

*The Problem of Double Remedies in International Trade Disputes and the Economics of Pass-Through **

THOMAS J. PRUSA*
Rutgers University and NBER

JAMES P. DURLING*
Curtis, Mallet-Prevost, Colt & Mosle LLP

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Abstract:

In 2007 the U.S. reversed its long-standing policy prohibiting the simultaneous imposition of anti-dumping duties (ADDs) and countervailing duties (CVDs) against non-market economies. Both the U.S. courts and the WTO have found the Department of Commerce's continued use of its NME methodology in the anti-dumping investigation while simultaneously applying CVDs to offset domestic subsidies to violate domestic and international legal norms. The U.S. Congress recently changed U.S. law, authorizing such double remedies, but also calling for an offset of the AD margin to reflect any duplicative remedy for the same alleged unfairness. We review how this double remedies issue is addressed under the new CVD legislation, how Commerce has addressed this issue in the past and is addressing the issue now, and explain how the large economics literature on "pass-through" can shed helpful light on these issues. Private parties making arguments to agencies, agencies making decisions, and tribunals reviewing these agency decisions will likely be struggling with these new issues for some time.

** Department of Economics, New Jersey Hall, 75 Hamilton Street, Rutgers University, New Brunswick, NJ 08901-1248, USA. Tel: +1.908.443.1565, E-mail: prusa@econ.rutgers.edu, web: <http://econweb.rutgers.edu/prusa/>.

* Curtis, Mallet-Prevost, Colt and Mosle LLP, 1717 Pennsylvania Avenue N.W., Washington, D.C., 20006, USA. Tel: +1.202.452.7328, E-mail: jdurling@curtis.com, web: <http://www.curtis.com>.

1. Introduction and Background

Trade policy toward China changed dramatically in 2007 when the Department of Commerce (“Commerce”) announced that it would begin conducting countervailing duty (“CVD”) investigations against non-market economies. Previously, Commerce policy had been that countervailable subsidies could not exist in non-market economies like China, a position repeatedly ratified by Congress and affirmed by the courts. Starting in 2007, Commerce changed its policy and began to argue that changes in China made it possible to begin measuring subsidies.¹

This policy shift led to a new issue: the possibility of “double remedies” for the same alleged unfairness. Although Commerce was now applying market economy CVD rules, Commerce was continuing to apply special non-market economy antidumping (“AD”) rules. Chinese interested parties challenged Commerce’s new policy in both the U.S. courts and the WTO. Both the U.S. courts and the WTO found problems with Commerce’s policy, in particular that the simultaneous use of CVD measures and special AD rules for non-market economies posed a serious risk of “double remedies” – imposing duties twice to offset the same underlying unfair pricing.²

Although the initial dispute was over the possibility of “double remedies,” recent changes to U.S. law have made that dispute moot. When the Court of Appeals ruled that Commerce had no authority to impose CVD measures against

¹ This history of these policy shifts, and the congressional and judicial reactions has been summarized in the numerous court decisions challenging the new policy. In particular, see *GPX Int’l Tire Corp. v. United States*, 645 F.Supp.2d 1231 (CIT 2009); *GPX Int’l Tire Corp. v. United States*, 666 F.3d 732 (Fed. Cir. 2011); *GPX Int’l Tire Corp. v. United States*, 678 F.3d 1308 (Fed. Cir. 2012).

² *GPX Int’l Tire Corp. v. United States*, 645 F.Supp.2d 1231 (CIT 2009); *United States – Anti-Dumping and Countervailing Duties on Certain Products from China*, WT/DS379/AB/R (25 March 2011)

non-market economies under the existing statute, Congress changed the statute.³ Under the new statutory provisions, Commerce has the authority to impose CVD measures (thus overturning the Court of Appeals decision), and also has the authority to make an adjustment to the antidumping margins for any demonstrated double remedy (thus addressing the WTO inconsistency found by the Appellate Body). The issue is now identifying and measuring any such double remedy.

Commerce has made its first administrative decision under the new law. This decision both highlights the limits of what has been done but also foreshadows further issues of dispute. When conducting a Section 129 proceeding to implement the adverse WTO decision, Commerce used the new law to determine the extent to which subsidies have been “passed through” to U.S. import prices, a phenomenon which was the source of the type of double remedy the new statute sought to address. Commerce’s initial effort was rushed and was crude. But it was a start. This paper seeks to describe what was done on pass-through, identify issues, and offer thoughts for how the policy process can use economic thinking to approach this issue of pass-through in a more serious way.

We begin with a brief review of the new law that requires Commerce to consider the issue of possible “double remedies” that may emerge from the simultaneous imposition of AD and CVD measures against non-market economies. We review the statutory language and highlight issues raised by that language.

The new law has been applied once.⁴ We discuss what Commerce has done in this first application of the new law in the Section 129 proceedings, and put that initial effort in the historical context of prior Commerce efforts to address pass-

³ *GPX Int’l Tire Corp. v. United States*, 666 F.3d 732 (Fed. Cir. 2011)(holding CVD law does not apply to NME countries); *GPX Int’l Tire Corp. v. United States*, 678 F.3d 1308 (Fed. Cir. 2012)(discussing Pub. L. No. 112-99, 126 Stat. 265 (2012)).

⁴ The Final Determination for all four cases and the decisional memos for each of the four cases can be found on-line under “China” at: <http://ia.ita.doc.gov/download/section129/full-129-index.html>.

through. After reviewing briefly how Commerce struggled with an analogous pass-through issue in the late 1980s, we describe in some detail how Commerce has handled these issues the second time around.

We then turn to the economic theory behind pass-through. Our focus here is to put the current Commerce methodology in the broader context of economic results and methods regarding pass-through. The statutory language and Commerce's application of the statute have implicitly raised economic issues. We briefly summarize how the field of economics thinks about these issues, and how that theory informs how Commerce should think about these issues.

Having framed the key economic issues from a theoretical perspective, we turn to the economics literature, to see how these issues have been addressed empirically. Economists have spent quite a bit of time studying pass-through, but in a somewhat different context. We summarize the most important parts of this literature, and discuss how this empirical work can also inform Commerce's thinking about pass-through.

We then conclude with some thoughts for how we think this issue will evolve, both before the agency and before those reviewing agency decisions. These issues are certain to be contested, both before Commerce in the first instance and then before the U.S. courts and the WTO. It will be some time before Commerce, the courts, and the WTO collectively settle upon a framework that parties can begin to rely upon with any degree of confidence.

