

CHAPTER 11

Regulating Import Competition and Unfair Trade

The last two chapters examined the basic principles of world trade law found in the *General Agreement on Tariffs and Trade* (GATT), in the other WTO agreements, and in the dispute resolution cases of the World Trade Organization (WTO). This chapter covers a few new areas: The first is how countries protect or “safeguard” domestic industries from foreign competition, and under what circumstances they legally may do so. Imagine an industry executive that says, “We’re doing the best we can to compete, but the same products we make are coming in from overseas with few tariffs. Our foreign competitors have lower wage rates, lower employee benefit costs, fewer government rules, and they are becoming more efficient and more productive. They are shipping ever-greater quantities here, and we need time to ‘adjust’—to retool our plants and retrain our workers to become more competitive again. Just give us some time!”

The second part of this chapter covers remedies for “unfair trade,” and the two most common unfair trade practices in international business: dumping and government subsidies. You might hear a business executive cry, “Foreign firms compete unfairly. They dump their goods in our market at ridiculously low prices. They are causing us losses until they drive us all out of business. We don’t have the whole U.S. market to themselves. They expect to sell our products here at half price. How can we match the price of imports? We may lose our market to our overseas competitors, but they are paid by their own governments, money, to build cheaper products and sell them here.”

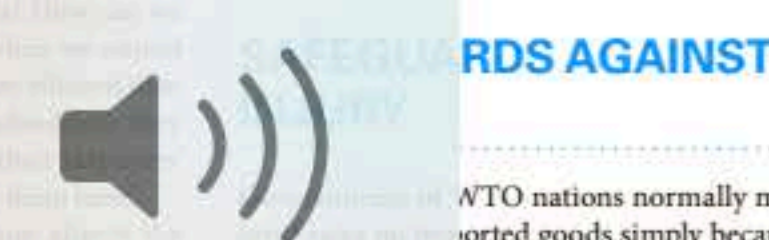
We will learn how import competition affects a private firm, and what remedies are available to a private firm in a barrage of competing imports and exports. We will learn what the firm can do, such as petitioning the responsible government for a legal remedy, and see what remedies are available. We can pursue through the World Trade Organization (WTO). Although we will focus on the United States, what you will study is not that different from what is

done in Canada, the EU, or in many other countries. In part, this is due to the internationalization of trade law through the WTO agreements, which require that national laws meet basic guidelines.

The chapter concludes with a brief explanation of “extraordinary trade remedies” that go beyond correcting “unfair” trade and explains why their use is limited.

Remember, you can view the regulation of import competition from two directions. Not only can it be seen as a means of protecting industries at home, perhaps your firm or firms in your country, but it can also be seen as limiting the attempts of foreign governments to protect their industries by denying foreign firms, perhaps yours, access to their markets. Thus international rules for safeguarding domestic industries are also an important part of trade liberalization and market access efforts.

In this chapter, we frequently mention two U.S. government agencies: the International Trade Commission (ITC), an “independent” agency, and the International Trade Administration (ITA), a “dependent” agency and part of the U.S. Department of Commerce, under the control of the executive branch. They have very different but complementary roles in administering U.S. unfair trade laws.



WTO nations normally may not raise tariffs on imported goods simply because of political pressure to protect a domestic industry or jobs. After all, nations are bound by agreement. Under limited conditions, a government may use safeguards to protect a domestic industry from injury caused by increased imports. **Safeguards against injury** are *emergency remedies* provided by law, usually tariffs, used to protect a domestic industry from injury resulting from increased imports of a like



or competing products. The legal authority and requirements for a WTO member nation to use a safeguard are set out in two important WTO agreements: Article XIX of GATT (1947), known as the “escape clause,” and in the *WTO Agreement on Safeguards* (1994).

The GATT Escape Clause

Nations enter into trade agreements and make tariff concessions to boost two-way trade. If one country agrees to a reduced duty on semiconductors in return for another country granting a reduced duty on auto parts, one of the countries should be prepared to see an increase in imports of semiconductors and the other will see an increase in imports of auto parts. However, the resulting increases in imports can disrupt domestic markets and injure competing domestic producers far more than had been expected. **Market disruption** from increased imports of foreign goods might include decreased sales volume, price suppression, lower profitability, lower wages, and other economic consequences to domestic firms.

The original drafters of GATT in 1947 were aware of the economic and possible political ramifications of tariff concessions and built in a mechanism, commonly called the **escape clause**, that permits a country to temporarily “escape” or be relieved from its tariff concessions under certain conditions. Article XIX permits a country to take a temporary corrective action (also called “emergency action”) to safeguard its domestic industry where (1) as a result of *unforeseen developments*, (2) and due to the effect of a tariff concession or obligation under a trade agreement, (3) *increased quantities* of an imported product, (4) are causing or threaten to cause *serious injury to domestic producers of like or directly competitive products*. The escape clause is not meant to be used as an excuse for raising tariffs just because there are increased imports of foreign goods. It may only be used when the increase is a result of “unexpected developments,” such as a sudden surge of imports resulting from an unexpected economic event. The most famous example of an unforeseen development occurred around 1950. The United States had agreed to lower tariff rates on fur hats at a time when fur hats were at the peak of fashion. When sales of women’s fur felt hats later “dropped off the charts,” due to an unexpected change in fashion, the United States invoked the escape clause. This was known as the *GATT Hatters’ Fur* case.

The WTO Agreement on Safeguards

The *WTO Agreement on Safeguards* (1994) provides details lacking in the 1947 GATT Article XIX escape

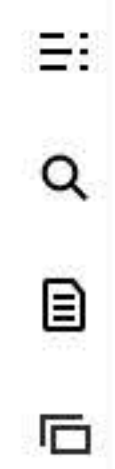
clause and sets out the procedural steps for countries imposing a safeguard.

