵⁸ Among other arguments, China claimed that both the absence of legal authority under P.L. 112-99 to account for double counting in proceedings initiated between November 20, 2006 and March 13, 2012 and U.S. failures to account for double counting in those proceedings are inconsistent with a number of provisions under the SCM Agreement and the WTO Antidumping Agreement.¹⁵⁹

IV. THE SUBSIDY PASS-THROUGH PRESUMPTION: ECONOMIC FALLACIES

From the above analyses, it is obvious that the double counting hypothesis is premised on the presumption that a subsidy passes through to the price of the subsidized product. This subsidy pass-through presumption has been acknowledged as theoretically possible by the DOC,¹⁶⁰ the CIT,¹⁶¹ the WTO Panel,¹⁶² and the Appellate Body.¹⁶³ The Federal Circuit found it inappropriate for the CIT to predicate its rulings in *GPX I* and *GPX II* on double counting, but it did so without challenging the theoretical validity of the subsidy pass-through presumption.¹⁶⁴

The subsidy pass-through presumption also underlies the allocation of the burden of proof for double counting. In *GPX I*, the CIT required the DOC to have the burden to ascertain whether and to what extent double counting was occurring because of the “substantial potential” for double counting.¹⁶⁵ In DS379, implicit in the Appellate Body’s finding that the DOC must affirmatively investigate whether double counting is occurring is the acknowledgment that double counting is at least theoretically possible.¹⁶⁶

The allocation of the burden of proof, in turn, may very well determine the outcome of a double counting dispute. As discussed earlier, both the CIT and the Appellate Body have required the DOC to conduct factual inquiries to ascertain whether double counting is occurring as a matter of fact.¹⁶⁷ But it could be very difficult, if not entirely impossible, to prove a *causal* relationship between the receipt of a subsidy and a decrease in the price of the subsidized product, as the

¹⁵⁸ See Request for Consultations by China, *United States—Countervailing and Anti-Dumping Measures on Certain Products from China*, WT/DS449/1 (Sept. 20, 2012).

¹⁵⁹ See *id.* at 4–5. China claimed that such failures violate Articles 10, 15, 19, 21, and 32 of the SCM Agreement, Article VI of GATT 1994, and Articles 9 and 11 of the WTO Antidumping Agreement. *Id.*

¹⁶⁰ Although the DOC rejected China’s argument that U.S. countervailing duty law presumes subsidy pass-through, it did not reject the theoretical possibility of subsidy pass-through. See *supra* Part III.C.1.

¹⁶¹ Recall that in *GPX I*, the CIT recounted the double counting hypothesis before holding that the DOC was required to account for double counting. See *GPX I*, 645 F. Supp. 2d 1231, 1240–42 (Ct. Int’l Trade 2009).

¹⁶² See *supra* notes 124–25 and accompanying text.

¹⁶³ In DS379, the Appellate Body cited, approvingly, the Panel’s and the DOC’s views on why double counting might be occurring. See DS379 AB Report, *supra* note 128, ¶ 602 n.589.

¹⁶⁴ See *supra* Part III.C.5.

¹⁶⁵ *GPX I*, 645 F. Supp. 2d at 1243 (“If there is a substantial potential for double counting, and it is too difficult for Commerce to determine whether, and to what degree double counting is occurring, Commerce should refrain from imposing [countervailing duties] on NME goods until it is prepared to address this problem through improved methodologies or new statutory tools.”).

¹⁶⁶ See *supra* note 128 and accompanying text.

¹⁶⁷ See *supra* notes 111, 133 and accompanying text.

final price of a product usually encompasses dozens or even more cost items,¹⁶⁸ subsidies being only one of them. As the CIT observed in *GPXI*, “there is likely no way for any respondent to accurately prove what may very well be happening [with respect to double counting.]”¹⁶⁹ Given the difficulties of proving the factual existence of double counting, the allocation of the burden of proof becomes a crucial factor in resolving double counting disputes.¹⁷⁰ Not surprisingly, both the United States and China attached much importance to the burden of proof issue in DS379.¹⁷¹

With so much riding on the subsidy pass-through presumption, it is curious that none of the double counting analyses offered so far has even questioned the validity of the presumption. In this Part, the Article demonstrates that the economics behind the subsidy pass-through presumption is wrong. Drawing upon economic theory of firm behavior, this Article shows that a subsidy changes the productive behavior of a subsidy recipient only if it lowers the marginal cost of production of the recipient, and a subsidy passes through to the price of the subsidized product only if the subsidy recipient has market power in the market for the subsidized product. In other words, the subsidy pass-through presumption is valid in much narrower circumstances than proponents of the double counting hypothesis have assumed it to be.

A. *The Behavioral Impact of Subsidies*

The first step in understanding the falsity of the subsidy pass-through presumption is to note that not all subsidies cause subsidy recipients to alter their output level or price. Below, the term “behavioral impact” will be used to refer to the impact of a subsidy on the output level or price of a subsidy recipient. For a subsidy to have a behavioral impact, it must cause a subsidy recipient to change either its output level or price, or both.

As discussed earlier, the scope of subsidies that are subject to regulation under the SCM Agreement is very broad. Under the SCM Agreement, a subsidy is defined as a financial contribution that confers a benefit on a specific enterprise or

¹⁶⁸ This can be seen from the DOC’s calculation of the constructed value of imports from NMEs. In constructing the value of an NME product, the DOC includes materials, labor, energy and utilities, factory overhead, selling, general and administrative expenses, profit, and packing. See IMPORT ADMIN., 2009 ANTIDUMPING MANUAL: CH. 10: NON-MARKET ECONOMIES 17–18 (2009), available at <http://ia.ita.doc.gov/admanual/2009/Chapter%2010%20NME.pdf>. Note that the cost items included in the DOC’s calculation are broad categories and can be broken down into more specific items. Materials, for example, could be broken down into as many items as the manufacturing of the product requires.

¹⁶⁹ *GPXI*, 645 F. Supp. 2d at 1243.

¹⁷⁰ In its section 129 determinations in DS379, the DOC did conclude that the Chinese respondents met their burden of proof with respect to input subsidies. See *supra* note 150 and accompanying text. But the DOC based that determination on a simple *correlation* between changes in input prices and changes in product prices. See *supra* notes 151–52 and accompanying text. This approach is erroneous because the DOC did not control for other factors that may have *caused* changes in product prices.

¹⁷¹ In DS379, China and the United States each argued that the burden of proof belonged to the other side. China argued that it was “the obligation of the investigating authority to investigate and make a determination as to whether it is offsetting the same subsidies twice,” whereas the United States argued that “the burden to establish the existence of such an alleged double remedy would be on China.” DS379 AB Report, *supra* note 128, ¶ 600.

industry or a group of enterprises or industries.¹⁷² This definition makes no distinction between subsidies that cause recipients to change productive behavior and subsidies that do not cause recipients to change productive behavior. An example of subsidies in the former category is a fixed payment to the recipient on each unit of its products. With a lower cost of production, the subsidy recipient may increase production or lower price.¹⁷³ An example of subsidies in the latter category will be a lump-sum payment that is not contingent on the recipient meeting any performance requirements. Such a subsidy will not alter the recipient's productive behavior and will only result in a transfer of benefits to the recipient.¹⁷⁴

That not all subsidies have a behavioral impact is supported by economic theory on firm behavior. In an important contribution to the economic literature on subsidies, Professors Goetz, Granet, and Schwartz laid out the general framework for analyzing the behavioral impact of subsidies.¹⁷⁵ They argued that for a foreign subsidy to adversely affect the interests of a U.S. producer, the subsidy must either directly or indirectly lower the foreign producer's marginal cost of production.¹⁷⁶ One example of such cost-reducing subsidies given by Goetz, Granet, and Schwartz is a reduction in the price of a variable input.¹⁷⁷

The economic reasoning behind Goetz, Granet, and Schwartz's proposition is straightforward. In economics, the marginal cost of production is the cost of producing one additional unit of products, whereas the marginal revenue is the increased revenue from selling one additional unit of products.¹⁷⁸ When the marginal cost of production is lower than the marginal revenue, it is more profitable for a firm to increase production and vice versa. A profit-maximizing firm, therefore, will choose a level of production where the marginal cost of production equals the marginal revenue, whether the firm is perfectly competitive or a monopoly.¹⁷⁹ Figures 2 and 3 below illustrate the productive behavior of a perfectly competitive firm and a monopoly firm respectively.

In Figure 2, *MC* represents the marginal cost of production of a perfectly competitive firm and *MR* represents the marginal revenue of such firm. Because a perfectly competitive firm cannot influence the market price, it faces a horizontal demand curve, *DD*, which is also the firm's marginal-revenue curve, *MR*.¹⁸⁰ The marginal-cost curve intersects with the marginal-revenue curve at (p, q^0) , meaning that the firm produces q^0 units at price p . When a subsidy lowers the marginal cost of production, the marginal-cost curve shifts downward from *MC* to *MC'* and intersects with the marginal-revenue curve at (p, q^1) , meaning that the firm produces q^1 units at price p . The subsidy has an impact on the firm's productive

¹⁷² See *supra* notes 43–45 and accompanying text.

¹⁷³ See Diamond, *Economic Foundations*, *supra* note 12, at 788–89.

¹⁷⁴ See *id.* at 787.

¹⁷⁵ See Goetz, Granet & Schwartz, *supra* note 12.

¹⁷⁶ *Id.* at 23. Note that Goetz, Granet, and Schwartz used the term “variable cost” to refer to “marginal cost.”

¹⁷⁷ *Id.*

¹⁷⁸ N. GREGORY MANKIW, *PRINCIPLES OF ECONOMICS* 283 tbl.2 (6th ed. 2008).

¹⁷⁹ For analysis of profit maximization by a perfectly competitive firm, see *id.* at 283–84. For analysis of profit maximization by a monopoly, see *id.* at 306–07.

¹⁸⁰ See *id.* at 281, 304.

behavior because it induces the firm to increase its volume of production. However, for this to happen, the subsidy must cause the marginal-cost curve to shift by lowering the firm's marginal cost of production.