2. The New Law

The combination of the loss in the WTO and the loss in the Court of Appeals led the Administration to push for legislative change. Starting in December 2011, immediately after the Court of Appeals decision, the Administration (with strong support from various domestic interests that had been pursuing CVD measures

against China) began working with Congress for a prompt legislative solution to the adverse Court of Appeals decision. The new law – Public Law 112-99 – was enacted March 13, 2012.⁵

The new law served two purposes. First, it changed U.S. law to authorize CVD measures against non-market economies like China. Section 1 amended Section 701 of the Tariff Act of 1930 to add a new subsection (f) that confirmed the applicability of CVD measures to proceedings involving non-market economies.⁶

Second, it codified a possible adjustment for “double remedies” in an effort to comply with U.S. international obligations under the WTO. Section 2 amended Section 777A of the Tariff Act of 1930 to add a new subsection (f) that authorized the adjustment of AD measures in certain circumstances to account for the double counting that occurs from simultaneous AD and CVD measures against non-market economies.⁷

For purposes of this paper, we focus on the new mechanism for an adjustment to correct for possible “double remedies.” We note the following features of the new statutory provisions that create this new adjustment to AD measures.

The adjustment can only offset domestic subsidies.⁸ The statute already has a mechanism for an adjustment for export subsidies, so the new law leaves that mechanism in place and only addresses domestic subsidies that Commerce has investigated and found to be countervailable.

⁵ The basic history that led to the new law has been recounted in *GPX Int'l Tire Corp. v. United States*, 678 F.3d 1308 (Fed. Cir. 2012). A more detailed version of the history can be found in the court papers filed by the parties in Consol. Ct. No. 08-00285, a CIT proceeding hearing constitutional challenges to the new law.

⁶ Public Law 112-99, Section 1(a) (adding 19 U.S.C. 1671(f))

⁷ Public Law 112-99, Section 2(a) (adding 19 U.S.C. 1677f-1(f))

⁸ Public Law 112-99, Section 2(a) (adding 19 U.S.C. 1677f-1(f)(1)(A))

The subsidy must have been provided to the “class or kind” of merchandise.⁹ The new law focuses on the “class or kind” of merchandise being investigated, and so draws no linkage between subsidies to certain specific products. As a practical matter, most domestic subsidies probably apply to a broader category of product. But that need not be true in every case. Presumably a subsidy to any specific product within the “class or kind” of merchandise would be considered a subsidy to the entire “class or kind” of merchandise.

The effects of the subsidy must have “been demonstrated.”¹⁰ The statutory language uses the passive voice, and thus does not indicate who must do the “demonstrating.” The open-ended language contemplates demonstration by the foreign respondents, the domestic petitioners, or Commerce itself. This open-ended language leaves Commerce with the maximum discretion regarding who has what burden of proof, at least for purposes of U.S. law.¹¹

The effects must have been to “reduce the average price of imports.”¹² This phrase has three key elements. First, the statute focuses on the effects on “imports” into the United States. Rather than focus on the effect on the prices of goods produced (still in a non-market economy country), the focus is on only those prices of goods being imported into the United States. Second, the statute focuses on the “average price” of imports, not only any specific prices for specific transactions. Unlike many adjustments that Commerce requires to be demonstrated on a transaction specific basis, this adjustment can be demonstrated based on average prices for the class or kind of merchandise. Third, the phrase refers to import prices

⁹ Public Law 112-99, Section 2(a) (adding 19 U.S.C. 1677f-1(f)(1)(A), 1677f-1(1)(B))

¹⁰ Public Law 112-99, Section 2(a) (adding 19 U.S.C. 1677f-1(f)(1)(B))

¹¹ In the Final Determination of the Section 129 Determinations discussed below, Commerce agreed with domestic parties that foreign respondents have the burden of proof for all adjustments. But this position was reached in the absence of any argumentation by the foreign respondents on this issue, and does not really address the language of the statute. Note this view of U.S. law is at odds with the Appellate Body’s view of the WTO obligations, which impose some burden on the authorities to make a determination themselves, and not to ignore the issue simply because the record may not be perfect.

¹² Public Law 112-99, Section 2(a) (adding 19 U.S.C. 1677f-1(f)(1)(B))

being “reduced,” which presumably means “reduced” from what they would have otherwise been. One can easily imagine a situation where other factors are leading to import prices increasing, but increasing by less than they would have but for the effects of the subsidy. Such a situation could occur any time the case involves allegations of price suppression (prices changing by less than the cost changes would suggest), rather than price depression (prices actually falling).

The effects must be demonstrated “during the relevant period.”¹³ The statute does not refer to any specific period of time, and instead refers more generally to the “relevant” period of time. This phrasing probably reflects the reality that this adjustment may be applied to original investigations or administrative reviews, each of which has a different period of investigation.

The authority must be able to “reasonably estimate the extent to which” the subsidy increased the dumping margin.¹⁴ Unlike the price effects that can be “demonstrated” by anyone, the judgment about “can reasonably estimate” must be made by Commerce. The term “estimate” confirms that Commerce need not make a precise measurement. The phrase “the extent to which” strongly suggests there will be something to “estimate,” and the only issue is really how large this “extent” is in a particular case. Note that the statute does not require Commerce to use the reduction in the average price of imports to determine the “estimate” of how much the subsidy increased the dumping margin. Although that linkage may exist in most (perhaps all) cases, the statute contemplates a two part determination.

Assuming some amount of effect can be estimated, Commerce is then directed to reduce the antidumping duty by that estimated amount. So to take a simple example, suppose a non-market economy has a subsidy that lowers the price of a key input, such as hot-rolled steel used to produce some downstream product, by

¹³ Public Law 112-99, Section 2(a) (adding 19 U.S.C. 1677f-1(f)(1)(B))

¹⁴ Public Law 112-99, Section 2(a) (adding 19 U.S.C. 1677f-1(f)(1)(C))

10 percent. Such an upstream subsidy would be a domestic subsidy, affecting all production. It should not be hard to demonstrate that having lower input costs reduced the average price of imported products that use that particular input. For example, a simple plot of hot-rolled steel prices and carbon steel pipe prices (a downstream product for which hot-rolled steel is the major raw material cost) shows a very similar pattern, which should demonstrate the price effect. The remaining step would be for Commerce to “reasonably estimate” the amount of this price effect, which would have lowered import prices and increased the dumping margin.

It is this last step – the need to “reasonably estimate” – that will prove to be the most challenging to implement.

3. Pass-Through at the Commerce Department

In May 2012, Commerce issued its first decision on “double remedies” under the new law, and addressed the issue of having to “reasonably estimate” the amount of pass-through taking place. But this is not the first time Commerce has confronted this issue. Before going into the details of what Commerce is doing now, it is useful to briefly recap the approaches considered two decades ago when Commerce struggled with pass-through in a different context – the pass-through of commodity taxes.

3.1. Commerce and the pass-through of commodity taxes

Commerce has struggled with pass-through before. In the late 1980s, petitioners challenged the standard Commerce practice of adjusting for home market commodity taxes by assuming complete pass-through of the tax. Commerce’s traditional practice had been to assume that if an exporter booked a tax in its accounting records, which tax was then “charged” to the customer buying the

product. This legal challenge was first successful in 1986, and was applied to a number of cases involving color televisions.¹⁵

The issue played out differently in different proceedings, including a series of fights with the Court of International Trade (CIT) over whether Commerce really had to measure pass-through, and battles with experts over the economics of pass-through in various administrative proceedings involving color televisions from Asia. Without delving too deeply into the details, we offer the following brief overview of each of these cases.