Safeguards may be used only after an independent administrative agency in the importing country has conducted an investigation of the industry and determines that the legal requirements to impose safeguards have been met. Article 4.2 of the *Agreement on Safeguards* requires that the investigating agency “evaluate all relevant factors of an objective and quantifiable nature having a bearing on the situation of that industry, in particular, the rate and amount of the increase in imports of the product concerned in absolute and relative terms . . .” The investigation must show that the increases in imports are the *actual cause* of the domestic industry’s decline. An overall decline in the economy due to a recession, or new technology breakthroughs by domestic competitors, are not reasons to impose safeguards.

The following report of the WTO Appellate Body, *Argentina—Safeguard Measures on Imports of Footwear*, discusses Article 4.2 and the requirements of a safeguard investigation.

Global Safeguards. Safeguards applicable to WTO member countries must be in the form of **global safeguards**—safeguard measures placed on imports of specific “like” products without discrimination as to their countries of origin. For example, in the last case Argentina had applied the safeguards to footwear imported from all countries except the MERCOSUR countries, a regional customs union of South American nations to which Argentina belongs. The Appellate Body ruled that Argentina’s safeguards must be applied without discrimination and could not be applied only to non-MERCOSUR countries.

WTO Limits on the Use of Safeguards. Safeguards may be used for no longer than four years (with an extension to eight years). Appellate Body reports have held that they not be greater or more restrictive than necessary to prevent injury, and must be gradually lifted when conditions warrant. Tariffs are the preferred safeguard. Safeguards can only apply to imports from developing countries if a particular developing country is supplying more than 3 percent of the total imports of that product. Where critical circumstances exist that could cause irreparable harm to a domestic industry, **provisional safeguards**, consisting of tariffs only, can be used if clear evidence justifies the safeguards, but they must be lifted within 200 days. The use of quotas is greatly restricted in almost all cases.



Argentina—Safeguard Measures on Imports of Footwear

Report of the Appellate Body, WT/DS121/AB/R (1999) World Trade Organization

BACKGROUND AND FACTS

Argentina conducted a safeguard investigation into imports of footwear during the period from 1991 to 1996 and found the following data related to absolute levels of imports:

TOTAL IMPORTS OF FOOTWEAR INTO ARGENTINA, 1991–1996		
	QUANTITY (MILLION PAIRS)	VALUE (US\$ MILLIONS)
1991	8.86	44.41
1992	16.63	110.87
1993	21.78	128.76
1994	19.84	141.48
1995	15.07	114.22
1996	13.47	116.61

Argentina then imposed safeguard measures that increased import duties on footwear from the bound rate of 35 percent to 200 percent. The European Community (now EU) and the United States brought an action at the WTO claiming that the data do not show an increase in absolute levels of imports as required by GATT Article XIX and the *WTO Agreement on Safeguards*. Argentina compared the 1991 figures to 1996 to show an increase. The EU and United States argued that using end points only was improper because it ignored intervening, declining trends over the period. A WTO panel held that Argentina’s safeguard investigation was inadequate, and Argentina appealed to the WTO Appellate Body.

REPORT OF THE APPELLATE BODY

*** We note once again, that Article XIX:1(a) requires that a product be imported “in such increased quantities and under such conditions as to cause or threaten serious injury to domestic producers.” [emphasis in Report] Clearly, this is not the language of ordinary events in routine commerce. In our view, the text of Article XIX:1(a) of the GATT 1994, read in its ordinary meaning and in its context, demonstrates that safeguard measures were intended by the drafters of the GATT to be matters out of the ordinary, to be matters of urgency, to be, in short, “emergency actions.” And, such “emergency actions” are to be invoked only in situations when, as a result of obligations incurred under the GATT 1994, a Member finds itself confronted with developments it

had not “foreseen” or “expected” when it incurred that obligation. The remedy that Article XIX:1(a) allows in this situation is temporarily to “suspend the obligation in whole or in part or to withdraw or modify the concession.” Thus, Article XIX is clearly, and in every way, an extraordinary remedy. ***

We agree with the Panel that Articles 2.1 and 4.2(a) of the *Agreement on Safeguards* require[s] a demonstration not merely of any increase in imports, but, instead, of imports “in such increased quantities . . . and under such conditions as to cause or threaten to cause serious injury.” In addition, we agree with the Panel that the specific provisions of Article 4.2(a) require that “the rate and amount of the increase in import . . . in absolute and relative terms” [emphasis in Report] must be evaluated. Thus, we do not dispute the Panel’s view and ultimate conclusion that the competent authorities are required to consider the trends in imports over the period of investigation (rather than just comparing the end points) under Article 4.2(a). As a result, we agree with the Panel’s conclusion that “Argentina did not adequately consider the intervening trends in imports, in particular the steady and significant declines in imports beginning in 1994, as well as the sensitivity of the analysis to the particular end points of the investigation period used.” ***

Although we agree with the Panel that the “increased quantities” of imports cannot be just any increase, we do not agree with the Panel that it is reasonable to examine the trend in imports over a five-year historical period. In our view, the use of the present tense of the verb phrase “is being imported” in both Article 2.1 of the *Agreement on Safeguards* and Article XIX:1(a) of the GATT 1994 indicates that it is necessary for the competent authorities to examine recent imports, and not simply trends in imports during the past five years—or, for that matter, during any other period of several years. In our view, the phrase “is being imported” implies that the increase in imports must have been sudden and recent.