Figure 2. The Productive Behavior of a Perfectly Competitive Firm

The same also holds true for a firm with market power. Figure 3 below illustrates the productive behavior of a monopoly firm in response to a subsidy. In Figure 3, MC represents the marginal cost of production of a monopoly firm and MR represents the marginal revenue of such firm. Since the quantity of the output of a monopoly firm could influence the market price, the marginal-revenue curve facing a monopoly firm, MR , is downward sloping¹⁸¹ and is always lower than the market demand curve, DD .¹⁸² Like a perfectly competitive firm, however, a monopoly firm will choose a level of production where the marginal cost equals the marginal revenue to maximize profits.¹⁸³ This means that the monopoly firm will produce q^0 units at price p^0 . When a subsidy lowers the monopoly firm's marginal cost of production, the marginal-cost curve shifts downward from MC to MC' . As a result of the subsidy, the monopoly firm produces q^1 units at price p^1 . The subsidy has an impact on the monopoly firm's productive behavior, as it induces the monopoly to increase production and lower the price. For this to happen, the subsidy must cause the marginal-cost curve to shift by lowering the marginal cost of production.

¹⁸¹ See *id.* at 305–06.

¹⁸² This is because when a monopoly increases production, the price of all units sold must fall. See *id.* at 306 fig.3.

¹⁸³ See *id.* at 307.

Figure 3. The Productive Behavior of a Monopoly Firm

Richard Diamond refined Goetz, Granet, and Schwartz's analysis and applied it to specific types of subsidies.¹⁸⁴ Diamond made it clear that the receipt of a subsidy by a firm does not *per se* change any of its actions or the action of any other participants in the relevant market.¹⁸⁵ Consistent with Goetz, Granet, and Schwartz's theory, Diamond argued that a subsidy will cause the recipient firm to change its productive behavior in a manner that adversely affects the "entitlement" of U.S. producers only if it lowers the recipient firm's marginal cost of production.¹⁸⁶ Diamond categorized various types of subsidies into three groups based on their impact on the recipient firm's marginal cost. First, some subsidies do not affect the marginal cost of the recipient firm. These subsidies include, among others, subsidies intended as a transfer of benefits to owners of the recipient firm and subsidies provided to cover operating losses, to decommission unused facilities, to help in the clean-up of existing company wastes, or to pay vested retirement allowances if the payments were unanticipated.¹⁸⁷ Second, some subsidies vary with production and therefore affect the recipient firm's marginal cost. Examples of these subsidies include per-unit subsidies (whereby the amount of subsidies received by the recipient firm varies with the quantity produced) and input subsidies (whereby the subsidy is based on the consumption of an input whose use varies with production).¹⁸⁸ Third, some subsidies affect firm decisions regarding capital assets, i.e., factors of production that remain fixed during the period for which production is set. Examples of these subsidies include grants¹⁸⁹ and low cost loans¹⁹⁰ that are used to purchase capital assets.¹⁹¹ As Diamond

¹⁸⁴ See Diamond, *Economic Foundations*, *supra* note 12, at 783.

¹⁸⁵ *Id.*

¹⁸⁶ *Id.* at 784–85.

¹⁸⁷ *Id.* at 787.

¹⁸⁸ *Id.* at 788–91.

¹⁸⁹ *Id.* at 803.

¹⁹⁰ *Id.* at 805.

explained, the impact of these subsidies on the recipient firm's marginal cost is uncertain: It may result in lower, equal, or greater marginal cost depending on the characteristics of the plant or machinery purchased.¹⁹²

The marginal-cost-of-production theory propounded by Goetz, Granet, and Schwartz and by Diamond is not without skeptics. Alan Holmer, Sosau Haggerty and William Hunter acknowledged that subsidies may not always alter the productive behavior of the subsidy recipients, but they argued that a subsidy that functions only as an income transfer to the subsidy recipient still affects the entitlements of foreign producers because the subsidy will increase the revenues of the recipient firm and will, over the long run, encourage other firms to enter the subsidized sector.¹⁹³ Alan Sykes holds a similar view that "virtually all subsidies" have the potential to cause recipients to increase output.¹⁹⁴ According to Sykes, a subsidy that increases the profitability of the recipient will attract more firms to enter the market, leading to increased output over the long run.¹⁹⁵ However, even if one were to accept the proposition that all subsidies increase output over the long run, the current subsidy regulation regime does not require a subsidy to *have increased* output before it could be regulated.¹⁹⁶ It is entirely possible, therefore, for a subsidy that does not alter the recipient firm's short-run cost structures and has yet to cause long-run effects—therefore a subsidy that has no behavioral impact yet—to be subject to regulation under the current subsidy regulation regime.¹⁹⁷

B. *The Price Impact of Subsidies*

Even assuming that all subsidies lower the marginal cost of production of the recipient firm, that condition alone is not sufficient for a subsidy to have an impact on the price of the subsidized product. As discussed below, for a subsidy to

¹⁹¹ *Id.* at 801.

¹⁹² *Id.* at 803.

¹⁹³ See Alan Holmer, Sosau Haggerty & William D. Hunter, *Identifying and Measuring Subsidies Under the Countervailing Duty Law: An Attempt at Synthesis*, in 1 THE COMMERCE DEPARTMENT SPEAKS ON IMPORT ADMINISTRATION AND EXPORT ADMINISTRATION 1984, at 301, 325–26 n.34 (1984).

¹⁹⁴ Sykes, *Questionable Case*, *supra* note 12, at 515.

¹⁹⁵ *Id.* at 515–16. Note that Sykes discussed the weakness of the marginal-cost-of-production theory in the context of Annex 2 of the WTO Agriculture Agreement, which Sykes argued reflects the marginal-cost-of-production theory by exempting certain government programs from the negotiated ceilings on domestic support if they have "no, or at most minimal, trade-distorting effects or effects on production." *Id.*

¹⁹⁶ As discussed in details below, the definition of the term "subsidies" under the SCM Agreement only requires a subsidy to confer a benefit on the recipient; it does not require any behavioral changes on the part of the recipient. See *infra* note 201 and accompanying text.

¹⁹⁷ Diamond made a similar point by arguing that even if a subsidy may induce future firms to increase output, "no reason exists why it would not be sufficient to impose a countervailing duty on such firms if and when they are subsidized." Diamond, *Economic and Financial Principles*, *supra* note 12, at 545. Diamond also pointed out that Holmer, Haggerty, and Hunter's argument assumes that the subsidy offered to the first firm or a similar subsidy will be available to other firms, while it is a question of fact whether such expectations realistically exist in a specific case. See *id.* Diamond further argued that there are problems with imposing countervailing duties on products of a firm receiving a subsidy on account of injury arising from the actions of future firms. First, in such scenario, "there would seem to be no relationship between the duty charged and the injury caused." *Id.* n.146. Second, when the later entrants come under countervailing duty investigation, "duties to neutralize the injury [caused by them] have already been paid by the first firm." *Id.*

pass through to the price of the subsidized product, the structure of the market for the subsidized product must be such that the recipient firm has the capacity to influence the world price of the product.

That a subsidy lowers the recipient firm's marginal cost of production is not a sufficient condition for the subsidy to have a price impact can be seen from Figures 2 and 3 above. In Figure 2, where the subsidy recipient is a perfectly competitive firm in the world market for the subsidized product, the lowering of the firm's marginal cost of production causes the marginal-cost curve of the firm to shift downward from MP to MP' , but the new marginal-cost curve still intersects with the demand curve at price p . The only change in the firm's productive behavior caused by the subsidy is increased production volume from q^0 to q^1 . Suppose that DD^d represents the domestic demand for the subsidized product. Prior to the subsidy, the domestic demand for the subsidized product at price p is q^d , resulting in a net export of $q^d q^0$ by the firm. After the subsidy is conferred, the domestic demand for the product remains at q^d , but the firm's quantity of production increases from q^0 to q^1 , resulting in a net export of $q^d q^1$ by the firm. In short, when a firm is too small to influence the world price of the subsidized product, a subsidy, even if it lowers the firm's marginal cost of production, will not pass through to the price of the subsidized product; it will only cause the firm to increase production and exports.

But when the subsidy recipient is large enough to have market power in the world market for the subsidized product, a subsidy that lowers the recipient firm's marginal cost of production will have a price impact. Figure 3 illustrates the price impact of a subsidy conferred on a monopoly firm. In Figure 3, because the demand curve (DD) and the marginal-revenue curve (MR) facing a monopoly firm are downward-sloping, a downward shift in the monopoly firm's marginal-cost curve from MC to MC' in response to a subsidy in the amount of S will lead to both a greater volume of production (q^1) and a lower price (p^1). Note that in Figure 3, the magnitude of the subsidy pass-through, $p^1 p^0$, does not necessarily equal the amount of the subsidy, S . The exact amount of a subsidy that passes through to price will depend on the shapes and slopes of the demand curve and of the marginal-cost curve.¹⁹⁸

While the above analyses are based on the assumption that a subsidy is conferred on a single firm, the same also holds true if a subsidy is conferred on more than one firm. Take, for example, the extreme case where a subsidy is

¹⁹⁸ In its section 129 determinations in DS379, the DOC correctly rejected the Chinese government's argument that a subsidy's impact on cost translates dollar-for-dollar to price. See CWP Section 129 Determination, *supra* note 146, at 24–25. The DOC's rationale for its determination, however, was incorrect. China argued that "producers in competitive markets tend to compete away any temporary advantage that they obtain from lower costs by passing anything that reduces their cost to the consumers in the form of lower prices." *Id.* at 23. According to China, therefore, the DOC's conclusion that a producer who has lower costs can retain a significant portion of the cost reduction implies that the producer possesses market power, a presumption the DOC presented no evidence to substantiate. The DOC did not respond to that argument. Instead, it rejected China's argument by citing a "feedback" effect of increased production on input prices. The DOC posited that firms that expand output because of a subsidy will increase their demand for production inputs, and this increased demand will in turn lead to higher input prices. *Id.* at 24–25. It is clear from the analysis presented here that the DOC's resort to the feedback effect was unnecessary. As shown in Figure 3, even if a firm has no market power, the magnitude of the pass-through of a subsidy is not necessarily one hundred percent; it will depend on the shapes and slopes of the demand and supply curves.

conferred on all firms in a domestic industry of the subsidy-granting country.¹⁹⁹ If the output of the subsidy recipients collectively accounts for only a minuscule percentage of the world market output, then a subsidy that reduces each recipient's marginal cost of production will have no impact on the world market price, as shown in Figure 2. But if the output of the subsidy recipients collectively accounts for a large enough share of the world market output, the subsidy recipients taken as a whole will face a downward-sloping demand curve as is the case in Figure 3, even though each individual recipient may face a horizontal demand curve. In such a scenario a subsidy that reduces each recipient's marginal cost of production will reduce the world market price.