The Japan case. The first time around, Commerce sought to comply with the CIT remand instructions by hiring its own economist to do a study of pass-through. Commerce hired economists who developed a complex model of oligopolistic competition among Japanese color television manufacturers. Using cost and price data from the Japanese firms and from some public sources, the study found significant pass-through, including measured pass-through in some cases of more than 100 percent. Based on this study, Commerce concluded that pass-through was complete.¹⁶

The Korea case. The second time around, Commerce again started the process with its own econometric study. The Commerce study again used a complex model of oligopolistic competition for a typical Korean firm, and found 100 percent pass-through. This result was challenged, and the CIT required Commerce to make firm-specific determinations more closely grounded in the record evidence. At this point, Commerce shifted the burden and required the Korean respondents and

¹⁵ *Zenith Elecs. Corp. v. United States*, 633 F.Supp. 1382 (CIT 1986)(Japanese color televisions), *appeal dismissed as moot*, 875 F.2d 291 (Fed Cir. 1989); *Daewoo Elecs. v. United States*, 712 F.Supp. 931 (CIT 1989)(Korean color televisions); *Zenith Elecs. Corp. v. United States*, 770 F.Supp. 648 (CIT 1991)(Taiwanese color televisions).

¹⁶ *See, e.g., Zenith Elecs. Corp. v. United States*, 755 F. Supp. 397 (CIT 1990); *Zenith Elecs. Corp. v. United States*, 988 F.2d 1573 (Fed. Cir. 1993). *See also* Larry Karp and Jeffrey Perloff, “Estimating Market Structure and Tax Incidence: The Japanese Television Market,” *Journal of Industrial Economics* 37:3 (1989), 225–239.

domestic petitioners to submit their own competing studies. Both sides hired economists who did separate analysis for each of the Korean firms. After reviewing this second round of studies, Commerce found technical problems with the study done by the Korean respondents, and used the study done by the domestic petitioners as “facts available,” finding pass-through of 33-63 percent. This ongoing technical battle was rendered moot, when the Court of Appeals issued a decision in 1993 (discussed below) reversing the CIT and reinstating the Commerce practice of using accounting evidence to presume complete pass-through.¹⁷

The Taiwan case. The third time around, Commerce did not even try to do its own study of pass-through. Instead, Commerce imposed that burden on the parties. The Taiwanese respondents produced an economic study that took a somewhat different approach to the earlier studies. This report argued that the Taiwan color television industry was highly competitive, consisting of numerous companies all competing for U.S. sales. Based on record evidence that the market was highly competitive, and economic theory explaining that in highly competitive markets tax pass-through would be complete, Commerce found 100% pass-through. This Commerce finding was appealed, and the CIT initially rejected the finding as not being sufficiently based on record evidence. But as with the Korean case, the Court of Appeals decision in 1993 (discussed below) reversing the CIT and reinstating the Commerce practice of using accounting evidence to presume complete pass-through rendered the issue moot.¹⁸

Ultimately the Court of Appeals eliminated the issue by reversing the CIT decisions and upholding the Commerce policy of presuming complete pass-through based on accounting records.¹⁹ The Court of Appeals put great weight on Commerce discretion when interpreting the AD law, and explained:

¹⁷ See, e.g., *Daewoo Elecs. Co., Ltd. v. United States*, 794 F. Supp. 389 (CIT 1992).

¹⁸ See, e.g., *Zenith Elecs. Corp. v. United States*, 812 F. Supp. 228 (CIT 1993).

¹⁹ *Daewoo Electronics Co. Ltd, v. United States*, 6 F.3d 1511 (Fed. Cir. 1993).

The statute does not speak to tax incidence, shifting burdens, or pass-through, nor does it contain any hint that an econometric analysis must be performed. The statutory language does not mandate that ITA look at the effect of the tax on consumers rather than on the Korean company. The reality is that, as an unavoidable incident of any sale by the company, these taxes can only be recouped in their entirety from purchasers.²⁰

The Court of Appeals appears to have been influenced by the complexity and difficulties of the several years of economic studies. After noting the “onerous burden” imposed by the CIT decision, the Court of Appeals went on:

In contrast to the commercial facts available in sales receipts, tax returns and other accounting records, an econometric analysis of pass-through requires numerous subsidiary market inquiries, entails a high degree of speculation based on one economic theory rather than another, and produces results of dubious soundness.²¹

Although one could debate whether accounting or economic approaches to commodity tax pass-through produced results of more “dubious soundness,” as a legal matter the issue was resolved with this Court of Appeals decision.

3.2. Commerce and pass-through – the second time around

Under the new statute, Commerce has had to return to the issue of “pass-through.” This first implementation was announced in preliminary determinations in May 2012, and then finalized in August 2012.²² This decision arose in the context of Section 129 implementation proceedings for the adverse WTO decisions in DS379, a Chinese challenge to four different U.S. countervailing duty orders. Commerce had delayed action in that implementation proceeding, probably in large

²⁰ 6 F.3d at 1517.

²¹ Id. at 1518.

²² The Preliminary Determinations have been released in the public record of each of the four cases, but has not been place on-line. The Final Determination for all four cases and the decisional memos for each of the four cases can be found on-line under “China” at: <http://ia.ita.doc.gov/download/section129/full-129-index.html>.

part to wait for the new legislation authorizing an adjustment for domestic subsidies. So by the time Commerce turned to the pass-through issue, time was severely limited and Commerce repeatedly cited the insufficient period of time as one of the reasons for the particular methodological choices being made in that determination.

In this determination, Commerce calculated a single pass-through rate. Commerce determined this rate of pass-through by calculating what it termed a “Ratio Change Test,” the ratio of two price series drawn from the Bloomberg data base. More specifically, Commerce took the producer price index in China (Bloomberg symbol “CHEFTYOY”) and divided by the purchasing price index in China (Bloomberg symbol “CNPPIY”). Both of these ratios are determined monthly, comparing the value from the same month in the prior year. Commerce specifically noted that this method of comparing a finished good price index with an intermediate good price index is a typical approach for studying how input costs pass-through to finished goods prices over time.

In adopting this particular methodology, Commerce made a number of decisions about the approach. Not surprisingly, many of these decisions were challenged by the parties in their comments on the methodology announced in the Preliminary Determinations on May 31, 2012.

Commerce made its determination for the Chinese manufacturing sector overall, not for a particular industrial sector. This decision appears to have reflected the fact that the Section 129 proceedings covered four different AD/CVD orders on (1) off-the-road tires, (2) circular welded carbon steel pipe, (3) light walled rectangular carbon steel pipe; and (4) laminated woven sacks. The variety of products at issue made a single determination more attractive. Moreover, these four orders covered products with more limited industry-specific data. It might have been possible to find useful industry specific data for the two steel products,

but the other two products almost certainly did not have useful industry-specific data readily available.