We recall here our reasoning and conclusions above on the meaning of the phrase “as a result of unforeseen developments” in Article XIX:1(a) of the GATT 1994. We concluded there that the increased quantities of imports should have been “unforeseen” or “unexpected.” We also believe that the phrase “in such increased quantities” in Article 2.1 of the *Agreement on Safeguards* and Article XIX:1(a) of the GATT 1994 is meaningful to this determination. In our view, the determination of whether the requirement of imports “in such increased quantities” is met is not a merely mathematical or technical determination. In other words, it is not enough for an investigation to show simply that



imports of the product this year were more than last year—or five years ago. Again, and it bears repeating, not just any increased quantities of imports will suffice. There must be “such increased quantities” as to cause or threaten to cause serious injury to the domestic industry in order to fulfill this requirement for applying a safeguard measure. And this language in both Article 2.1 of the *Agreement on Safeguards* and Article XIX:1(a) of the GATT 1994, we believe, requires that the increase in imports must have been recent enough, sudden enough, sharp enough, and significant enough, both quantitatively and qualitatively, to cause or threaten to cause “serious injury.”

*** We . . . uphold the Panel’s ultimate conclusion that “Argentina’s investigation provides no legal basis for the application of the definitive safeguard measure at issue, or any safeguard measure.”

Decision. The Appellate Body agreed with the conclusion (but not completely with the reasoning) of the Panel that Argentina’s investigation was inadequate under the standards of the WTO safeguard provisions.

- Case Questions**
1. What is the role of a WTO panel in reviewing the safeguard investigations conducted by a national administrative agency?
 2. What kind of “increased quantities” of imports must be found by the investigating authority to impose safeguard measures?
 3. Locate the *Agreement on Safeguards* and read Article 2. Why did Argentina’s exemption for footwear imported from MERCOSUR countries violate the WTO Agreements?

Trade Compensation. WTO agreements encourage a country imposing a safeguard to compensate a supplying nation for the burden the safeguard measure has imposed on it. For example, if the United States imposes safeguard tariffs on imported bicycles and Taiwan supplies large numbers of bicycles to the United States, then the United States should make trade compensation to Taiwan by reducing tariffs on other Taiwanese imports in an equivalent amount. Thus, **trade compensation** is the act of lowering import duties on certain products coming from a foreign country for the purpose of offsetting increased duties imposed on other products from that country. The countries are expected to negotiate trade compensation; if they fail to reach agreement, then the supplying nation may “suspend . . . substantially equivalent concessions” or raise tariffs in retaliation.

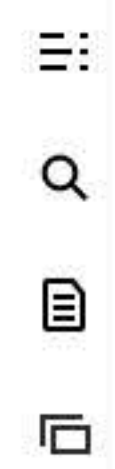
Safeguards against Injury under U.S. Law

The U.S. safeguards law is found in *Section 201* of the *Trade Act of 1974* as amended by later statutes and are codified in Title 19 of the U.S. Code. The law does not exactly follow the specific language and guidelines of GATT Article XIX and the *WTO Agreement on Safeguards*, but is similar. The U.S. law does not refer to the term “safeguards,” but rather to a “positive adjustment to import competition” or **import relief**. The two greatest differences between the WTO safeguards provisions and U.S. law is that U.S. law lacks the requirement that safeguards only be imposed where the injury to industry results from “unforeseen developments,” and the requirements for determining “serious injury” are different. These differences have caused the WTO Dispute

Settlement Body to rule against the United States in a number of safeguard actions reviewed at the WTO since 1994.

Under the U.S. statute, the president can grant import relief when the International Trade Commission (ITC) determines that “an article is being imported into the United States in such increased quantities as to be a *substantial cause of serious injury*, or threat thereof, to the domestic industry producing an article like or directly competitive with the imported article.” A “substantial cause” is that cause of the industry’s decline that is the most important cause, and “not less than any other cause.” Thus, the ITC may look to see what factors other than the increase in imports contributed to the industry’s decline, although it may not consider overall economic trends, such as the impact of a recession on the industry. In determining “serious injury,” the ITC may look at all relevant factors including:

1. A significant idling of productive facilities in the industry
2. The inability of firms to operate at a reasonable profit
3. Unemployment or underemployment in the industry where serious injury to a domestic industry is threatened, or *clearly imminent*, the commission may consider all relevant factors including:
4. A decline in sales or market share
5. A downward trend in production, profits, wages, productivity, or employment
6. Growing inventories
7. A firm’s inability to generate capital for plant and equipment modernization or for research and development



- 8. An actual increase in imports or in market share held by imports
- 9. Other factors that may account for the serious injury to the domestic industry (e.g., incompetent management or lack of technological innovation)

A petition for import relief may be filed with the ITC by any firm, trade association, union, or group of workers, or by Congress or the president, or the commission may initiate an investigation itself. The ITC gives public notice in the *Federal Register* of its investigations and hearings. The commission conducts public hearings at which interested parties may present evidence and make suggestions as to the form of import relief. The ITC prepares a detailed economic analysis of the affected market and then makes either an affirmative or negative determination as to injury. If the ITC finds that the requirements of the law are met, it can recommend a remedy or course of action to the president. Notably, there have been only 11 ITC safeguard investigations between 2003 and 2016.

Trade Remedies Under U.S. Law. The president may make an **adjustment to imports** if, in the president's discretion, it will help the domestic industry make a positive adjustment to import competition and if it will provide *greater economic and social benefits than costs*. Because of this discretionary power, a president who

adopts free trade or free-market concepts might be reluctant to apply a safeguard remedy at all. Although largely political in nature, a president's decision is usually based on the national interest. Although U.S. safeguard actions were common in the 1970s, their use has declined in recent decades, and their use to protect U.S. industry from foreign competitions is now rare. The same has been true in Canada, where safeguards are now seldom imposed.