To summarize, from an economic point of view, it is far from certain that a subsidy always lowers the price of the subsidized product. For a subsidy to pass through to the price of the subsidized product, the subsidy must alter the recipient firm's productive behavior, and the recipient firm must have market power in the market for the subsidized product.

It is abundantly clear that subsidies that do pass through to the price of the subsidized product are only a subset of the subsidies that are subject to regulation under the SCM Agreement. Recall from earlier discussions that three requirements must be met for a subsidy to be subject to the SCM Agreement: It must be a financial contribution, confer a benefit, and be specific to a firm or industry or a group of firms or industries.²⁰⁰ Under this definition of subsidies, what matters is whether a subsidy "benefits" the recipient;²⁰¹ whether the subsidy changes the

¹⁹⁹ Note, however, that the subsidy has to be considered "specific" within the meaning of Article 2 of the SCM Agreement before it can be made subject to the SCM Agreement. See SCM Agreement, *supra* note 41, art. 1.2.

²⁰⁰ See *supra* notes 43–45 and accompanying text.

²⁰¹ Article 14 of the SCM Agreement provides the following guidelines for calculating the amount of a subsidy in terms of its benefit to the recipient:

- (a) government provision of equity capital shall not be considered as conferring a benefit, unless the investment decision can be regarded as inconsistent with the usual investment practice (including for the provision of risk capital) of private investors in the territory of that Member;
- (b) a loan by a government shall not be considered as conferring a benefit, unless there is a difference between the amount that the firm receiving the loan pays on the government loan and the amount the firm would pay on a comparable commercial loan which the firm could actually obtain on the market. In this case the benefit shall be the difference between these two amounts;
- (c) a loan guarantee by a government shall not be considered as conferring a benefit, unless there is a difference between the amount that the firm receiving the guarantee pays on a loan guaranteed by the government and the amount that the firm would pay on a comparable commercial loan absent the government guarantee. In this case the benefit shall be the difference between these two amounts adjusted for any differences in fees;
- (d) the provision of goods or services or purchase of goods by a government shall not be considered as conferring a benefit unless the provision is made for less than adequate remuneration, or the purchase is made for more than adequate remuneration. The adequacy of remuneration shall be determined in relation to prevailing market conditions for the good or service in question in the country of provision or purchase (including price, quality, availability, marketability, transportation and other conditions of purchase or sale).

SCM Agreement, *supra* note 41, art. 14.

These guidelines generally employ a "market benchmark," comparing what the subsidy recipient pays or receives under the subsidy program to what it would pay or receive under normal market conditions. For analysis of the market benchmarks for identifying and measuring subsidies under the SCM Agreement, see Zheng, *Market Benchmark*, *supra* note 12, at 16–18. See also Sykes, *Questionable Case*, *supra* note 12, at 504.

recipient firm's productive behavior and reduces the price of the subsidized product is irrelevant.²⁰² Therefore, from an economic point of view, it is simply wrong to presume that *all* subsidies subject to the SCM Agreement pass through to prices in *all* circumstances.

V. THE SUBSIDY PASS-THROUGH PRESUMPTION: INTERNAL INCONSISTENCIES

Not only is the subsidy pass-through presumption economically wrong, but it is also not consistently employed by the current subsidy regulation regime. As noted above, the double counting controversy arises in part because the SCM Agreement and U.S. countervailing duty law are silent as to whether and how to take account of double counting for domestic subsidies.²⁰³ To the extent that there is no explicit guidance on this issue, attempts might be made to examine whether the SCM Agreement and U.S. countervailing duty law embody implicit principles that may inform the double counting analyses.²⁰⁴ In this Part, the Article demonstrates that efforts to seek implicit guidance from the current subsidy regulation regime would fail, because the SCM Agreement and U.S. countervailing duty law are internally inconsistent as to the behavioral and price impacts of subsidies. On one hand, proponents of the double counting hypothesis could point to the SCM Agreement and U.S. countervailing duty law for requirements that support the subsidy pass-through presumption. On the other hand, opponents of the double counting hypothesis could point to the SCM Agreement and U.S. countervailing duty law for requirements that reject the subsidy pass-through presumption. Both sides would be correct in their own analysis, but neither side would be correct in arguing that the law is solely on their side. The only conclusion that could be drawn from these internal inquiries would be that the current subsidy regulation regime is self-contradictory as to the behavioral and price impacts of subsidies.

A. The "Injury" and "Adverse Effects" Requirements: Behavioral Impact of Subsidies Required

First of all, the current subsidy regulation regime implicitly requires a subsidy to have an impact on the productive behavior of the recipient firm before it can be regulated. This can be seen from the "injury" requirement for the imposition of countervailing duties and the "adverse effects" requirement for seeking multilateral remedies against subsidies.

Under Article VI of GATT 1994, an importing country can impose countervailing duties to offset a subsidy conferred by a foreign government only if

²⁰² Goetz, Granet, and Schwartz call this approach the "benefit oriented" approach, as opposed to the "cost-based" approach that would discipline subsidies only if they affect recipient firms' costs. See Goetz, Granet & Schwartz, *supra* note 12, at 19–22.

²⁰³ See *supra* Part III.B.

²⁰⁴ In the DOC proceeding leading to DS379, China attempted this type of argument by claiming that the presumption that a domestic subsidy lowers the export price is "the whole basis for imposing countervailing duties." See CFS PAPER AD I&D MEMO, *supra* note 94, at 14. Apparently, the logic of this argument is that if U.S. countervailing duty law implicitly embodies a general subsidy pass-through presumption, then NME cases should not be subject to a separate subsidy pass-through analysis.

the “effect of . . . subsidization . . . is such as to cause or threaten material injury to an established domestic industry, or is such as to retard materially the establishment of a domestic industry.”²⁰⁵ Article 11 of the SCM Agreement provides that an application for the imposition of countervailing duties should include sufficient evidence of “injury within the meaning of Article VI of GATT 1994” and “a causal link between the subsidized imports and the alleged injury.”²⁰⁶ The SCM Agreement further provides that in determining whether subsidized imports cause injury, the relevant factors are “the volume of the subsidized imports and the effect of the subsidized imports on prices in the domestic market for like products” and “the consequent impact of these imports on the domestic producers of such products.”²⁰⁷ Under these requirements, a subsidy is subject to regulation only if it has the effects of causing the volume of exports to increase or the price in the domestic market of the importing country to decrease, or both. These effects hinge on the subsidy changing the productive behavior of the recipient firm. The injury requirement, therefore, essentially requires a subsidy to have a behavioral impact before it can be subject to regulation.

The WTO prong of the current subsidy regulation regime contains similar requirements. The SCM Agreement classifies subsidies into two categories: prohibited subsidies and actionable subsidies.²⁰⁸ Prohibited subsidies refer to subsidies contingent upon export performance or the use of domestic over imported goods.²⁰⁹ When challenging prohibited subsidies before the WTO, a complainant is not required to demonstrate any trade effects of such subsidies.²¹⁰ This, however, is not because the SCM Agreement does not consider prohibited subsidies to have trade effects. To the contrary, a complainant is not required to demonstrate the trade effects of prohibited subsidies because such subsidies are considered inherently trade-distorting and therefore evidence of trade effects is not necessary.²¹¹

For a complainant to challenge actionable subsidies, i.e., subsidies other than prohibited subsidies,²¹² the subsidies must cause “adverse effects” to the interests of other WTO members.²¹³ The “adverse effects” of a subsidy can be established by demonstrating: (1) injury to the domestic industry of another WTO

²⁰⁵ GATT 1994, *supra* note 87, art. VI:6(a). The SCM Agreement adopts the same injury requirement for the imposition of countervailing duties. Article 11 of the SCM Agreement provides that an application for the imposition of countervailing duties should include sufficient evidence of “injury within the meaning of Article VI of GATT 1994” and “a causal link between the subsidized imports and the alleged injury.” SCM Agreement, *supra* note 41, art. 11.2.

²⁰⁶ SCM Agreement, *supra* note 41, art. 11.2.

²⁰⁷ *Id.* art. 15.1.

²⁰⁸ See MICHAEL TREBILCOCK, ROBERT HOWSE & ANTONIA ELIASON, *THE REGULATION OF INTERNATIONAL TRADE* 375–84 (4th ed. 2013). The SCM Agreement originally included a third category of subsidies—non-actionable subsidies—but that classification expired at the beginning of the year 2000 pursuant to Article 31 of the SCM Agreement. *Id.* at 375.

²⁰⁹ SCM Agreement, *supra* note 41, art. 3.1.

²¹⁰ Under the SCM Agreement, a complainant is only required to provide evidence with regard to “the existence and nature” of prohibited subsidies. See *id.* art. 4.2.

²¹¹ TREBILCOCK, HOWSE & ELIASON, *supra* note 208, at 376; see also Working Party on GATS Rules, *Report of the Meeting of 23 June 2004*, ¶ 8, S/WPGR/M/48 (July 20, 2004) (“[T]rade distortive effects were inherent to export subsidies.”).

²¹² The SCM Agreement does not provide a definition of “actionable subsidies”; it simply uses the term “actionable subsidies” in the title of the part pertaining to subsidies other than prohibited subsidies. See SCM Agreement, *supra* note 41, pt. III.