In its Final Determination commenting on complaints by the domestic parties against using an overall national average, Commerce affirmed the use of national data. Commerce basically relied on the time constraints of the specific Section 129 investigations. Commerce also noted its view that the Government of China responses for all four cases suggested enough similarities to justify the use of a single manufacturing average for these four particular industries. Finally, Commerce noted that it had found record evidence in each of the four individual cases to justify finding that the specific foreign producers had booked to their accounting records the input items that had received the domestic subsidies. But the discussion of this issue was rather limited, and it is likely to be fiercely contested in future cases.

Commerce also made its determination for all companies in the Chinese manufacturing sector, not for specific companies in the specific sectors. Although Commerce sent a questionnaire to the Government of China, it did not make any additional efforts to gather additional company specific data. Moreover, none of the Chinese companies in any of the four cases submitted comments on the Commerce preliminary determinations. Since these proceedings were Section 129 proceedings to implement a WTO decision, the individual Chinese companies perceived the proceedings as a “government” matter that did not require their direct participation. (On the U.S. side, there was active participation by all the affected domestic producers.) Commerce had some company specific data for the Chinese producers from the original investigations, but time constraints made it unrealistic for Commerce to do much work with this data. That being said, Commerce did review the records of each case to find evidence of the companies booking as cost items the inputs that had received subsidies.

In a crucial decision Commerce determined this pass-through ratio only for variable costs. Commerce did not consider fixed costs, or total costs (variable and fixed costs), even though many of the alleged subsidies related to fixed cost items such as land. Commerce cited to some analyst reports to assert purchasing managers were facing changing variable costs, but the underlying reports were not particularly specific in distinguishing variable costs from total costs. More likely, Commerce wished to focus on variable costs because the index being used reflected changes in the purchasing price index, which reflected changes in raw materials, fuels, and power – all variable costs.

This issue was disputed by the Government of China, but Commerce reaffirmed its approach in its Final Determination. Commerce argued that the evidence was limited, and that China had not demonstrated the necessary price effects on other types of inputs, including fixed cost inputs. Commerce had relied on a few, very brief comments in Credit Lyonnais Securities Asia reports, and Commerce construed those comments as only addressing partial pass-through of input costs, which Commerce took to mean variable cost inputs. As with the issue of using broad manufacturing or narrower industry-specific measurements, this issue is likely to remain contentious.

It is worth noting that this focus on only variable costs meant the adjustment had very different impacts in the four different cases, based on the extent to which the subsidies at issue affected variable input costs. The following table summarizes the final adjustments made to the dumping margins for the investigated companies in the four cases:²³

²³ These margins are the most typical margins reported for most of the companies that received separate rates but were not fully investigated mandatory respondents. Some individual companies that were mandatory respondents had slightly different rates, but order of magnitude of the change in the AD margin is the same. The same is true to the “all others rate” for each of these four cases.

Table 1: AD Margins in Commerce’s Initial Double Remedy Adjustment

Case	Original AD Margins	Revised AD Margins
Circular Welded Carbon Steel Pipe	69.2%	45.35%
Off-the-road Tires	12.91%	12.83%
Laminated Woven Sacks	64.28%	20.19%
Light Walled Rectangular Pipe	249.12%	247.90%

Only the cases involving circular pipe and woven sacks had significant adjustments to their antidumping margins.

Commerce made its determination to correspond with a particular six month period. Not surprisingly, the period corresponded to the six month period of investigation from the underlying administrative proceeding. (Commerce used the same pass-through rate in all four of the cases that were part of this combined Section 129 implementation.) The actual pass-through used was for the October 2006 through March 2007 period, with the mean value of six data points at 0.6307. Commerce also included in the decisional memorandum data for the same ratio for a longer period of time. It is worth summarizing the reported descriptive statistics for both time periods:

Table 2: Descriptive Statistics for Commerce’s Ratio Change Test

Descriptive Statistic	October 2006 to March 2007 (6 months)	January 2003 to December 2011 (108 months)
Mean	.6307	.5967
Std. Deviation	.0688	.1151
Median	.6370	.6110
High Value	.7143	.8661
Low Value	.5179	.2609

The six-month period used had somewhat more stable trends for both series, and trended upwards for the entire six month period while staying in the range of 50 to 70 percent pass-through. The longer period showed much more variability, with up and down trends that saw pass-through ranging from 25 to 85 percent.

None of the parties argued about the use of a six month period, or the use of this particular six month period, but they did argue about using old data about pass-through to determine adjustments to be applied prospectively. Commerce relied on the ambiguity in the statutory term “relevant period,” and reaffirmed its use of historical pass-through data that corresponded roughly to the period of investigation in the underlying cases.

Commerce did not take into account market structure or the nature of competition in either the Chinese or the U.S. markets. The questionnaire given the Government of China asked questions about conditions in the export market and the extent of intra-industry price competition, so Commerce signaled its awareness of this issue. But given the limited response by the Government of China and the limited time, Commerce did not do anything with this issue.

The parties argued about this omission in their comments on the Preliminary Determination, but Commerce dismissed them as being insufficiently documented. The Government of China argued about the degree of pass-through in competitive markets, but Commerce rejected this argument as not addressing adequately the distinction between shifting a supply curve and moving along a supply curve, and the implications of each. The various domestic interests proposed other adjustments they claimed accounted for the different market structures, but Commerce rejected this argument as not sufficiently matching comparable data series, and thus risking serious measurement issues.

3.3. Commerce's very different approaches

It is worth noting a few points of contrast with Commerce's first foray into determining pass-through back in the last 1980s. First, Commerce ignored the specifics of particular industries. In the early efforts at pass-through, Commerce and the parties consistently focused on the specific industry at issue – consumer color televisions. In the Section 129 cases, Commerce needed an easier solution and so turned to an overall average for the Chinese manufacturing sector. Commerce may reconsider this approach in future cases when it has more time. But in doing so, Commerce will have to balance the tension between specific findings for a specific industry, and the administrative convenience of an overall approach that can apply to all manufacturing sectors. Decisions in particular cases may well vary depending on the availability of data, and the extent to which parties present industry sector specific arguments.

Second, given the use of an overall average for the manufacturing sector, Commerce made no efforts at company specific estimates. In the early efforts, Commerce sometimes required company specific estimates. When the Korean color television producers presented an argument based on a “typical” Korean producer, Commerce required the respondents to produce firm specific estimates. But when the Taiwan color television producers presented a more general argument based on the overall industry, Commerce accepted that approach. Decisions in particular future cases may well vary depending on the willingness and ability of individual foreign producers to present data, and the practicality of doing so for multiple companies.