Any relief that the president grants must be temporary (limited to four years, with an extension to eight years if the firms in the industry are making needed changes) and designed to allow those firms sufficient time to regain their competitive positions in the market. Relief should only provide time to retool, modernize, streamline, recapitalize, improve quality, or take other actions to better meet new competitive conditions in the market. The president's options for adjusting imports include (1) tariff increases, (2) tariff-rate quotas, (3) absolute quotas, (4) auctioned quotas, or (5) grant trade adjustment (financial) assistance to workers or to the domestic industry.

In the following *ITC Report on Heavyweight Motorcycles*, the commission found that increased imports of motorcycles threatened serious injury to the petitioner, Harley-Davidson, despite the severe impact of a long recession on total sales in the industry.



Heavyweight Motorcycles & Engines & Power-Train Subassemblies

Report to the President on Investigation No. TA-201-47 (1983) United States International Trade Commission

BACKGROUND AND FACTS

In 1982, the ITC instituted an investigation to determine if motorcycles having engines with displacement more than 700 cubic centimeters were being imported into the United States in such increased quantities as to be a substantial cause of serious injury, or threat thereof, to domestic industry producing like or directly competitive articles. The investigation was in response to a petition for relief filed by Harley-Davidson Motor Co., a U.S. firm. The investigation showed that from 1977 to 1981, U.S. shipments of motorcycles grew by 17 percent, with domestic production capacity increasing by nearly 82 percent (largely as a result of American Honda's increased production in the United States). During that same period, the number of U.S. jobs increased by 30 percent. In 1982, however, consumption fell, domestic shipments declined, and employment dropped. In the first nine months of 1982, domestic shipments fell by 13 percent and inventories rose, leaving large numbers of unsold

motorcycles. Production during that period showed a decline of 36 percent, profits were down by 20 percent, and employment was down by 12 percent. Inventories of imported motorcycles doubled in that period, representing a tremendous threat to Harley-Davidson. The country as a whole was in the midst of a recession, and demand for heavyweight motorcycles was depressed.

VIEWS OF CHAIRMAN ALFRED ECKES

It is evident that inventories of imported motorcycles have increased significantly during the most recent period. These increases exceed growth in consumption and surpass historical shipment trends for importers. The mere presence of such a huge inventory has had and will continue to have a depressing effect on the domestic industry. Also, given the natural desire of consumers for current design and up-to-date performance capabilities, motorcycles cannot be withheld from the market



indefinitely. They must be sold. And given the realities of the market place, there is a strong incentive to liquidate these inventories as quickly as possible. The impact of such a massive inventory build-up on the domestic industry is imminent, not remote and conjectural.

I have seen no persuasive evidence that would suggest imports of Japanese heavyweight motorcycles will decline in the near future. Instead, the Japanese motorcycle industry is export oriented . . . exporting in 1982 some 91 percent of the heavyweight motorcycles produced in Japan. Because motorcycles of more than 750cc, which include the merchandise under investigation here, cannot be sold in Japan under current law, Japanese producers cannot consider domestic sales as a replacement for exports. The other option, which they apparently pursued in 1982, is to push export sales in the face of declining demand in the U.S. market. This tactic helps to maintain output and employment in the producing country but it shifts some of the burden of adjustment to competitors in the importing country. Evidence that the Japanese producers will seek to maintain a high level of export sales to the U.S. is found in an estimate of the Japanese Automobile Manufacturer's Association. This organization estimated that exports of 700cc or over motorcycles to the United States for 1982 and 1983 would average 450,000 units or less for both years combined. That figure results in import levels higher than recent levels.

Finally, imports of finished heavyweight motorcycles pose a "substantial cause" of threat of serious injury. Under section 201(b)(4), a "substantial cause" is a "cause which is important and not less than any other cause." In my view, there is no cause more important than imports threatening injury to the domestic motorcycle industry.

In reaching this conclusion I have considered the significance of the present recession in my analysis. Without a doubt the unusual length and severity of the present recession has created unique problems for the domestic motorcycle industry. Without a doubt the rise in joblessness, particularly among blue-collar workers, who constitute the prime market for heavyweight motorcycles, has had a severe impact on the domestic industry. Nonetheless, if the Commission were to analyze the causation question in this way, it would be impossible in many cases for a cyclical industry experiencing serious injury to obtain relief under section 201 during a recession. In my opinion Congress could not have intended for the Commission to interpret the law this way.

There are other reasons for doubting the domestic recession is a substantial cause of injury or threat to the U.S. industry. During the current recession, imports from Japan have increased their market share from domestic producers, gaining nearly six percentage points. Imports have taken market share from the domestic facilities of Honda and Kawasaki as well as Harley-Davidson.

Moreover, while the current recession has undoubtedly depressed demand for heavyweight motorcycles,

economic conditions are beginning to improve in this country . . . As demand responds to this improvement, the domestic industry will be pre-empted from participating in any growth because of the presence of a one-year supply of motorcycles poised and ready to capture market share. Consequently, not the recession, but the inventory of motorcycles coupled with anticipated future imports constitute the greatest threat of injury in the months ahead.

Decision The commission recommended that incremental duties be imposed for five years at the declining rates of 45, 35, 20, 15, and 10 percent, in addition to the existing rate of 4.4 percent *ad valorem*.

Comment. President Reagan followed the commission's recommendations, but added tariff-rate quotas of 5,000 units to keep the U.S. market open to European firms that exported to the United States in smaller quantities. The remedy has been considered one of the most successful uses of safeguards. Under protection, Harley-Davidson recapitalized, introduced quality control processes and just-in-time inventory control, and regained its competitiveness. The safeguards were discontinued in 1987. Within a few years, Harley was one of the most demanded motorcycles in the world, including in Japan. In 2012, 35 percent of Harley's sales were outside the United States.