²¹³ See *id.* arts. 5, 7.2.

member, (2) nullification or impairment of benefits accruing directly or indirectly to other WTO members under GATT 1994, or (3) serious prejudice to the interests of another WTO member.²¹⁴ With the exception of nullification or impairment of benefits, all three methods of establishing adverse effects require a subsidy to have a behavioral impact. First, as for injury to the domestic industry, the SCM Agreement states that the term “is used in the same sense” as it is used in the countervailing duty prong of the SCM Agreement,²¹⁵ which, as discussed above, requires a subsidy to have a behavioral impact. Second, as for nullification or impairment of benefits, the SCM Agreement states that the term “is used in the same sense as it is used in the relevant provisions of GATT 1994” and “the existence of such nullification or impairment shall be established in accordance with the practice of application of these provisions.”²¹⁶ Under GATT case law, whether nullification or impairment of benefits under GATT 1994 requires a showing of a noticeable change in trade flows depends on the nature of the benefit in question.²¹⁷ A noticeable change in trade flow is not required if the benefit in question consists of “the protection of expectations on competitive conditions.”²¹⁸ However, the GATT and the WTO have yet to opine on what the nature of the benefit under the SCM Agreement is and whether “nullification or impairment of benefits” under the SCM Agreement requires a showing of a tangible trade effect. It is uncertain, therefore, whether a subsidy is required to have a behavioral impact before it can be considered to cause adverse effects through nullification or impairment of benefits. Finally, as for serious prejudice, the SCM Agreement provides that a subsidy may cause serious prejudice in four scenarios: (1) the subsidy displaces or impedes the imports of a like product of another WTO member into the market of the subsidizing country; (2) the subsidy displaces or impedes the exports of a like product of another WTO member from a third country market; (3) the effect of the subsidy is a significant price undercutting by the subsidized product as compared with the price of a like product of another WTO member in the same market or significant price suppression, price depression or lost sales in the same market; and (4) the effect of the subsidy is an increase in the world market share of the subsidizing country in a particular subsidized primary product or commodity.²¹⁹ Obviously, all of the four scenarios require the subsidy in question to change the productive behavior of the recipient firm in terms of either output level or price, or both.

In sum, the SCM Agreement requires a subsidy to cause injury or adverse effects before it can be regulated. A logical extension of this requirement is that if a subsidy has been made subject to the SCM Agreement, it should be presumed to have caused injury or adverse effects—otherwise there would be no basis to regulate the subsidy to begin with. For a subsidy to cause injury or adverse effects,

²¹⁴ *Id.*

²¹⁵ *Id.* art. 5(a) n.11.

²¹⁶ *Id.* art. 5(b) n.12.

²¹⁷ See Report of the Panel, *EEC—Payments and Subsidies Paid to Processors and Producers of Oilseeds and Related Animal-Feed Proteins*, ¶ 151 (Jan. 25, 1990), GATT B.I.S.D. (37th Supp.) at 86 (1991).

²¹⁸ *Id.* See also Report of the Panel, *United States—Taxes on Petroleum and Certain Imported Substances*, ¶ 5.1.9 (Jun. 17, 1987), GATT B.I.S.D. (34th Supp.) at 136 (1988).

²¹⁹ *Id.* art. 6.3.

it must have an impact on the productive behavior of the recipient firm. Therefore, in this sense, the current subsidy regulation regime presumes subsidies brought under its purview to have a behavioral impact.

B. The Identification and Measurement of Subsidies: Behavioral Impact of Subsidies Irrelevant

While implicitly requiring subsidies to have a behavioral impact before they can be regulated, the current subsidy regulation regime disregards the behavioral impact of subsidies in identifying and measuring subsidies. As noted earlier, what makes a subsidy prohibited or actionable under the SCM Agreement is that it confers a benefit on the subsidy recipient, not that it alters the productive behavior of the subsidy recipient.²²⁰ The benefit of a subsidy, in turn, is measured by comparing what the subsidy recipient pays or receives under the subsidy program to what it would pay or receive under normal market conditions.²²¹ Under this benefit-based definition of subsidies, the behavioral impact of a subsidy is completely irrelevant to its identification and measurement.

In theory, the benefit-based definition of subsidies and the injury and adverse effects requirements are not necessarily contradictory to each other. If the effects of a subsidy could be reliably ascertained, the injury and adverse effects requirements could be said to operate in conjunction with the benefit-based definition of subsidies to narrow the scope of prohibited and actionable subsidies to only those that cause injury or adverse effects. As discussed earlier, however, it is next to impossible to reliably ascertain the effects of a specific subsidy program.²²² As a result, subsidies that confer a benefit on their recipients but do not cause injury or adverse effects to foreign producers may very well be classified as prohibited or actionable subsidies under the SCM Agreement.

The difficulty of determining the effects of specific subsidy programs can be seen from the lack of rigorous analyses by WTO dispute settlement panels and the Appellate Body in cases brought under the WTO prong of the current subsidy regulation regime. In *US—Large Civil Aircraft (Second Complaint)*, for example, the WTO dispute settlement panel hearing the case had to resort to what it described as “commonsense reasoning” and “drawing of inferences from conclusions regarding the nature” of certain U.S. subsidies to Boeing to determine the price effects of those subsidies.²²³ More troublingly, the WTO panel in that case even relied on what U.S. officials said about the policy objectives of the U.S. subsidies as a basis on which to infer the actual effects of those subsidies.²²⁴ In some cases, WTO panels and the Appellate Body have engaged in more formal causation analyses by examining how a subsidy might affect a recipient’s marginal cost of

²²⁰ See *supra* note 201 and accompanying text.

²²¹ *Id.*

²²² See *supra* notes 168–69 and accompanying text.

²²³ See Report of the Panel, *United States—Measures Affecting Trade in Large Civil Aircraft (Second Complaint)*, ¶ 7.1820, WT/DS353/R (Mar. 31, 2011) [hereinafter *US—Large Civil Aircraft (Second Complaint)*].

²²⁴ *Id.* ¶¶ 7.1704–.1740.

production.²²⁵ But as discussed earlier, the impact of a subsidy on a recipient's marginal cost of production could be theoretically ambiguous.²²⁶ It is not surprising, therefore, that many of the marginal-cost-of-production analyses by WTO panels and the Appellate Body amount to little more than mere assertions.²²⁷

The inability to reliably ascertain the effects of specific subsidy programs has sometimes forced WTO panels and the Appellate Body to group subsidies together and examine their effects on an aggregated basis. The WTO panel in *US—Upland Cotton*, for example, determined that “[w]e do not see the Article 6.3(c) reference to ‘the effect of the subsidy’ (in the singular, rather than the plural) as meaning that a serious prejudice analysis of price suppression must clinically isolate each individual subsidy and its effects.”²²⁸ The panel further held that “[t]o the extent a sufficient nexus with these exists among the subsidies at issue so that their effects manifest themselves collectively, we believe that we may legitimately treat them as a ‘subsidy’ and group them and their effects together.”²²⁹ Under this practice, a subsidy that has no behavioral impact may nonetheless be subject to WTO regulation as long as other subsidies that are being investigated at the same time happen to cause serious prejudice. In other words, once the effects of subsidies are evaluated on an aggregated basis, whether a subsidy has a behavioral impact will cease to be a necessary condition for the subsidy to be subject to WTO regulation under the SCM Agreement.

That said, the WTO prong of the current subsidy regulation regime at least endeavors, or pretends to endeavor, to ascertain the effects of specific subsidy programs. That effort or pretense of effort has been abandoned under the countervailing duty prong of the current subsidy regulation regime. Initially, under Article VI:6(a) of GATT 1947, GATT contracting states were required to demonstrate that “the effect of subsidization . . . is such as to cause or threaten to cause material injury”²³⁰ But in a legislative sleight of hand, the SCM Agreement in 1994 substituted the “effects of subsidized imports” for the “effect of subsidization” as the focus of material injury determinations in countervailing duty proceedings.²³¹ The SCM Agreement does preserve one reference to the effects of

²²⁵ In *EC—Large Civil Aircraft*, for example, the WTO panel analyzed whether certain subsidies granted by the European Communities and its member states to Airbus affected Airbus' pricing through affecting its marginal cost of production. See Report of the Panel, *European Unions and Certain Member States—Measures Affecting Trade in Large Civil Aircraft*, ¶¶ 7.1997–2024, WT/DS316/R (Jun. 30, 2010) [hereinafter *EC—Large Civil Aircraft*].

²²⁶ See *supra* notes 189–192 and accompanying text.

²²⁷ In *EC—Large Civil Aircraft*, for example, the United States argued that certain European subsidies reduced Airbus' cost of capital and marginal cost of production, “thereby enabling Airbus to be more flexible on price.” See *EC—Large Civil Aircraft*, *supra* note 225, ¶ 7.2023. In rejecting the U.S. arguments, the WTO panel held:

We do not understand there to be any dispute about whether better creditworthiness results in a lower cost of capital. However, we are not convinced that this will necessarily translate into a reduction in the marginal cost of production. The United States has provided very little, if any, explanation for why it considers this relationship would hold.

Id.

²²⁸ Report of the Panel, *United States—Subsidies on Upland Cotton*, ¶ 7.1192, WT/DS267/R (Sept. 8, 2004).

²²⁹ *Id.*

²³⁰ GATT 1947, *supra* note 27, art. VI:6(a) (emphasis added).

²³¹ Articles 15.1–15.4 of the SCM Agreement all refer to the effect of subsidized imports in laying out the standards for material injury determinations. Article 15.1, for example, states:

subsidies by requiring, under Article 15.5, that WTO members demonstrate that “the subsidized imports are, *through the effects of subsidies*, causing injury within the meaning of this Agreement.”²³² But that reference, when interpreted in light of footnote 47 to the SCM Agreement,²³³ could mean that a demonstration of the effects of subsidized imports will be sufficient to establish the fact that the injury is caused through the effects of subsidies.²³⁴ The distinction here between the “effects of subsidies” and the “effects of subsidized imports” is crucial. When a demonstration of the effects of subsidies is required, an investigating authority has to demonstrate that it is the *subsidies* that cause the injury. But when only a demonstration of the effects of subsidized imports is required, an investigating authority need only demonstrate that the injury is caused by the *imports* under countervailing duty investigation; exactly which subsidy causes the injury and whether the injury is caused by subsidies at all will be irrelevant to the injury determination.