Third, the issue of variable versus fixed costs did not arise in the earlier pass-through disputes. The issue in the earlier cases involved the degree of pass-through for a specific cost item – a commodity tax. The commodity tax was inherently a variable cost. While the economics of variable costs may be different, there is little

justification to ignore fixed costs, which are often the more important part of costs for certain products. Moreover, since many of the subsidies Commerce has been investigating relate to fixed costs, to ignore fixed costs is to ignore an important part of the issue Commerce has been directed to address.

Fourth, the issue of period of time always arises. In the earlier efforts to measure pass-through the various studies used various approaches, sometimes looking at data for longer periods of time but then drawing inferences for a particular period of time based on these longer term data. Commerce has a tendency to focus on its “period of investigation,” but needs to resist the temptation to ignore broader periods of time when doing so makes more analytic sense. Focusing on a narrow six month period will lead to excessive volatility, since the inclusion or exclusion of one month will have a disproportionate impact on the mean value of the ratio Commerce has been using.

4. The Economics of Pass-Through: The Theory

As a theoretical matter, pass-through analysis reflects basic economic theory about supply and demand. The economic theory behind pass-through reflects core concepts in microeconomic theory.²⁴ As taught in Economics 101, a change in the cost of an input used to produce a widget will affect the quantity of that widget that will be supplied. This change affects the supply, which then affects the quantity demanded, and there is then a new equilibrium price and quantity. This basic framework has been set for the past century.

²⁴ Specifically, the flip-side to the issue of the pass-through of subsidies is the pass-through of taxes (a subsidy is a “negative” tax). Tax incidence is taught in nearly every undergraduate microeconomics course. For example, Chapter 6 in N. Gregory Mankiw, *Principles of Microeconomics*, 5th edition, South-Western Cengage Learning, 2007 and Chapter 7 in Paul Krugman and Robin Wells, *Microeconomics*, 2nd edition, Worth Publishers, 2009.

But this basic explanation needs to take into account a variety of important issues. The degree of “pass-through” will vary based on several key factors. First, one must consider the nature of the demand and supply curves. The magnitude of these changes depends on various elasticities of demand, supply, and substitution. Second, one must decide on the scale being measured: the pass-through by a specific firm, or the average pass-through for an industry, or the average pass-through for an economy. Third, one must consider the time horizon being evaluated. Many economic dynamics play out differently over the short term or over the longer term. Finally, one must consider the market structure and the nature of competition. We address each of these issues below.

4.1. The economic logic of partial pass-through

There are several main lessons from the economic theory. First, pass-through depends on the price elasticity of demand and price elasticity of supply. When demand is more inelastic, more of the subsidy (or tax) will be passed-through. Inelastic demand is associated with goods or markets where consumers have a hard time reducing their quantity consumed (e.g., gasoline, insulin). Conversely, when demand is elastic, the pass-through is small. The supply elasticity also matters. When supply is elastic pass-through is larger than when supply is inelastic. Thus, this means it is quite possible that Commerce could determine very different pass-through rates for different products. In fact, if Commerce assesses pass-through for the “class or kind” of merchandise then it almost surely will not use the same pass-through rate for all investigations.

Second, the availability of possible substitutes affects pass-through. All else equal, a good with close substitutes will have high pass-through while a good with few (or no) substitutes will have low pass-through. For example, very little (if any) of a subsidy on gasoline would be realized in the consumers’ price. By contrast, a subsidy on carbonated beverages would largely (or even fully) pass-through, due to

intra-beverage competition (i.e., Coke vs. Pepsi or more broadly carbonated beverages vs. juices, etc.)

4.2. Partial Equilibrium Modeling of Pass-Through

The notion that subsidies are likely only partially passed-through to the foreign price is well known within the U.S. trade policy community. Since the early 1990s the U.S. International Trade Commission (USITC) has on various occasions used a technique referred to as “partial equilibrium modeling” to estimate pass-through rates in its injury analysis (under AD, CVD, and safeguard provisions) and remedy recommendations (under safeguard provisions). The USITC refers to this approach as COMPAS or “COMmmercial Policy Analysis System”.²⁵ The COMPAS model analyzes the impact of dumping and/or subsidized imports on the U.S. market. In simplest terms, COMPAS is a spreadsheet model that captures the impact of supply, demand, and substitution elasticities on prices (and, consequently, on pass-through). The COMPAS model is based on industry level data implying that pass-through rates derived in this method reflect industry data, not firm-level data.

4.3. The scale considered: the firm, the industry, or the economy

As discussed, pass-through can be measured at several levels. Commerce could collect pricing and input cost data for each firm and use this data to compute firm-specific pass-through rates. This is similar to what was done in the color television pass-through cases in the late 1980s and early 1990s. Important academic studies (discussed below) have estimated pass-through using firm-level

²⁵ Joseph Francois and Keith Hall, “COMPAS—Commercial Policy Analysis System Documentation,” Version 1.4: USITC working paper, May 1993.

data. The drawback to this approach is that it is relatively data intensive and requires considerable advance planning by Commerce to produce the estimates in a timely fashion.

At the other extreme pass-through can be estimated using aggregate price data. This is what Commerce chose to do in its initial effort to account for double remedy. Although this approach is convenient, its considerable drawback is that it fails to capture any and all important industry-specific factors that might make pass-through higher (or lower) for the actual product being investigated. Using the economy-wide average will surely understate pass-through rates for a highly competitive industry.

Finally, the middle ground involves estimating pass-through using industry level data. The quality of the results depends crucially on the quality of the price indices. The United States, for instance, has devoted considerable effort to creating high quality import price indices on an industry-basis. The Bureau of Labor Statistics also has very high quality price indices for many important manufacturing inputs and raw materials costs.

4.4. The time horizon: short term versus long term pass-through

A highly robust result – both in theory and empirically – is that pass-through increases over time. Textbook discussions often say “demand and supply become more elastic in the long run.”

Firms often are unable to adjust prices in the shorter run, due to the presence of long-term contracts or other pricing rigidities. Economists often dub this phenomenon “sticky” prices. Consequently, when a firm’s costs change, in the short- to medium-run (i.e., one to four quarters) measured pass-through will be smaller than it will be in the longer run (i.e., eight quarters). What is the

appropriate period of time? A subsidy received in January 2006 may only partially lower prices in December 2006, but may be completely passed-through to prices by December 2007.

4.5. The nature of competition: the role of market structure and conduct

Economic theory implies that competitive conditions affect pass-through. Said differently, economic theory implies that the elasticities depend on the competitive conditions. When a market is highly competitive (e.g., a situation with many alternative suppliers selling similar products) then supply is highly elastic and pass-through of the subsidy to the import price will be high. The intuition is that the alternative suppliers will compete away the value of the subsidy. If the market is perfectly competitive then pass-through should be complete.

Market share affects pass-through. All else equal, firms with larger market share will have lower pass-through, stemming from their larger market power. This means that domestic firms and exporting firms will likely have different pass-through rates as domestic firms generally control a far larger share of the market than do firms from any single foreign country.