Case Questions

1. In the early 1960s, Honda entered the U.S. motorcycle market with the slogan, "You meet the nicest people on a Honda." During the next two decades, the Japanese company not only made motorcycling acceptable and fun but it also introduced motorcycles known for quality, dependability, and easy starting. By 1982, Japanese motorcycles had reached their peak sales in the United States. In the meantime, Harley-Davidson was plagued with quality and image problems. Do you think this should have been considered in the ITC's recommendations or considered by President Reagan?
2. Assume that a domestic firm is not competitive in price and quality with foreign firms, but that competition by high tariffs protects it. What are the effects of the protection on the firm in the short term? How might it affect the firm's competitiveness in the long term?
3. President Reagan later rejected recommendations to place quotas on footwear because of estimates it would have cost American consumers \$3 billion in increased tariffs, and because there was no indication it would have helped American manufacturers return to competitiveness. How important do you think cost is to a president's decision?
4. Although the administrative process is handled through a bipartisan, independent commission (the ITC), in what way might the process still be very political?



Trade Adjustment Assistance

Workers who become unemployed as a result of increased imports of foreign goods may be entitled to federal financial assistance, known as **trade adjustment assistance (TAA)**. The Trade Adjustment Assistance Program was originally created by President Kennedy in 1962, modified by the *Trade Act of 1974*, and has been regularly reauthorized by Congress. It is administered by the U.S. Department of Labor. A group of three or more workers, an employer, a state workforce or jobs agency, or a labor union representing affected workers may file petitions for TAA with the department.

For workers to be eligible to apply for TAA, the Secretary of Labor must determine that (1) a significant number or group of workers in a firm have become, or are threatened to become, partially or totally separated from their employment; (2) the firm's sales or production have decreased absolutely; and (3) increased imports of like or directly competitive products contributed importantly to the separation and to a decline in the firm's sales or production. Once a group of workers is certified as eligible, the workers in that group apply individually for benefits with their local state job agency office. Assistance to workers, in the form of cash benefits, tax credits, or vouchers, is available to cover the expenses of job search, retraining and relocation, and health insurance coverage. It includes a weekly income payment for certified workers who have exhausted their regular unemployment compensation. Under certain conditions, and in lieu of other benefits, workers age 50 or older who find reemployment at lower wage rates have the option to receive wage subsidies (a portion of the difference between what they were earning and what they can earn now).

The industries with the largest concentration of certified workers during the last several decades have been automotive equipment, textiles and apparel, furniture, leather and leather products, industrial machinery, and electrical and electronic equipment. A special TAA program exists for farmers, and it is administered by the U.S. Department of Agriculture. TAA programs are amended frequently and every few years Congress renews their authority.

Trade Assistance to Firms. Trade adjustment assistance is not just available for U.S. workers but also for U.S. companies. The U.S. Department of Commerce administers it. It is intended to help U.S. companies become more competitive. Companies are eligible if increased imports contributed importantly to a decline

in sales and to the unemployment of a significant number of its workers. Twelve assistance centers nationwide help certified companies develop business recovery plans over a two-year period. The plans include such things as improving production capabilities, marketing, computer systems and website development, and standards certification. To receive financial assistance, the certified firm must contribute its own matching funds.

UNFAIR IMPORT LAWS: DUMPING

Dumping is the selling of products in a foreign country for less than the price charged for "like" or comparable products in the exporter's or producer's home market. It is an **unfair trade practice** in the form of export price discrimination. It causes injury to domestic producers through artificially low prices against which they cannot compete at a profitable level. Dumping has been a fairly persistent problem in international trade and it is not uncommon. The original GATT agreement has prohibited dumping since 1947.

Reasons for Price Cutting in an Export Market

The theories that explain the economics of dumping, its causes and effects, fill entire volumes, and any detailed discussion is certainly beyond the scope of this book. Exporting products to a foreign market at an unfairly low price might be done by a firm wanting to sell its excess production capacity at bargain prices to cover fixed costs and to avoid cyclical worker layoffs. As long as dumped products are not sold in the exporter's own country, causing price suppression in its home market, then it has everything to gain and little to lose. In some cases, an exporter may simply not be able to command the same prices for their goods in a foreign market as at home, such as where they do not have the same market power, brand recognition, or brand loyalty. So there may be some perfectly valid business reasons for dumping. Nevertheless, dumping is recognized as a predatory practice.

At first glance, one might wonder what is wrong with consumers in one country being able to buy the products of another nation cheaply. As long as the products remain available at reasonable market prices, there may be little harm to consumers at first. But selling at an unfairly low price in a foreign market is often intended



to drive local firms out of business so that the foreign dumping firms will ultimately be free to raise their prices to monopoly levels.

Of course, while the explanations for dumping are of interest to economists, the reasons why an individual firm sells its products at an unfairly low price in a foreign country are irrelevant in determining whether the dumping was unlawful. Thus we leave that part of the discussion to our economist friends.

Remedies for Dumping. The usual remedy for dumping is for the importing country to place **antidumping (AD) duties** on the dumped products. (Throughout the chapter, we will substitute AD for the term “antidumping.”) AD duties are special import tariffs assessed in addition to normal tariffs imposed for the purpose of offsetting the unfairly low price of dumped goods. They are not criminal fines, and they are not “damages” that are awarded to an injured firm.

Virtually all developed nations have AD statutes that define dumping and that set out the administrative procedures and remedies available in dumping cases. The United States has had AD laws since 1916; the current version is found in the *Tariff Act of 1930*, as amended and published in Title 19 of the U.S. Code. In the EU, AD laws are imposed only on trade between a member country and a nonmember country. Japan has similar laws, although they are not widely enforced. Developing countries, such as Mexico, Brazil, Argentina, India, and Korea, also have AD codes. It is important to point out that many economists disagree with the use of AD duties. Some claim that the laws injure consumers by “fixing prices” at high levels. Once the prices rise for imported products, domestic manufacturers follow suit by raising their prices as well.