Whatever the meaning of the reference to the “effects of subsidies” in Article 15.5 of the SCM Agreement, that reference has vanished under national countervailing duty laws. U.S. countervailing duty law, for example, only requires a demonstration that injury is “by reason of imports.”²³⁵ EU countervailing duty law, for another example, only requires the examination of the effects of “subsidized imports” in injury determinations.²³⁶

The elimination of the need to examine the effects of subsidies in countervailing duty proceedings is most complete under U.S. countervailing duty law: Not only has U.S. countervailing duty law omitted any references to the effects of subsidies in injury determinations, but it has explicitly stated that “[t]he administering authority is not required to consider the effect of the subsidy in determining whether a subsidy exists”²³⁷ This provision was added by the Uruguay Round Agreements Act to repeal a 1993 ruling by a U.S.-Canada dispute settlement panel that a government practice has to have an effect on the price or output of the merchandise under investigation in order for the government practice

and the effect of the *subsidized imports* on prices in the domestic market for like products and (b) the consequent impact of these imports on the domestic producers of such products.

SCM Agreement, *supra* note 41, art. 15.1 (emphasis added) (footnote omitted).

²³² *Id.* art. 15.5 (emphasis added).

²³³ Footnote 47 is placed after the word “effects” in Article 15.5:

15.5. It must be demonstrated that the subsidized imports are, through the effects⁴⁷ of subsidies, causing injury within the meaning of this Agreement.

47. As set forth in paragraphs 2 and 4.

Id. art. 15.5.

²³⁴ See MARK BENITAH, *THE LAW OF SUBSIDIES UNDER THE GATT/WTO SYSTEM* 284 (2001). But as Benitah pointed out, interpreting footnote 47 this way would render Article 15.5 redundant. *Id.* Benitah argued that an alternative interpretation of footnote 47 would require a demonstration of not just the effects of subsidized imports as set forth under Articles 15.2 and 15.4, but also the effects of subsidies. *Id.* at 285–86. Benitah acknowledged, however, that the latter interpretation would stretch the literal meaning of footnote 47. *Id.* at 286.

²³⁵ See 19 U.S.C. § 1671(a) (2011).

²³⁶ See Council Regulation (EC) No. 2026/97 of 6 October 1997 on Protection Against Subsidized Imports from Countries Not Members of the European Community, art. 8, 1997 O.J. (L 288) 1.

²³⁷ 19 U.S.C. § 1677(5)(C) (2011).

to be considered a subsidy.²³⁸ The Statement of Administrative Action accompanying this provision clarified that this provision was intended to make clear that “the new definition of subsidy [under the SCM Agreement and the Uruguay Round Agreements Act] does not require that [the DOC] consider or analyze the effect (including whether there is any effect at all) of a government action on the price or output of the class or kind of merchandise under investigation or review.”²³⁹

U.S. countervailing duty law, therefore, suffers from a fundamental self-contradiction: On one hand, a subsidy has to cause injury in order for it to be countervailable, but on the other hand, the effects of a subsidy are not investigated at all in countervailing duty proceedings and are irrelevant to the identification and measurement of the subsidy anyway. Since injury determinations in U.S. countervailing duty proceedings are made on the basis of the effects of subsidized imports, not on the basis of the effects of specific subsidy programs, it may very well be the case that a subsidy that has no behavioral impact is found to cause injury.

This self-contradiction also plagues the WTO prong of the current subsidy regulation regime, albeit to a lesser degree. As discussed above, the WTO prong of the current subsidy regulation regime at least tries, or pretends to try, to ascertain the effects of a subsidy before determining whether the subsidy is subject to WTO regulation. But given the difficulties with assessing the effects of specific subsidy programs, and given the lack of rigorous analyses by WTO panels and the Appellate Body of the effects of specific subsidy programs, it may still be the case that a subsidy that has no behavioral impact will be found to cause adverse effects.

C. Upstream Subsidies: No Presumption of Subsidy Pass-Through

Yet another example of the internal inconsistencies of the current subsidy regulation regime regarding the behavioral impact of subsidies can be found in the treatment of upstream subsidies. Under U.S. countervailing duty law, the term “upstream subsidy” refers to a subsidy conferred on an input product that is used in the manufacture or production of the merchandise that is the subject of a countervailing duty investigation.²⁴⁰ To qualify as an upstream subsidy, a subsidy must bestow a “competitive benefit” on the subject merchandise and must have a significant effect on the cost of manufacturing or producing the subject merchandise.²⁴¹ For example, if the merchandise that is subject to a countervailing duty investigation is steel, then a subsidy conferred on the production of iron ores will be an upstream subsidy if it bestows a “competitive benefit” on the steel producer and if it has a significant effect on the cost of producing the steel.

Under U.S. countervailing duty law, an upstream subsidy confers a competitive benefit on a downstream product if the price of the upstream product is lower than the price that the downstream producer would otherwise pay for the

²³⁸ See URAA, STATEMENT OF ADMINISTRATIVE ACTION, H.R. DOC. NO. 103-316, vol. 1, at 926 (1994).

²³⁹ *Id.*

²⁴⁰ See 19 U.S.C. § 1677-1(a)(1)(2011).

²⁴¹ *Id.* § 1677-1(a)(2)–(3).

product in obtaining it from another seller in an arms-length transaction.²⁴² To use the above steel/iron ore example again, if the downstream steel producer pays \$100 a ton for iron ores that received an upstream subsidy while it otherwise would have to pay \$150 a ton to obtain iron ores from a seller in an arms-length transaction, then the upstream subsidy conferred on iron ores will be considered to bestow a competitive benefit of \$50 on the downstream steel product. If an upstream subsidy is conferred, the DOC will be required to add the amount of the competitive benefit conferred by the upstream subsidy on the downstream product to the amount of countervailing duties imposed on the downstream product.²⁴³ Again, in the above steel/iron ores example, the DOC will be required to add \$50 to the amount of countervailing duties imposed on the downstream steel product.

A key issue in the upstream subsidy analysis is what the DOC needs to do to prove that an upstream subsidy “passes through” from the upstream producer to the downstream producer. U.S. countervailing duty law provides that if the upstream producer and the downstream producer are unrelated, then the DOC “shall decide” that a competitive benefit is conferred by the upstream subsidy.²⁴⁴ In other words, the DOC needs to definitively establish that an upstream subsidy passes through to the downstream product; it could not simply presume that an upstream subsidy will pass through.

The treatment of upstream subsidies under U.S. countervailing duty law finds support in WTO case law concerning the issue. In *United States—Final Countervailing Duty Determination with respect to Certain Softwood Lumber from Canada*, a WTO dispute settlement panel and the Appellate Body dealt with the question of whether the DOC was required to conduct a subsidy pass-through analysis when imposing countervailing duties on imports of softwood lumber products from Canada to offset subsidies conferred on the harvesting of timber by timber harvesters that sold raw logs to unrelated lumber producers.²⁴⁵ Both the panel and the Appellate Body ruled that the definition of the term “countervailing duty” in footnote 36 to Article 10 of the SCM Agreement,²⁴⁶ as well as Article VI:3 of GATT 1994,²⁴⁷ requires a pass-through analysis.²⁴⁸ Both the panel and the

²⁴² *Id.* § 1677-1(b)(1).

²⁴³ *Id.* § 1677-1(c).

²⁴⁴ *Id.* § 1677-1(b)(1).

²⁴⁵ See Report of the Appellate Body, *United States—Final Countervailing Duty Determination with Respect to Certain Softwood Lumber from Canada*, ¶¶ 123–66, WT/DS257/AB/R (Jan. 19, 2004) [hereinafter DS257 AB Report]; Report of the Panel, *United States—Final Countervailing Duty Determination with Respect to Certain Softwood Lumber from Canada*, ¶¶ 7.81–99, WT/DS257/R (Aug. 29, 2003) [hereinafter DS257 Panel Report].

²⁴⁶ Article 10 of the SCM Agreement reads as follows:

Members shall take all necessary steps to ensure that the imposition of a countervailing duty³⁶ on any product of the territory of any Member imported into the territory of another Member is in accordance with the provisions of Article VI of GATT 1994 and the terms of this Agreement. Countervailing duties may only be imposed pursuant to investigations initiated [footnote omitted] and conducted in accordance with the provisions of this Agreement and the Agreement on Agriculture.

36. The term “countervailing duty” shall be understood to mean a special duty levied for the purpose of offsetting any subsidy bestowed directly or indirectly upon the manufacture, production or export of any merchandise, as provided for in paragraph 3 of Article VI of GATT 1994.

SCM Agreement, *supra* note 41, art. 10.

²⁴⁷ Article VI:3 of GATT 1994 provides:

Appellate Body held that in the instant dispute, the DOC's failure to conduct a pass-through analysis with respect to arms-length sales of logs by timber harvesters to lumber producers violated these WTO rules.²⁴⁹

To some extent, the requirement for a definitive pass-through analysis for upstream subsidies has also been read into the WTO prong of the subsidy regulation regime. In *United States—Subsidies on Upland Cotton*, Brazil challenged subsidies allegedly conferred by the United States on producers, users and exporters of upland cotton before the WTO.²⁵⁰ The United States argued that in determining whether the alleged subsidies caused "serious prejudice" under Article 6.3(c) of the SCM Agreement, the WTO dispute settlement panel failed to establish the extent to which the benefit of certain subsidies paid to producers of raw cotton passed through to processed cotton.²⁵¹ The Appellate Body held that, since the requirement in Article VI:3 of GATT 1994 and Article 19.4 of the SCM Agreement that countervailing duties imposed on a product be limited to the amount of the subsidy accruing to that product has no parallel in Part III of the SCM Agreement, the need for a pass-through analysis is "not critical" for an assessment of significant price suppression under Article 6.3(c) in Part III of the SCM Agreement.²⁵² Nevertheless, the Appellate Body held that a "subsidized product" must be identified for purposes of determining price suppression under Article 6.3(c) and, to identify a "subsidized product," it must be established that the upstream subsidy has flowed to the downstream product.²⁵³

The requirement for a definitive pass-through analysis for upstream subsidies means that investigating authorities and the WTO are prohibited from relying on a presumption of subsidy pass-through when analyzing upstream subsidies. Under this requirement, if an upstream producer receives a subsidy, the producer could not be *presumed* to pass the subsidy along to an unrelated downstream producer by charging a lower price than would be charged by a seller in an arms-length transaction. Investigating authorities must affirmatively determine that the upstream subsidy passes through to the price of the upstream product.