5. The Economics of Pass-Through: Measurement

Fortunately, policy makers addressing “pass-through” are not starting with a blank slate. Although this issue may be “new” to the legal community, this issue has been the subject to extensive work in the economics community. The challenge for lawyers, however, is to learn what economists have said about pass-through and to think about how those insights apply to the immediate problem of determining an amount of pass-through in specific trade remedy cases.

An enormous economics literature has examined pass-through both theoretically and empirically over the past two decades and there is overwhelming evidence that pass-through is rarely complete or zero.²⁶ Even weak forms of the “law of one price,” which follows from an assumption of symmetric pass-through, are rejected in empirical study after empirical study.²⁷ Economists have repeatedly found that pass-through will not typically be symmetric across destination markets. The robust empirical finding is that a cost shock will result in a price change of $x\%$ to one market but of $y\%$ to another market. Market structure, technology, upstream and downstream cost conditions, market share, the nature and duration of cost shocks and product differentiation have all been found to affect pass-through.

Conveniently for private parties and for Commerce, the empirical question regarding how much of a change in the cost of a good is passed-through to a good’s final price is an issue where there is a large amount of empirical research. A recent literature review by Burstein and Gopinath (2012) contains over 100 citations, a number made more impressive when you realize the review primarily focuses on papers written in the last 15 years.²⁸ Commerce does not need to reinvent the

²⁶ See Michael Knetter, “International Comparisons of Pricing-to-Market Behavior,” 83 *American Economic Review*, 473-486 (1993); Michael Knetter, “Is Export Price Adjustment Asymmetric?” 13 *Journal of International Trade and Finance*, 55-70 (1994); Pinelopi K. Goldberg & Michael M. Knetter, “Goods Prices and Exchange Rates: What Have We Learned?,” 35:3 *Journal of Economic Literature*, 1243-1272 (1997); S. McCorriston, C.W. Morgan, and A.J. Rayner, “Processing Technology, Market Power and Price Transmission,” 49 *Journal of Agricultural Economics*, 185-201 (1998); S. McCorriston, C.W. Morgan, and A.J. Rayner, “Price Transmission: The Interaction between Market Power and Returns to Scale,” 28 *European Review of Agricultural Economics*, 143-159 (2001); José Manuel Campa and Linda S. Goldberg, “Exchange Rate Pass-Through into Import Prices,” 87:4 *Review of Economics and Statistics*, 679-690 (2005); Jose Manuel Campa and Linda S. Goldberg, 2008. “Pass-Through of Exchange Rates to Consumption Prices: What Has Changed and Why?,” in *International Financial Issues in the Pacific Rim: Global Imbalances, Financial Liberalization, and Exchange Rate Policy* (NBER-EASE Volume 17), pages 139-176 National Bureau of Economic Research, Inc.; José Manuel Campa and Linda S. Goldberg (2010). “The sensitivity of the CPI to exchange rates: Distribution margins, imported inputs, and trade exposure,” *Review of Economics and Statistics*, 92(2):392-407.

²⁷ See Kenneth Rogoff, “The Purchasing Power Parity Puzzle,” 34:2 *Journal of Economic Literature*, 647-68 (1996); Kenneth Froot, Michael Kim, and Kenneth Rogoff, “The Law of One Price over 700 Years,” International Monetary Fund Working Paper, WP/01/174 (2001).

²⁸ Burstein and Gopinath (2012) mostly discuss papers written since the last prominent literature review on pass-through, K. Froot and K. Rogoff, (1995). Perspectives on PPP and long-run real exchange rates. In Gene Grossman, and K. Rogoff, editors, *Handbook of International*

wheel. It can follow in the well-traveled footsteps of academic economists.²⁹ Commerce should adopt approaches developed by academics and apply these insights to the specific cases before it.

Although there are a number of important theoretical analyses of pass-through, the basic economic theory of pass-through based on supply and demand is sufficient for the analysis required of Commerce.³⁰ Thus, the following discussion focuses on empirical approaches and findings in the pass-through literature. This literature helps answer the question “how much pass-through actually occurs?”

5.1. A few caveats

Before discussing some of the key lessons academics have learned regarding pass-through, we make a couple of preliminary comments. First, in this paper we avoid the specifics of how one actually estimates pass-through. We instead discuss major themes and robust insights in the literature. We stress, however, that in general estimating pass-through is not a straightforward exercise. The sensitivity of a good’s price to changes in its costs often differs from a simple correlation between prices and costs because of independent activity in the production or demand sectors; this is especially true when the pass-through is estimated over a longer run horizon. Models used to estimate pass-through must control for other forces that affect a firm’s price, such as demand conditions in the importing country and market power considerations. As an example, we expect a foreign monopolist to pass-through a cost change differently than a foreign firm competing in a highly

Economics, volume 3. Elsevier.

²⁹ Jabara (2009) offers a more concise literature review and pays special attention to results regarding pass-through of Asian exporters.

³⁰ See Kenneth A. Froot and Paul D. Klemperer, “Exchange Rate Pass-Through When Market Share Matters,” 79:4 *American Economic Review*, 637-654 (1989); Paul Krugman, “Pricing to Market When the Exchange Rate Changes”, Arndt, Sven W. and J. David Richardson (eds.) *Real-financial linkages among open economies*. Cambridge, MA and London: MIT Press, 1987.

competitive industry. This suggests that Commerce's approach in its initial decision could be improved.

Second, the "change in cost" is due to Commerce's finding of a domestic subsidy program. For example, Commerce needs to determine how much a foreign firm's export price changed due to a subsidy that lowered costs by 5%. Much of the academic literature has focused on changes in the exchange rate as the basis for the change in cost. For instance, academics have sought to quantify how much French exporters change their prices on products destined for the U.S. if the euro depreciates 5% versus the U.S. dollar. Although the source of the change in cost varies, the basic theory behind the pass-through is the same. We therefore believe this economics literature offers important insights, even though it focuses on a different change in cost.

Third, with respect to the double remedies issue the exporter of interest will generally be in China. Although there are some trade disputes involving Vietnam, most of the disputes involve China. The existing empirical studies have generally used U.S. or OECD export or import data. This approach primarily reflects data availability and data quality rather than indicating that the existing empirical approaches only apply to developed countries. There is nothing inherently special about the Chinese industries or products that make it difficult to apply existing pass-through estimation techniques.³¹ This is especially the case because Commerce needs to study pass-through to import prices, not pass-through to China's home market prices. High quality import price indices already exist for the U.S.

³¹ Bernard (2008) discusses but does not estimate pass-through in the context of Chinese exports of textiles and apparel.

5.2. “Consensus” evidence for partial pass-through

Empirical finding #1: Pass-through is almost always “incomplete” – a 1 percent decrease in the cost of a good will lead to an decrease of less than 1 percent in the price of the export good.

Put differently, pass-through is rarely 0 or 1. Not surprisingly, the far more common pattern is to find less than complete pass-through.