The WTO Antidumping Agreement

The laws of WTO member countries must meet the requirements of GATT 1994 Article VI and the 1994 *WTO Antidumping Agreement*. The agreement permits the imposition of AD duties only when dumping threatens or causes “material injury” to a domestic industry producing “like products,” and only after an investigation determines the amount of the dumping and the extent of material injury.

U.S. Antidumping Investigations

In the United States, AD investigations involve two different federal agencies: the United States International Trade Administration (ITA), which determines whether

dumping occurred and the extent of it; and the International Trade Commission (ITC), which determines whether the dumping has caused, or threatens to cause, a material injury to U.S. producers of like products. Petitions for an investigation may be filed by producers of like or competing domestic products, including manufacturers, sellers, or labor groups. By law, U.S. producers or workers who account for at least 25 percent of the total production of the domestic like products must support the petition. The ITA can poll industry and labor to see if that support exists. Most WTO member countries have a similar administrative process, patterned after the WTO requirements. For example, in Canada, the Canada Border Services Agency and the Canadian International Trade Tribunal handle unfair trade law investigations.

Calculating the Dumping Margin in the United States. The U.S. statute provides that AD duties may be imposed on imported merchandise if that merchandise is sold or is likely to be sold in the United States at *less than fair value*. Contrary to popular belief, dumping does not require that the foreign products be sold for less than the cost to produce them, although sales over an extended period at below cost are considered to be at less than fair value. A sale at **less than fair value** is one in which the “export price” of a product sold in the United States is less than the “normal value” of a foreign like or similar product sold for consumption in the exporter’s or producer’s home country. The **export price** is the price at which a product is sold to an unaffiliated or unrelated buyer in the United States, exclusive of shipping and insurance charges. This difference between normal value and the export price (or constructed export price) is known as the **dumping margin**. AD duties are calculated on the merchandise in an amount equal to the dumping margin.

When the exporter and importer are “affiliated,” or related companies, or when the product’s price is “hidden” in some other type of pricing arrangement (such as barter), the export price is deemed to be the price at which the imported product is first resold in its original condition to an independent buyer.

Calculating the Normal Value in the Exporting or Producing Country. The **normal value** is the price at which a “foreign like product” is sold for consumption in the producing or exporting country in usual commercial quantities and in the ordinary course of business, and at the same level of trade—in other words, comparing wholesale sale to wholesale sale, or retail to



retail—as the dumped product. But if the product is not sold in the country where it is made or from which it is exported, then the dumping margin is calculated by comparing the dumped product to the price of a like product exported to a *third country* where it is sold. If there are insufficient third country sales, then a constructed value is used instead. **Constructed value** is the price of the dumped product compared to the cost of producing the product in the exporting country plus a reasonable amount for selling, packaging, administration, and other costs and for a reasonable profit.

The ITA sends questionnaires to foreign exporters requesting product cost and pricing data based on generally accepted accounting principles. The agencies rely on the responses in determining the dumping margin. Foreign producers have an incentive to respond accurately: The U.S. statute states that if any party fails to cooperate or provide requested data or information to the ITA or any U.S. agency, or if it cannot be verified, then the agency may rely only on the facts that it does have that are adverse to the noncomplying party.

Foreign Like Product. The export price of the dumped product in the United States has to be compared to the “foreign like product” sold for normal value in the exporting or producing country. Realize that many AD actions are taken against an entire category, kind, or classification of merchandise, not just on a single item or product. Therefore, the ITA must determine which products to include in its price analysis and which to

exclude. Also keep in mind that in many cases the products sold by a manufacturer or producer in one country are not like those sold in foreign countries. For example, the range of qualities, specifications, or dimensions may differ. The products may be packaged differently or in different quantities and bulk packs. For example, in the home market, bed sheets may be packaged separately, with customers purchasing the flat sheet, fitted sheet, and pillowcases individually. However, in the export market they may be packaged and sold as “sheet sets.” Adjustments must be made to make “like” comparisons. A **foreign like product** is merchandise produced in the same country and by the same person as the allegedly dumped merchandise, or of the same component materials, or of the same general class or kind of merchandise as that dumped in the United States. The tariff classification of merchandise is identical in physical characteristics, whether the same or different firms produce them, whether they are made of the same or similar component materials, whether they are of equal commercial value, and whether their use is for the same purpose. The following case, *Pesquera Mares Australes Ltda. v. United States*, illustrates a typical problem that might face the ITA in determining a “like product.” It is actually one of the more readable opinions in this area of the law, as most cases deal with far more complex industrial product classifications than salmon. As you read, consider how the agency made its decision and the deference given to that decision by the Court of Appeals for the Federal Circuit.



Pesquera Mares Australes Ltda. v. United States

266 F.3d 1372 (2001) United States Court of Appeals (Fed. Cir.)

BACKGROUND AND FACTS

Pesquera Mares Australes, a Chilean salmon exporter, was accused of dumping salmon in the U.S. market at less than fair value. An AD duty petition was filed in 1997 by the Coalition for Fair Atlantic Salmon Trade. The U.S. Department of Commerce (ITA) conducted an investigation to compare the price of the salmon sold in the United States with its “normal value” in the home market. Finding no sales of Mares Australes’ salmon in Chile during that time, ITA based normal value on the price of the salmon sold in Japan. However, while the salmon sold in the United States was of the “premium” grade, the salmon sold in Japan was of both “premium” and “super-premium” grades. ITA nevertheless found that the salmon sold in Japan and in the United

States had “identical physical characteristics” and thus were “like products” as defined by the U.S. statute. ITA then included the price of the super-premium Japanese grade in its determination of normal value. This resulted in the ITA finding a larger dumping margin and imposing higher AD duties. The duties were affirmed by the Court of International Trade, and Mares Australes appealed to the Court of Appeals for the Federal Circuit.