No countervailing duty shall be levied on any product of the territory of any contracting party imported into the territory of another contracting party in excess of an amount equal to the estimated bounty or subsidy determined to have been granted, directly or indirectly, on the manufacture, production or export of such product in the country of origin or exportation, including any special subsidy to the transportation of a particular product. The term "countervailing duty" shall be understood to mean a special duty levied for the purpose of offsetting any bounty or subsidy bestowed, directly, or indirectly, upon the manufacture, production or export of any merchandise.

GATT 1994, *supra* note 87, art. VI:3.

²⁴⁸ See DS257 Panel Report, *supra* note 245, ¶ 7.91; DS257 AB Report, *supra* note 245, ¶ 146.

²⁴⁹ See DS257 Panel Report, *supra* note 245, ¶ 7.99; DS257 AB Report, *supra* note 245, ¶ 146.

²⁵⁰ See Report of the Appellate Body, *United States—Subsidies on Upland Cotton*, ¶ 1, WT/DS267/AB/R (Mar. 3, 2005).

²⁵¹ *Id.* ¶ 470.

²⁵² *Id.* ¶ 472.

²⁵³ *Id.* The Appellate Body held, however, that Article 6.3(c) does not require a precise quantification of the upstream subsidy at issue because the remedy envisioned under Part III of the SCM Agreement is the withdrawal of the subsidy or the removal of the adverse effects, not the imposition of countervailing duties whose amount cannot be in excess of the amount of the subsidy. *Id.* ¶ 464.

The treatment of upstream subsidies under U.S. countervailing duty law directly contradicts the subsidy pass-through presumption that underlies the double counting hypothesis. The double counting hypothesis states that when a producer sells a subsidized product to an unrelated buyer, the presumption is that the seller passes the subsidy along to the buyer by lowering the price of the subsidized product. But when an upstream producer sells a subsidized product to an unrelated downstream buyer, U.S. countervailing duty law makes no presumptions as to whether the upstream producer will pass along the subsidy to the downstream buyer. Seen in this light, the subsidy pass-through presumption underlying the double counting hypothesis is firmly rejected by U.S. countervailing duty law, albeit in a different context.

VI. THE CASE FOR FUNDAMENTAL REFORMS OF THE CURRENT SUBSIDY REGULATION REGIME

The foregoing discussions demonstrate that the double counting issue that has entangled the current round of subsidy disputes is indeed a false issue, as the subsidy pass-through presumption thought to give rise to double counting is economically wrong and is not consistently employed by the current subsidy regulation regime. In this Part, the Article argues that it is impossible to arrive at a coherent, economically sensible solution to the double counting issue within the framework of the current subsidy regulation regime. This Article further argues that the problem with the double counting issue is indeed a problem with the current subsidy regulation regime, which embraces conflicting rationales for regulating subsidies in the first place. This Article renews the call for fundamental reforms of the current subsidy regulation regime and proposes a blueprint for such reforms.

A. The Impossibility of a Coherent Approach to the Double Counting Controversy

As discussed earlier, whether a subsidy is double-counted in concurrent NME antidumping and countervailing duty cases depends on whether the subsidy passes through to the price of the subsidized product. Economic theory indicates that the question of whether a subsidy passes through to the price of the subsidized product is necessarily a factual one: It depends on whether the subsidy in question alters the productive behavior of the recipient firm, and whether the recipient firm has market power in the market for the subsidized product.²⁵⁴ It is wrong, therefore, to simply *presume* a subsidy to pass through to price.

The economic fallacies of the subsidy pass-through presumption mean that most, if not all, of the double counting analyses ventured so far are misguided. If a subsidy does not necessarily pass through to the price of the subsidized product, it is inappropriate to allocate to the investigating authority the burden to prove that double counting does *not* occur, as the CIT and the Appellate Body did in *GPX I*

²⁵⁴ See *supra* Part IV.

and DS379 respectively.²⁵⁵ Indeed, without the subsidy pass-through presumption, double counting would not even have become an issue to begin with.

Therefore, the correct approach to double counting appears to be to require parties arguing for the existence of double counting to bear the burden of factually proving that a subsidy passes through to the price of the subsidized product before an investigating authority is obligated to investigate the potential double counting of subsidies. Without at least plausible evidence of subsidy pass-through, it seems wrong to devote administrative and judicial resources to an issue that is at best speculative.

The above approach would pose high hurdles for claims of double counting. As discussed earlier, it is very difficult, if not impossible, to establish a causal relationship between a specific subsidy program and a change in the price of the subsidized product.²⁵⁶ If a party could somehow meet the burden of proving the existence of double counting, the next challenge will be the calculation of the magnitude of double counting. As illustrated in Figure 3 above, even if a subsidy does pass through to price, it may not always reduce price one for one. The exact magnitude of the subsidy pass-through will depend on the shapes and slopes of the supply and demand curves for the product in question.²⁵⁷ But if both the existence and magnitude of double counting could be established, the above approach would require the investigating authority to adjust the amount of antidumping and/or countervailing duties to take account of double counting.

However, as intuitive as it appears, the above approach would solicit a greater problem than it solves. Requiring investigating authorities to take account of double counting once the existence and magnitude of subsidy pass-through are established would open the door to examining the effects of subsidies in countervailing duty proceedings.²⁵⁸ But once the effects of subsidies begin to be examined, it would be difficult to set a limit on that exercise. Specifically, if a respondent could obtain a lower duty rate by demonstrating that a subsidy passes through to price and therefore is double counted, should a respondent be allowed to argue that a subsidy should not be countervailable if it could demonstrate that the subsidy has no behavioral impact (or has no behavioral impact yet)? Logic would require respondents to be given that option: After all, a subsidy that has no behavioral impact (or has no behavioral impact yet) will not cause (or will not have caused) injury, thus failing a prerequisite for the imposition of countervailing duties. Therefore, if anything, the above approach to double counting would reveal the self-contradictions of U.S. countervailing duty law: On one hand, U.S.

²⁵⁵ See *supra* notes 111, 133 and accompanying text.

²⁵⁶ See *supra* notes 168–69 and accompanying text.

²⁵⁷ See *supra* Figure 3. A separate question is who should have the burden to calculate the magnitude of subsidy pass-through. Recall that in PL 112-99, the United States Congress allocated this burden to the DOC. See *supra* note 143 and accompanying text.

²⁵⁸ Technically, one might argue that the effects of subsidies are accounted for in antidumping proceedings, not in countervailing duty proceedings, since the amount of subsidy pass-through would be subtracted from the amount of antidumping duties, not from the amount of countervailing duties. See *supra* note 153 and accompanying text. This distinction, however, is purely formalistic. For a respondent firm facing concurrent antidumping and countervailing duty investigations, what matters is the combined antidumping and countervailing duty rate. It is immaterial whether the reduction in the combined duty rate is due to a reduction in the antidumping duty rate or due to a reduction in the countervailing duty rate; in either scenario it is the subsidy pass-through that results in the lower duty rate.

countervailing duty law requires a subsidy to cause injury, but on the other hand, it does not require a demonstration of the effects of a subsidy and countervails a subsidy regardless of its behavioral impact. Because of these self-contradictions, it is simply impossible to arrive at a coherent solution to the double counting issue within the framework of the current subsidy regulation regime.

B. Conflicting Rationales for Subsidy Regulation

The foregoing analyses beg the more important question of why the current subsidy regulation regime is internally inconsistent as to the behavioral impact of subsidies. As this Article will discuss below, the answer to that question could be because the current subsidy regulation regime embraces two conflicting rationales for subsidy regulation, one based on economic efficiency and one based on the protection of entitlements.

1. The Efficiency Rationale

According to the efficiency rationale for subsidy regulation, subsidies need to be regulated because they distort resource allocation and reduce economic efficiency. The original framework of the GATT, for example, treats subsidies as a “distortion” that creates a disparity between the actual costs of producing a particular good and those that are borne by the firm producing it.²⁵⁹ This conception of subsidies as a distortion was formally recognized by the DOC, which, in *Carbon Steel Wire Rod from Poland* in 1984, defined a subsidy as “any action that distorts or subverts the market process, results in a misallocation of resources, encouraging inefficient production and lessening world wealth.”²⁶⁰ In 1989, in the preamble to its newly proposed countervailing duty regulations, the DOC fully embraced this efficiency rationale as the whole basis of its countervailing duty regulations.²⁶¹

The efficiency rationale could explain why the SCM Agreement regulates subsidies regardless of their behavioral impact. The efficiency rationale posits that since subsidies reduce overall economic efficiency, other countries should be allowed to adopt countervailing measures for the benefit of the collective welfare of the world even if the subsidies do not have an adverse impact on their own interests.²⁶² The purpose of subsidy regulation, according to the efficiency

²⁵⁹ Schwartz & Harper, *supra* note 12, at 833 (citing W. BROWN, *THE UNITED STATES AND THE RESTORATION OF WORLD TRADE: AN ANALYSIS AND APPRAISAL OF THE ITO CHARTER AND THE GENERAL AGREEMENT ON TARIFFS AND TRADE* 214–15 (1950); KENNETH W. DAM, *THE GATT: LAW AND INTERNATIONAL ECONOMIC ORGANIZATION* 132 (1970)).

²⁶⁰ See *Carbon Steel Wire Rod from Poland*, *supra* note 69, at 19,375.

²⁶¹ See Countervailing Duties: Notice of Proposed Rulemaking and Request for Public Comments, 54 Fed. Reg. 23,366, 23,367 (May 31, 1989) (“Conceptually, the [countervailing duty] regulations are based upon the economic model articulated by the Department in its final determination[] in . . . *Carbon Steel Wire Rod from Poland* . . .”).