This empirical finding is itself quite interesting, since it is so fundamentally at odds with the legal premise of the AD and CVD margins. When determining a NME AD margin, Commerce ignores the prices in the foreign market, and so ignores even the possibility of a subsidy lowering that domestic price. When determining a CVD margin, Commerce assumes that a domestic subsidy is fully passed-through to the final price. The statute requires Commerce to offset the full amount of the subsidy, and does not care about whether or how much the subsidy actually affects the price.³² This approach allows Commerce to levy a countervailing duty equal to the full value of the calculated subsidy amount. This assumption underlying the law, however, has no credible support in the empirical literature.

The empirical finding of incomplete pass-through finds very strong support in the literature. Using broadly defined price indices, Hellerstein, Daly, and Marsh (2006) report that from 1985 to 2005, the average pass-through rate for the United States was 51 percent, an estimate that accords well with traditional estimates of a one-year pass-through rate of about 50 percent (Goldberg and Knetter, 1997).³³ These estimates imply that U.S. import prices generally fall by about ½ percentage

³² See 19 U.S.C. 1671(a) (requiring an offsetting duty “equal to the amount of the net countervailable subsidy”); 19 U.S.C. 1677(6)(defining “net countervailable subsidy” as the gross subsidy minus certain specific offsets; no offset for less than complete pass through of the subsidy).

³³ The traditional approaches use much more disaggregated data than Hellerstein et al. (2006) so the consistency between the estimates is noteworthy. As is often done, Hellerstein et al. (2006) exclude petroleum products from their data.

point following a 1 percent decrease in foreign supplier costs (e.g., due to a subsidy).³⁴

Hellerstein et al's. (2006) findings are remarkably robust. Burstein and Gopinath (2012) also use aggregate price data to estimate pass-through for eight industrialized countries (1975-2011 period); they find all eight countries have two-year pass-through rates between zero and one, with a low of 47% for Switzerland to a high of 97% for France.³⁵ Campa and Goldberg (2005) also use aggregate price data to estimate pass-through for 23 OECD countries for the period 1975-2003; they report an average one-year pass-through rate of 64%.

These empirical findings provide an important base-level insight. Although there may be different circumstances in a particular case, in general one should expect to find pass-through rates in the 40-60% range, and least for the U.S. market. When parties are making arguments, or agencies making decisions, they should be increasingly skeptical when arguments about pass-through suggest a pass-through rate radically different from these norms (i.e., either zero or one). Note there may well be specific reasons why pass-through is higher or lower in a particular case. But there should be some articulated (and factually supported) reason for the difference.

³⁴ In important work, Gopinath and Itskhoki (2010) and Gopinath, Itskhoki, and Rigobon (2010) tackle a much discussed, but difficult to estimate, subtlety in the pass-through literature – the impact of currency invoicing. They find a very large difference in pass-through rates for exports destined the U.S. market depending upon whether the transaction is denominated in dollars or non-dollars. The pass-through rate for dollar-denominated trade is 25% as compared to 95% for non-dollar denominated trade. The overall average of about 50%, therefore, reflects that fact that the majority of U.S. imports are denominated in dollars.

³⁵ These estimates imply that foreign firms' pass-through cost changes far less to Switzerland than to France.

5.3. Pass-through and the aggregation of data

Empirical finding #2: Pass-through will vary depending on the level at which it is measured. Pass-through can be estimated using many alternative data sources, ranging from aggregate price data (e.g., all manufacturing imports) to industry-level data to firm-level data to product-level data. There is no robust finding regarding what type of data (highly disaggregated or highly aggregated) yields higher pass-through.

Economists have estimated pass-through using a diverse set of data sources, from highly disaggregated firm-level data to highly aggregated import and export price indices, from detailed 9-digit product-level data to 3-digit industry level data. The breadth of existing studies makes it clear that pass-through can be estimated using a wide range of data sources.

The early prominent work used highly detailed 7-digit product level data as a way to bypass complications due to differences in technology and market structure. Knetter (1989, 1993) gathered export prices on homogeneous products (e.g., dry desiccated onions) and estimated pass-through by exploiting exchange rate variation across destination markets. He finds a range of pass-through rates from 30% to 70%. Parsons and Sata (2008) follow a similar strategy using Japanese 9-digit product level data and get comparable range of pass-through rates.

Campa and Goldberg (2005, 2008, 2010) analyze pass-through using industry level data. They find pass-through rates vary considerably across industry and exporting country. For instance, they demonstrate that the pass-through rate for energy products (81%) is much higher than for manufactured goods (62%).

Hellerstein, Daly, and Marsh (2006) estimate pass-through rates using both aggregate pricing data and 2- and 3-digit industry level data. The industry level results reveal the overall average (51%) partially reflects changing trade volume across industries. When they statistically control for such changes, their pass-

through rate falls to 36%. This means that a foreign firm decreases its destination (export) price by about 1/3 percentage point following a 1 percent decrease in its costs.

Gopinath and Itskhoki (2010) and Gopinath, Itskhoki, and Rigobon (2010) is arguably the most detailed effort to measure pass-through. They use firm level import prices (transaction level) from a variety of exporting countries to estimate pass-through. They find incomplete pass-through pervasive, most often in the 40-60% range.

5.4. Short-run versus long-run perspectives

Empirical finding #3: Pass-through rate varies depending upon time horizon. Pass-through is smaller the shorter the time horizon examined.

Economists distinguish between short-run and long-run pass-through. By “short-run” economists typically mean price changes that occur within a quarter or two of the cost change.³⁶ By “long run” economists mean price changes that occur with one to two years of the cost change.

In the preceding discussion we have cited long-run pass-through rates. Not surprising, economists find pass-through rates are smaller in the short-run. On average, Campa and Goldberg (2005) report the short-run pass-through rate is about two-thirds as large as the long run pass-through rate (46% versus 64%). Similar differences are reported by Burstein and Gopinath (2012).

³⁶ Empirically, economists considered pass-through rates estimated from one to four quarters as short-run estimates.

5.5. The role of market structure and competition

Economists are acutely aware that pass-through depends on market structure and competitive conditions. Competitive industries will generally have high pass-through rates; oligopolistic industries, on the other hand, pass-through rates can vary depending on exactly the number of firms, technology issue (e.g., increasing returns to scale), and demand. For these industries, pass-through need not fall between zero and one, but can easily exceed one. This has been documented by Karp and Perloff (1989) in their study of the Japanese television market.³⁷ More generally, Campa and Goldberg (2005) document numerous examples of pass-through rates exceeding one, especially in the long-run.³⁸

The variation in pass-through depending on the market structure is a primary reason many researchers prefer industry- or firm-level pass-through estimates (Goldberg and Knetter, 1997). Pass-through estimated at more aggregate levels likely averages across industries of very different market structures and thus potentially do not represent the actual pass-through in any single industry.