DYK, CIRCUIT JUDGE * * *

[T]he antidumping statute specifically defines “foreign like product,” as . . . merchandise *which is identical in physical characteristics* In this case ITA . . . sought to identify salmon sold by Mares Australes to Japan that was “identical in physical characteristics” to



salmon exported by that company to the United States. It is ITA's interpretation of the phrase "identical in physical characteristics" that is at issue. * * *

Mares Australes argued that the super-premium salmon it sold to Japan could not be considered "identical in physical characteristics" to the premium grade salmon it sold to the United States. As evidence of this distinction, the company stressed . . . that certain physical defects (such as external lacerations to the salmon) were present in premium but not super-premium salmon; that super-premium salmon enjoyed a darker, redder color than premium salmon; and that its customers in Japan, recognizing these physical and color distinctions, paid higher prices for premium-grade salmon But ITA noted that "the record also contains evidence that the distinctions between the two grades were, in practice, nominal"

As support for its conclusion that super-premium was not a commercially recognized separate grade, ITA also pointed to commercial practice in countries (other than Chile) exporting to Japan, whose salmon industries did "not recognize any grade higher than 'superior.'" [In its final determination] ITA stated: ". . . The Norwegian, Scottish, Canadian, and U.S. salmon industries do not recognize any grade higher than 'superior.' The 'superior' grade is consistent with the premium grade and permits minor defects Nonetheless, all salmon in this range are graded equally, and are comparable products in the market place. [Notice of Final Determination of Sales at Less Than Fair Value: Fresh Atlantic Salmon From Chile, 63 Fed. Reg. 31411 (June 9, 1998)]. ITA thus determined that "salmon reported as super-premium are in fact of premium grade," and accordingly compared the sales of both super-premium and premium salmon to Japan to corresponding sales of premium salmon only in the United States. The practical consequences of ITA's decision to classify the two grades of salmon as "identical in physical characteristics" was to increase Mares Australes' dumping margin from the *de minimis* level (1.21%) to a final dumping margin of 2.23%. * * * This case requires us to interpret the phrase "identical in physical characteristics" as that phrase appears in the definition of "foreign like product" [U.S. Code]. In order to ascertain the established meaning of a term such as the word "identical," it is appropriate to consult dictionaries. There are a variety of dictionary definitions of "identical." Some require exact identity. See, e.g., *American Heritage Dictionary*, 896 (3d ed. 1996) (defining "identical" as "being the same" and "exactly equal and alike") Others allow "minor differences" so long as the items are

"essentially the same." See, e.g., *The American Heritage Dictionary*, 639 (2d ed. 1991) We find nothing in the statute to suggest that Congress intended to depart from the ordinary definition of the term "identical." But that leaves the question of which of the two common usages was intended by Congress: *exactly the same* or *the same with minor differences*?

We conclude that Congress intended the latter usage As Coalition for Fair Atlantic Salmon Trade points out, Congress could hardly have intended to require ITA in each and every instance to compare *all* the physical characteristics of the goods. It might not be possible, for example, with certain types of merchandise to "account for every conceivable physical characteristic" of that merchandise.

Despite our conclusion that Congress intended to allow identical merchandise to have minor differences, the phrase "identical in physical characteristics" [as used in the U.S. statute] remains ambiguous, and, as we learn from *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 104 S.Ct. 2778 (1984), ITA has discretion to define the term.

The ITA has concluded that merchandise should be considered to be identical despite the existence of minor differences in physical characteristics, if those minor differences are not commercially significant. We conclude that this standard adopted by ITA constitutes "a permissible construction of the statute." We conclude that this finding is supported by substantial evidence, and that it has been adequately explained. * * *

Decision. The Chilean salmon exporter violated the AD laws of the United States by selling foreign salmon in the United States at less than fair value. The super-premium salmon sold by Mares Australes in Japan was similar enough to the premium grade sold in the United States to be considered a "foreign like product," the price of which should be included in determining the normal value for purposes of calculating the dumping margin.

Case Questions

1. What is the purpose of comparing the price of salmon sold in the United States to that sold in Japan?
2. Why did Mares Australes not want the ITA to compare the price of salmon sold in the United States to the price of the "super-premium" salmon it sold in Japan?
3. Explain the problem confronting the ITA in determining "foreign like product." How did the court define that term?

Adjustments to Normal Value and Export Price. A fair comparison often requires adjustments to either the export price or to normal value to compensate for differences in the sale—comparing "apples to apples."

For example, if the German manufacturer of ball bearings must pay a sales commission to sales representatives for ball bearings sold in Germany but does not pay commissions on sales to the United States, then



the difference must be accounted for in the calculation. Adjustments can be made for differences in the terms and conditions of sale, the cost of ocean containers and packaging, freight and warehouse expenses, customs brokerage fees, insurance on the goods in transit, and other expenses. Adjustments should also be made for differences in taxes, advertising and sales commission expenses, quantity discounts, and other factors that might legitimately cause the export price to be lower than normal value. The federal law spells out the rules for making adjustments in U.S. dumping cases.

The Material Injury Requirement

In U.S. administrative law, AD investigations are a bifurcated process. While the ITA determines if dumping exists and calculates the dumping margin, the International Trade Commission must determine whether an industry in the United States has been or is threatened with material injury, by reason of dumped imports. The *Tariff Act of 1930* defines the domestic industry as the “producers as a whole of a *domestic like product*, or those producers whose collective output . . . constitutes a major proportion of the total domestic production of the product.” The term **domestic like product** is broadly defined as “a product which is like, or . . . most similar in characteristics and uses with, the article subject to an investigation . . . Relevant factors include tariff classification, physical characteristics and uses, channels of distribution, customer perceptions, and price.