²⁶² See JOHN H. JACKSON, *THE WORLD TRADING SYSTEM: LAW AND POLICY OF INTERNATIONAL ECONOMIC RELATIONS* 282 (2d ed. 1997) (describing the argument that international disciplines on subsidies are better justified from a worldwide perspective).

rationale, is not to remedy the adverse consequences of subsidies but to deter the use of subsidies in the first place.²⁶³

The current subsidy regulation regime, however, could not be fully reconciled with the efficiency rationale. From a theoretical point of view, not all subsidies distort the market process and reduce economic efficiency; many subsidies indeed “correct” the market process and enhance economic efficiency.²⁶⁴ A subsidy may enhance economic efficiency when it corrects “market failures,” a situation in which the actual price differs from the socially optimal price.²⁶⁵ The definition of the term “subsidies” under the SCM Agreement, however, makes no distinction between subsidies that distort the market process and subsidies that correct the market process, belying any claim that the purpose of subsidy regulation under the SCM Agreement is to enhance efficiency.²⁶⁶

2. The Entitlement Rationale

In search of an alternative rationale for subsidy regulation, some scholars posited that the purpose of subsidy regulation is to protect the “entitlements” of the producers of the importing countries.²⁶⁷ Under this entitlement rationale for subsidy regulation, governments are free to grant subsidies in ways they see fit, but other countries will be allowed to take countervailing measures to offset those subsidies that harm the entitlements of their own producers.²⁶⁸ Unlike the efficiency rationale, which emphasizes deterrence, the entitlement rationale emphasizes the neutralization of the adverse effects of subsidies.²⁶⁹ John Jackson called this motive for applying countervailing measures “parochial or selfish,” but recognized that this motive in the long run tends to coincidentally inhibit a practice that reduces world welfare.²⁷⁰

²⁶³ See Goetz, Granet & Schwartz, *supra* note 12, at 19–20 (describing the deterrence rationale of the countervailing duty law).

²⁶⁴ Schwartz & Harper, *supra* note 12, at 833. Schwartz and Harper went as far as arguing that “perhaps all” subsidies can be defended as a correction, rather than a distortion, of the market process. *Id.*

²⁶⁵ WTO, WORLD TRADE REPORT 2006: EXPLORING THE LINKS BETWEEN SUBSIDIES, TRADE AND THE WTO 58 (2006); see also Schwartz & Harper, *supra* note 12, at 833–34 (“The need for correction is said to derive from the existence of ‘externalities,’ that is, costs or benefits that are borne or reaped by nonparties to a transaction and are not therefore taken into account in the market process.”).

²⁶⁶ See Sykes, *A Critique*, *supra* note 12, at 699; see also Diamond, *Economic and Financial Principles*, *supra* note 12, at 532.

²⁶⁷ Goetz, Granet, and Schwartz first used the term “entitlement” to describe the interests of U.S. producers in being protected from injury caused by foreign subsidies:

We assume that American firms are entitled to that domestic market outcome which would have resulted from a “fair,” competitive process, by which is meant one which has not been “manipulated” by foreign government subsidization. The idea then is to restore competition in the American market to its “but for” state by neutralizing the effect of the subsidy.

Goetz, Granet & Schwartz, *supra* note 12, at 18–19. See also Diamond, *Economic Foundations*, *supra* note 12, at 780–82. Simon Lester also formulated an approach to the countervailing law that resembles the entitlement approach. See generally Lester, *supra* note 12 (arguing that a possible purpose of the multilateral subsidy regulation regime is to fight protectionist subsidies).

²⁶⁸ See Goetz, Granet & Schwartz, *supra* note 12, at 20–23 (describing the cost-based approach to the countervailing duty law).

²⁶⁹ See *id.*

²⁷⁰ See JACKSON, *supra* note 262, at 282.

To some extent, the injury and adverse effects requirements under the current subsidy regulation regime reflect the entitlement rationale: A subsidy, no matter how detrimental it may be to the welfare of the country that grants the subsidy, will not be subject to regulation under the SCM Agreement unless it affects the entitlements of producers in other countries. As discussed earlier, however, the injury and adverse effects requirements alone do not narrow the scope of subsidies that are subject to regulation, as it is practically impossible to establish causal relationships between specific subsidy programs and injury or adverse effects.²⁷¹ To fully reflect the entitlement rationale, the definition of subsidies must be changed so that a subsidy that has no behavioral impact and therefore does not affect the entitlements of foreign producers will not be considered a subsidy in the first place. Proponents of the entitlement rationale themselves readily acknowledge that the current subsidy regulation regime is not fully consistent with the entitlement rationale.²⁷²

The current subsidy regulation regime could be described as a paradoxical amalgam of the efficiency rationale and the entitlement rationale.²⁷³ On one hand, it reflects the efficiency rationale because subsidies are identified and measured regardless of their behavioral impact.²⁷⁴ On the other hand, it reflects the entitlement rationale because conceptually, subsidies are required to cause injury or adverse effects before they may be subject to regulation.²⁷⁵ The tension between these two rationales underlies the internal inconsistencies of the current subsidy regulation regime as to the behavioral impact of subsidies and makes it impossible to have a coherent solution to the double counting issue.²⁷⁶

C. A Renewed Call for a Country-Specific Safeguard

The self-contradictions of the current subsidy regulation regime as revealed by the double counting controversy add urgency to the need to reexamine the fundamental purpose of subsidy regulation and ways to reform the current subsidy regulation regime. Below, this Article concurs with the current literature that the case for subsidy regulation in general is questionable. It then renews the call for fundamental reforms of the current subsidy regulation regime by replacing the countervailing duty prong of the regime with a new trade remedy instrument—a country-specific safeguard—that this author proposed in another article. This Article argues that the country-specific safeguard represents a politically feasible improvement over the status quo and also solves the double counting problem.

²⁷¹ See *supra* notes 168–69 and accompanying text.

²⁷² See Diamond, *Economic and Financial Principles*, *supra* note 12, at 533–65 (arguing that U.S. countervailing duty rules are inconsistent with the entitlement rationale); Goetz, Granet & Schwartz, *supra* note 12, at 28 (noting that the benefit-oriented subsidy definition is wholly inconsistent with the entitlement rationale).

²⁷³ Goetz, Granet, and Schwartz first pointed out the “basic tension” between the efficiency rationale and the entitlement rationale. See Goetz, Granet & Schwartz, *supra* note 12, at 27.

²⁷⁴ See *supra* Part V.B.

²⁷⁵ See *supra* Part V.A.

²⁷⁶ See *supra* Part VI.A.

1. The Questionable Case for Subsidy Regulation

As discussed above, efforts to justify the current subsidy regulation regime under certain normative principles have been unsuccessful, as neither of the two main candidates—the efficiency rationale and the entitlement rationale—is fully consistent with the current subsidy regulation regime. But questions remain as to whether the current subsidy regulation regime could be reconfigured in accordance with the efficiency or entitlement principle. As shall become clear below, the answer to those questions is “no.”

First of all, it is impracticable to reconfigure the SCM Agreement in accordance with the efficiency rationale. Such reconfiguration would require a regulatory scheme that regulates only inefficient subsidies, not efficient subsidies. Scholars have outlined several obstacles to such a reconfiguration. First, there is no international consensus as to what subsidies are efficient and what subsidies are inefficient.²⁷⁷ Second, even if an international consensus on efficient subsidies could be reached, the “haphazard and uncoordinated” imposition of countervailing duties will yield “little systematic deterrent effect.”²⁷⁸ Finally, that a subsidy enhances efficiency conceptually does not preclude the possibility that a government may over-remedy the market failure that the subsidy is intended to remedy, and it is practically impossible for investigating authorities to gather all the information necessary for determining whether a government is subsidizing by the correct amount.²⁷⁹

Similarly, it is impracticable to reconfigure the current subsidy regulation regime in accordance with the entitlement rationale. Such reconfiguration would require the regulation of only subsidies that have a behavioral impact. Identifying the behavioral impact of subsidies, however, is not always easy. Proponents of the entitlement rationale themselves acknowledge that the impact of certain subsidies on recipient firms’ marginal costs of production is theoretically ambiguous²⁸⁰ and the process for separating out the behavioral impact of a subsidy in a specific jurisdiction is “costl[y]” and “error-prone.”²⁸¹ In addition, requiring an analysis of the behavioral impact of subsidies in every case would undoubtedly result in a subsidy regulation regime that is too unwieldy.²⁸²

Besides the efficiency and entitlement rationales, scholars have considered, but rejected, several other possible objectives of across-the-board subsidy

²⁷⁷ Sykes, *A Critique*, *supra* note 12, at 699.

²⁷⁸ *Id.* See also Diamond, *Economic and Financial Principles*, *supra* note 12, at 533 (“[T]otal deterrence would be difficult to achieve given the nature of countervailing duties.”); Sykes, *An Economic Perspective*, *supra* note 12, at 200–01.

²⁷⁹ See Zheng, *Market Benchmark*, *supra* note 12, at 47–48.

²⁸⁰ See *supra* note 192 and accompanying text.

²⁸¹ Goetz, Granet & Schwartz, *supra* note 12, at 26.