The confounding effects of market structure can be seen by looking at an industry that has often been the subject of AD and CVD trade actions, the flat-rolled steel industry. One segment of the industry, hot-rolled steel, has many, many producers; there are over a dozen U.S. producers of hot-rolled steel alone. By contrast a related but more specialized segment of the industry, tin-plated steel, has just a few producers. In the U.S. there are only two steel companies who produce tin-plated steel. Consequently, one would expect competitive pressures to result in different pass-through rates for hot-rolled steel as compared with tin-plate steel.

³⁷ For an example, Larry Karp and Jeffrey Perloff, "Estimating Market Structure and Tax Incidence: The Japanese Television Market," *Journal of Industrial Economics* 37:3 (1989), 225–239

³⁸ José Manuel Campa and Linda S. Goldberg, "Exchange Rate Pass-Through into Import Prices," 87:4 *Review of Economics and Statistics*, 679-690 (2005).

6. Concluding Thoughts

6.1. Issues that the agency should address

In light of the above discussion we believe there are several key issues that Commerce will need to address as it develops its approach toward measuring the extent of double remedies.

The preferred data for the analysis: Due to time limitations Commerce opted for aggregate price and cost data from Bloomberg to compute pass-through. Although the measured pass-through rate (about 60%) is in the range typically reported by many academic studies, the academic literature also makes it clear that pass-through rate varies considerably by the type of data used: firm level, industry level, or country level. Given the statutory language, in our opinion Commerce would be on better legal ground if it used firm or industry level to estimate pass-through rates. Given the massive literature Commerce can draw on, the extra effort to estimate precise industry-/product-level pass-through rates should not be considered onerous.

Moreover, the academic literature also makes it clear that the simple correlation analysis done by Commerce is likely biased. Other events or shocks that occurred in the sample period should be controlled for. As we have emphasized, Commerce should not decline to perform this more sophisticated pass-through study because it is perceived to be overly arduous. There are dozens of related studies showing Commerce how such adjustments can be factored in with little extra burden.

Commerce's approach in the initial investigation (or something similar to that approach) would seem appropriate in cases when the record is incomplete. In such circumstances, using aggregate price and cost data would be an appropriate

benchmark adjustment. This does not mean, however, that the simple approach adopted by Commerce in the initial case is a “best practice” when better data is available.

Time Horizon: Commerce compared year-over-year price and cost changes in its initial pass-through study. Although the statute is silent on the exact time frame that should be used, it is clear that firms are continuing to make price adjustments (for a given cost change) for at least eight quarters (Burstein and Gopinath, 2012). If Commerce wants to capture the actual pass-through rate, it should opt for a two-year pass-through rate.

Moreover, the methods used in the academic literature also suggest Commerce’s approach toward creating the “average pass-through” rate should be adjusted. The methods in the literature involve simple regression analysis where the quarterly pass-through rates are cumulated to compute the one-year or two-year pass-through rate. By contrast, Commerce simply averaged one-year pass-through correlations.

Nature of competition in the market: Regardless of the data used, Commerce will have to address how it is adjusting its estimates to account for differences in the competitive marketplace. An average pass-through rate might be appropriate for many cases, but it is surely inappropriate when cases involve hundreds of small firms, which is actually quite typical in numerous Chinese industries. Economic theory is unambiguous in concluding that pass-through is high, if not complete, when a market is very highly competitive.

6.2. Issues the Courts and WTO will face

Pass-through has had a contentious history, and there is every reason to believe it will remain a contentious issue. Indeed, this first Commerce effort to use the new law to implement U.S. WTO obligations is currently back before the WTO,

where the WTO will have to review the steps taken by Congress and Commerce to evaluate their WTO consistency.³⁹ As these issues play out before Commerce and are appealed, U.S. courts and the WTO will need to address, among others, the following issues.

Who has what burden of proof? This issue will probably play out differently in different legal settings. U.S. law gives Commerce more discretion in allocating the burden of proof, and generally presumes that respondents must demonstrate their eligibility for an adjustment. WTO obligations, however, often require authorities to make a good faith effort to investigate issues and not impose unreasonable burdens on the parties to avoid the agency's own obligations. Given these overlapping obligations, one can expect Commerce to seek a balance – not doing dramatically more than it need do under U.S. law, but doing enough to be able to defend itself credibly in the WTO.

To what degree can presumptions replace analysis of specific record facts? The early experience with pass-through in the late 1980s shows how complicated econometric measurement can become. Not surprisingly, Commerce is now much less willing to go down such paths. The recent implementation shows a hybrid approach, of taking some record facts, and then using them to justify a simplistic, presumption type approach. Commerce did a very simple analysis that very crudely measured variable cost pass-through over a narrow six month window for the Chinese manufacturing sector, and then essentially presumed that this rough estimate made sense for a variety of specific industries. Although certainly better than assuming no pass-through, this simplistic approach can be dramatically improved. But it is unclear the extent to which Commerce will continue to prefer an overarching approach that can apply to many or all cases, or will begin to develop more tailored approaches that reflect the greater availability of details facts in

³⁹ The United States has reported to the WTO on the status of its actions to date. {cite} China has not yet formally requested an Article 21.5 implementation panel. {check and confirm status}

certain industries and certain cases. The challenges for courts and the WTO will be to evaluate Commerce decisions to forego other options. When is an authority justified to ignore a better approach just because some other approach is easier to administer? Can an authority use a broad estimate for the entire manufacturing sector if one of the parties presents a detailed estimate for that specific industry, which could be a higher estimate (if submitted by Chinese respondents) or a lower estimate (if submitted by domestic petitioners)?

How much detail is reasonable? Commerce can be somewhat inconsistent, sometimes pursuing methodologies that are excessively detailed and sometimes the accepted methodologies are unnecessarily crude. On one level, courts and the WTO will respect a reasonable exercise of discretion about methodologies. But courts and the WTO will also have an obligation to critically review the use of that discretion to prevent abuses.

What happens when the record evidence is incomplete? The hardest cases may prove to be those where the parties do not engage the issues fully before the agency, but then decide to fight the issues in the courts and WTO. For example, with Commerce having found 63 percent pass –through using its crude estimate based on price indices, could Commerce ignore that finding for the entire manufacturing industry in a future case because some smaller Chinese companies were unable or unwilling to answer detailed questionnaires? Or having found a method for variable costs, can Commerce continue in future cases to do nothing about fixed costs, even though many of the most common subsidies involve fixed costs or other aspects of the cost structure of companies not being captured by the current Commerce methodology?

None of these issues have easy answers. Much will depend on the forum (U.S. law and WTO obligations differ), the specific facts of each case (low tech carbon steel pipe is very different from high tech solar panels), and the intensity with which parties in particular cases are willing to fight about the issues (larger

companies with deeper pockets tend to fight more aggressively than smaller companies that must depend on their government or have to give up). Rather than resolve the issue, the new law has really just recast the issue and set up a new set of challenges to be resolved.

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