

**ARTICLE 2 – PROFITABILITY TEST AND COST ALLOCATIONS**

Paper from Canada

The following communication, dated 18 January 2006, is being circulated at the request of the Delegation of Canada.

The submitting delegation has requested that this paper, which was submitted to the Rules Negotiation Group as an informal document (JOB(06)/5), also be circulated as a formal document.

In a previous submission to this Group<sup>1</sup>, Canada identified several specific issues related to the calculation of dumping margins that warrant clarification and improvement, including the provisions of the Anti-Dumping Agreement (ADA) on “ordinary course of trade” and cost allocations. With this submission, Canada elaborates on these issues and proposes textual changes to clarify and improve these concepts in the ADA.

**Profitability Test**

Issue

Article 2.1 introduces the concept of “ordinary course of trade” with the sentence:

*For the purpose of this Agreement, a product is to be considered as being dumped, i.e. introduced into the commerce of another country at less than its normal value, if the export price of the product exported from one country to another is less than the comparable price, in the ordinary course of trade, for the like product when destined for consumption in the exporting country.*

Article 2.2.1 elaborates on the concept of “ordinary course of trade” by permitting authorities to treat certain home market sales or third-country sales as not being in the “ordinary course of trade by reason of price” and, as a consequence, to disregard those sales in determining normal value. The conditions under which this can be done are together generally known as the “profitability test”.

In TN/RL/W/47, Canada noted that the current profitability test has particular implications for those industries whose product pricing is especially sensitive to shifts in supply and demand and for agricultural and other commodity sectors whose producers are typically “price takers”. Specifically,

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<sup>1</sup> TN/RL/W/47.

the profitability test provides that when sales below cost are made in substantial quantities<sup>2</sup>, normal values may be determined on the sole basis of those individual transactions that are not below cost. Accordingly, in situations where, for example, there is substantial price volatility, the application of the profitability test often results in normal values that reflect higher price levels that would not normally be sustainable in the market and, therefore, do not reflect market realities.

Canada considers that straightforward modifications to the profitability test would address this issue. Authorities should be allowed to disregard transactions because they are not in the ordinary course of trade by reason of price only if, over an extended period of time, the weighted-average selling price of the transactions under consideration is below the weighted-average costs, regardless of the quantities of transactions that may have been made individually at prices below cost. In such situations, the transactions under consideration should be considered collectively as “not in the ordinary course of trade by reason of price”, with the investigating authorities precluded from determining normal values on the basis of any of those transactions. Rather, the investigating authorities could resort to constructed normal value in such cases.

That said, Canada notes that some Members have proposed that Article 2.2.1 be clarified to require that the profitability test only be conducted on the basis of all sales of the domestic like product as a whole, and not any sub-groups of these sales<sup>3</sup>. In Canada’s view, such a modification could raise concerns for authorities and exporting countries alike, for instance when the mix of exports differs significantly from the mix of sales of the like product as a whole in the domestic market. Therefore, Canada is not proposing any changes to that aspect of Article 2.2.1.

#### Proposed Text

Canada proposes that current Article 2.2.1 of the ADA, and its footnotes, be replaced by the following:

**2.2.1** Sales of the like product under consideration for the determination of the normal value, either made in the domestic market of the exporting country or sales-made to a third country at prices below per unit (fixed and variable) costs of production plus administrative, selling and general costs may, on a collective basis only, be treated as not being in the ordinary course of trade by reason of price and may, on that basis, be disregarded in determining normal value only if the authorities<sup>3</sup> determine that such sales are made within an extended period of time<sup>4</sup> at a weighted average selling price that is below weighted average per unit fixed and variable costs of production plus administrative, selling and general costs, in substantial quantities<sup>5</sup> and are at prices which do not provide for the recovery of all costs within a reasonable period of time. If prices which are below per unit costs at the time of sale are above weighted average per unit costs for the period of investigation, such prices shall be considered to provide for recovery of costs within a reasonable period of time.

<sup>3</sup> When in this Agreement the term "authorities" is used, it shall be interpreted as meaning authorities at an appropriate senior level.

<sup>4</sup> The extended period of time should normally be one year, but shall in no case be less than six months.

<sup>5</sup> ~~Sales below per unit costs are made in substantial quantities when the authorities establish that the weighted average selling price of the transactions under consideration for the determination of the normal value is below the weighted average per unit costs, or that the volume of sales below per unit costs represents not less than 20 per cent of the volume sold in transactions under consideration for the determination of the normal value.~~

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<sup>2</sup> Footnote 5 of the ADA provides two ways to test if sales at a loss are made in substantial quantities: if the weighted-average selling price of the transactions under consideration is below the weighted-average cost of those transactions, or if the volume of sales at a loss is 20 per cent or more of the transactions under consideration.

<sup>3</sup> TN/RL/GEN/9.

## Cost Allocations

### Issue

In various aspects of the calculations to determine whether a product under investigation is being dumped, authorities need to make allocations of costs incurred to a specific product or products. In this context, Article 2.2.1.1 directs authorities to "... consider all available evidence on the proper allocation of costs..." In many, if not most, cases, these allocations are not regularly made outside of the context of a dumping investigation, as anti-dumping investigations normally require a greater degree of detailed allocations than either regular financial or management accounting systems contain. Exporters or producers whose sales are being examined rarely allocate all costs (fixed and variable) on the detailed product-level basis that is required for a thorough and complete dumping determination. However, the second sentence of Article 2.2.1.1 appears to suggest that significance should be ascribed to whether or not the allocations in the final clause of that sentence have been utilized by an exporter or producer, with the phrase:

*"...provided that such allocations have been historically utilized by the exporter or producer, in particular in relation to establishing appropriate amortization and depreciation periods and allowances for capital expenditures and other development costs."*

Canada believes that this language in Article 2.2.1.1 should be eliminated so that authorities are simply directed to consider all available evidence on the proper allocation of costs, including evidence provided by respondents. Canada considers that this would make clear that authorities are required to consider the individual circumstances of each exporter or producer under investigation, and take into account the evidence submitted by it in determining the appropriate amounts of costs to be allocated to a specific product. This would not, of course, prevent authorities from taking into account other available evidence.

### Proposed Text

Canada proposes that Article 2.2.1.1 of the ADA be modified as follows:

2.2.1.1 For the purpose of paragraph 2, costs shall normally be calculated on the basis of records kept by the exporter or producer under investigation, provided that such records are in accordance with the generally accepted accounting principles of the exporting country and reasonably reflect the costs associated with the production and sale of the product under consideration. Authorities shall consider all available evidence on the proper allocation of costs, including that which is made available by the exporter or producer in the course of the investigation ~~provided that such allocations have been historically utilized by the exporter or producer, in particular in relation to establishing appropriate amortization and depreciation periods and allowances for capital expenditures and other development costs.~~ Unless already reflected in the cost allocations under this sub-paragraph, costs shall be adjusted appropriately for those non-recurring items of cost which benefit future and/or current production, or for circumstances in which costs during the period of investigation are affected by start-up operations.[footnote 6 to remain unchanged]

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