²⁸² Indeed, in the early 1990s, respondents in a countervailing duty investigation proposed a test that would make a subsidy countervailable only if the subsidy lowers producers’ marginal costs and causes a net economic effect on producers’ output or prices. See Certain Softwood Lumber Products from Canada, 57 Fed. Reg. 22,570, 22,604–05 (Dep’t of Commerce May 28, 1992) (final determination). The DOC rejected this proposal, arguing that “[f]rom a practical perspective, Respondents’ thesis would push the Department into a complex causation analysis in every case and for every type of countervailable subsidy, including all the usual direct subsidies that the Department analyzes.” *Id.* at 22,605. The DOC pointed out that “it would be difficult” to show a causal link between the receipt of a subsidy and changes in the productive behavior of a subsidy recipient. *Id.*

disciplines. Scholars have acknowledged that subsidy disciplines aimed at protecting the expectations of market access created by trade agreements might be legitimate, but have expressed doubts that additional, across-the-board subsidy disciplines are necessary.²⁸³ Merit Janow, Robert Staiger, and Kyle Bagwell argued that across-the-board disciplines on subsidies may be undesirable because they hinder the ability of trading nations to pursue nonprotectionist objectives and make them reluctant to enter trade agreements in the first place.²⁸⁴ Alan Sykes hypothesized that across-the-board subsidy disciplines might serve several other objectives, including the promotion of free trade, the prevention of competitive subsidization, and the avoidance of time-inconsistency problems faced by governments in their political interaction with domestic industries.²⁸⁵ He concluded, however, that the WTO subsidy rules do not accomplish those objectives successfully because of the inability of the WTO rules to identify subsidization and to distinguish undesirable from desirable subsidies.²⁸⁶

In addition to the lack of defensible rationales, the case for subsidy regulation is questionable particularly because a major pillar of the current subsidy regulation regime—the imposition of countervailing duties—has dubious welfare consequences at best. As Alan Sykes pointed out, under conditions of perfect competition, a subsidy will enhance the welfare of an importing country and the imposition of countervailing duties will often reduce the welfare of the importing country.²⁸⁷ Although the imposition of countervailing duties may have positive effects on the welfare of the importing country when subsidized imports cause sustained unemployment or adjustment costs in the importing country, the existing countervailing duty laws “are poorly suited to identify the circumstances in which the imposition of a duty might be appropriate for these purposes.”²⁸⁸ Similarly, when the product market departs from conditions of perfect competition, the imposition of countervailing duties may enhance the welfare of an importing country if foreign governments use subsidies to finance the predatory campaigns of their producers²⁸⁹ or use subsidies to seek strategic advantages for their producers.²⁹⁰ But as Sykes analyzed, existing countervailing duty laws are not properly tailored to counter those subsidies.²⁹¹ For these reasons, Sykes argued that “abolition of the countervailing duty laws might best serve the national economic interest.”²⁹²

²⁸³ See Sykes, *Questionable Case*, *supra* note 12, at 496–97.

²⁸⁴ Merit E. Janow & Robert W. Staiger, *U.S.—Export Restraints*, in THE WTO CASE LAW OF 2001 (Henrik Horn & Petros C. Mavroidis eds., 2003); Kyle Bagwell & Robert W. Staiger, *Will International Rules on Subsidies Disrupt the World Trading System?*, 96 AM. ECON. REV. 877–95 (2006).

²⁸⁵ See Sykes, *Questionable Case*, *supra* note 12, at 498–501.

²⁸⁶ *Id.* at 501–20.

²⁸⁷ See Sykes, *An Economic Perspective*, *supra* note 12, at 214.

²⁸⁸ *Id.* at 229.

²⁸⁹ See Schwartz & Harper, *supra* note 12, at 834–35; J. A. Ordover, A. O. Sykes & R. D. Willig, *Unfair International Trade Practices*, 15 N.Y.U. J. INT’L L. & POL. 323, 332 (1983).

²⁹⁰ This justification for trade barriers such as countervailing duties was advanced by scholars subscribing to the “strategic trade policy” theories. See Sykes, *An Economic Perspective*, *supra* note 12, at 250–51 n.182.

²⁹¹ See *id.* at 241–56.

²⁹² *Id.* at 263.

Similarly, Warren Schwartz argued that “no convincing case can be made for having a countervailing duty law.”²⁹³

2. A Renewed Call for a Country-Specific Safeguard

Despite doubtful justifications for subsidy regulation in general and countervailing duty laws in particular, a completely *laissez-faire* approach to subsidy regulation would appear to be politically unfeasible.²⁹⁴ One possible way of reforming the current subsidy regulation regime, however, would be to create a new trade remedy instrument to replace the countervailing duty prong of the current subsidy regulation regime. As this Article will argue below, the new trade remedy instrument will put subsidy regulation on a firmer intellectual foundation, will be politically feasible, and, incidentally, will solve the double counting problem.

In a previous article, this author proposed to replace antidumping and countervailing duties with a country-specific safeguard—a new trade remedy instrument that allows an importing country to impose additional duties on imports on a country-by-country basis upon a showing that the imports cause serious injury to the domestic industries of the importing country.²⁹⁵ Unlike antidumping duties and countervailing duties, the country-specific safeguard would not inquire into the fairness of the underlying trade practices, be they dumping or subsidies. Instead, it would focus completely on injury caused by imports and assesses the injury under an elevated “serious injury” standard.²⁹⁶ Since the country-specific safeguard would not have an “unfair trade” component, the amount of additional duties that could be levied under the country-specific safeguard would have nothing to do with the existence and magnitude of unfair trade practices, be they dumping or subsidies. Instead, the amount of additional duties under the country-specific safeguard would be determined in a process in which all constituents whose interests would be affected by the safeguard could seek bargains and compromises.²⁹⁷ The country-specific safeguard differs materially from the global safeguard authorized under current WTO rules in that it requires neither nondiscrimination nor compensation.²⁹⁸

This author originally proposed the above country-specific safeguard to replace antidumping duties, and argued that countervailing duties should be subsumed under the country-specific safeguard as well because the country-specific

²⁹³ Schwartz, *supra* note 12, at 304. See also Schwartz & Harper, *supra* note 12. But see Barcelo, *supra* note 12 (advocating the use of countervailing duties to counteract export subsidies as well as certain targeted domestic subsidies).

²⁹⁴ Scholars advocating the abolition of countervailing duty laws themselves acknowledge that their proposal might be unlikely to succeed. See, e.g., Sykes, *Economic Foundations*, *supra* note 12, at 263.

²⁹⁵ Wentong Zheng, *Reforming Trade Remedies*, 34 MICH. J. INT’L L. 151, 158 (2012) [hereinafter Zheng, *Trade Remedies*].

²⁹⁶ The “serious injury” standard under the proposed country-specific safeguard would require that imports be a substantial cause of a significant amount of injury. See *id.* at 183–86.

²⁹⁷ *Id.* at 189–90. The political nature of the determination of duty levels under the country-specific safeguard is aimed at remedying the “democracy deficit” in the trade remedy process, whereby antidumping and countervailing duty rates are set using mechanical formulas without taking into account the impact of the duties on constituents. For discussions of the democracy deficit in the context of antidumping, see *id.* at 176–81.

²⁹⁸ See *id.* at 186–88.

safeguard would have addressed injury caused by all sources, including subsidies.²⁹⁹ But in light of the foundational problems of the current subsidy regulation regime as discussed above, replacing the countervailing duty prong of the regime with the country-specific safeguard has normative justifications as well. First and foremost, the country-specific safeguard is no longer about subsidies, thus obviating the need to determine what subsidies should be regulated and what subsidies should not. As a result, the country-specific safeguard would not face the difficult conceptual issues that have beset the current subsidy regulation regime as to the behavioral impact of subsidies.³⁰⁰ Second, the country-specific safeguard can be better justified on efficiency grounds than countervailing duties. That is because when import duties do enhance the welfare of an importing country, they enhance the welfare of the importing country whenever there is increased import competition, regardless of whether the increased import competition results from subsidies.³⁰¹ Therefore, a policy response that is not conditioned on the existence of subsidies makes more policy sense than countervailing duties.³⁰²

Admittedly, the country-specific safeguard would preserve the ability of importing countries to impose additional duties, and that might have adverse welfare consequences under certain circumstances.³⁰³ That, however, does not weaken the case for the country-specific safeguard, since a complete abolitionist approach, which may be ideal theoretically, would be politically unfeasible. By contrast, the country-specific safeguard leaves domestic industries an effective trade remedy instrument that may be invoked in circumstances warranting protection.³⁰⁴ With its inquiries completely untethered from subsidies, the country-specific safeguard is as close to a complete abolition of countervailing duties as is possible. Furthermore, given that countries always face pressures to protect domestic industries,³⁰⁵ the country-specific safeguard may enhance welfare *ex ante* by encouraging countries that otherwise would not be willing to undertake trade concessions to enter into free trade agreements.³⁰⁶

To be sure, the country-specific safeguard does not offer a complete fix of the current subsidy regulation regime. It would only replace the countervailing duty prong of the regime, but would leave the WTO prong of the regime intact. Under the country-specific safeguard, the WTO prong of the current subsidy regulation regime would continue to face the difficult problem of ascertaining the effects of specific subsidy programs—a problem that would persist short of a complete abolition of subsidy regulation of any sorts.

That said, one problem that the country-specific safeguard would be able to solve is the double counting problem. The double counting problem would not

²⁹⁹ See *id.* at 203–04.

³⁰⁰ See *supra* Part VI.B.

³⁰¹ See Sykes, *An Economic Perspective*, *supra* note 12, at 237.

³⁰² See *id.* at 237–38.

³⁰³ For example, the imposition of additional duties will often reduce the welfare of the importing country under conditions of perfect competition. See *supra* note 287 and accompanying text.

³⁰⁴ See Zheng, *Trade Remedies*, *supra* note 295, at 194–95.

³⁰⁵ See Chad P. Bown, *Why Are Safeguards Under the WTO So Unpopular?*, 1 WORLD TRADE REV. 47, 49 (2002).

³⁰⁶ This is the “safety valve” argument for temporary protection mechanisms. See Zheng, *Trade Remedies*, *supra* note 295, at 163–67.

even arise under the country-specific safeguard, because the amount of additional duties under the country-specific safeguard would not be tied in any way to the magnitude of dumping or subsidies. Unlike the approach called for under the current subsidy regulation regime,³⁰⁷ the country-specific safeguard represents a coherent, economically sensible solution to the double counting controversy.

VII. CONCLUSION

Subsidy regulation is in a precarious state. While it has been so ever since the conception of the current subsidy regulation regime, the recent double counting controversy between the United States and China has threatened the mere functionality of the current regime. This Article argues that the double counting controversy reveals the self-contradictions of the current subsidy regulation regime as to the fundamental question of why subsidies need to be regulated. These self-contradictions make it impossible to devise a coherent solution to the double counting problem within the framework of the current subsidy regulation regime and sharpen the need for fundamental reforms of the current regime. As a first step towards such reforms, this Article proposes to replace countervailing duties with a country-specific safeguard, which this Article argues will solve the double counting problem and, more importantly, help restore the intellectual foundation of the current subsidy regulation regime.

³⁰⁷ See *supra* Part VI.A.