Material injury is injury that is “not inconsequential, immaterial, or unimportant.” In determining material injury, the ITC must consider all relevant economic factors, including (1) import volume, (2) the effect on prices for like domestic products, and (3) the impact on the domestic industry sales, profits, market share, wages, unemployment, growing inventories, and other measures of economic health. A finding of material injury must be reviewed every five years if the AD order is still in effect at that time. The “material injury” standard under the AD law is less than the “serious injury” standard in safeguard actions (studied earlier). Later in the chapter, we will see that another U.S. unfair trade law (on countervailing duties) will also rely on the same definition of material injury.

WTO Dispute Settlement in Dumping Cases

In addition to AD actions being brought before U.S. agencies, WTO member countries can seek consultations and dispute resolution with each other at the WTO. Although

private parties are not part of the WTO proceeding, individual companies often have considerable influence in which actions their governments take to the WTO.

The WTO panel may review a final AD order of an administrative agency in the importing country to determine if it is consistent with the *WTO Antidumping Agreement*. The panel can look to see if the agency misinterpreted the provisions of the agreement or whether it properly followed all administrative procedures in an unbiased and objective manner. If the panel finds that an AD order violates WTO rules, the panel can recommend measures to be taken against the importing country.

The scope of review of an agency’s investigation and AD order is limited. A dispute panel cannot reconsider issues of fact determined during a dumping investigation or overturn an interpretation of the agreement made by the investigating agency. Thus, in reviewing U.S. dumping cases, a panel must accept the facts as found by the ITA and ITC in their investigations. This standard of review is similar to the process found in the United States in which courts of law review decisions of administrative agencies. Of course, as discussed in earlier chapters, an adverse ruling by the WTO Dispute Settlement Body does not have legal effect on U.S. agencies or courts, but does permit other WTO countries who were party to the WTO proceeding to impose retaliatory sanctions.

Dumping and Nonmarket Economy Countries

The United States has long had special rules for AD investigations involving goods it imports from **non-market economy countries** (NMEs). These are countries whose political and economic systems are rooted in the socialist principles of a state-controlled economy. The number of NME countries has declined greatly since the late 1980s due to the fall of communist governments and the integration of others into the world economy. Some are still in a stage of transition. When China entered the WTO, the United States (and EU) agreed that they would treat China as an NME country through 2016, and Vietnam through 2018. In determining if goods are being imported from an NME country, U.S. statutes give the ITA considerable discretion, but require the agency to look at the following factors: (1) the extent to which the currency of the foreign country is convertible into the currency of other countries, (2) the extent to which wage rates in the foreign country are determined by free bargaining between labor and



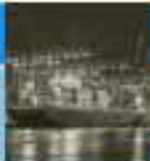
management, (3) the extent to which joint ventures or other investments by firms of other foreign countries are permitted in the foreign country, (4) the extent of government ownership or control of the means of production, and (5) the extent of government control over the allocation of resources and over the price and output decisions of enterprises.

In AD cases involving NMEs, it is difficult or even impossible to determine the “normal value” of merchandise sold in an NME country because of likely government manipulation of costs and prices. Instead, the ITA looks at the value of the **factors of production** that would be incurred if the subject merchandise had been produced in a **surrogate market economy country** that is at a level of economic development comparable to that of the NME country and that is a significant producer of comparable merchandise. The factors of production include raw materials used, hours of labor required, energy and utilities consumed, capital costs and depreciation, packaging, other general expenses, plus a reasonable amount for profit. The ITA presumes that the normal value established by the factors of production method is applicable to all firms in that industry, unless in an AD duty action a firm can prove that it is a “market-oriented exporter.”

Market-Oriented Exporters. In countries with a history of socialist or communist control, the transition to a market economy does not occur overnight. Rather,

it might take place in steps, with the government freeing certain market sectors to competition or by selling state-owned companies through privatization. So, even if the exporting country has an NME, the ITA may look to see if the particular firm producing the dumped products in that country is a market-oriented exporter. A **market-oriented exporter** is an exporting firm in an NME country that is not under government control and that does business on competitive terms. Generally, management negotiates export contracts and prices autonomously, and the government does not share in the profits of the firm. Some industries in an NME country can also be considered market-oriented industries. A **market-oriented industry** is one in which resources (materials, energy, etc.) and labor costs are procured at free-market prices, where there is little government involvement in controlling production and capacity decisions, where prices are set by markets, and where the producers are mostly privately owned. Very few industries in NME countries have ever been given market-oriented industry status in U.S. AD actions.

In the following case, *Bulk Aspirin from the People’s Republic of China*, a French-owned chemical giant with a plant in the United States petitioned the government for AD duties against its Chinese competitors. As you read the case, and especially the comment that follows, consider the ironies in the case, the impact of the AD laws on workers and consumers, and the place of dumping laws in the future of the global economy.



Bulk Aspirin from the People’s Republic of China

Notice of Preliminary Determination of Sales at Less Than Fair Value 65 Fed. Reg. 116 (2000) International Trade Administration

BACKGROUND AND FACTS

Rhodia Pharma Solutions is one of the world’s leading manufacturers of specialty chemicals, including acetyl-salicylic acid (bulk aspirin). With corporate headquarters in France, it has about 25,000 employees in offices and manufacturing plants in the United States and throughout the world. In 1999, Rhodia filed a petition with the Department of Commerce (ITA) alleging that imports from the People’s Republic of China (PRC) were being dumped in the United States for less than fair value. Based on industry information, Rhodia believed that their customers were paying less than half of Rhodia’s price for the same product. No other firms joined the petition, and Rhodia was apparently the only producer of aspirin in the United States at the time.

PRELIMINARY DETERMINATION

The ITA has treated the PRC as a nonmarket economy (“NME”) country in all past AD investigations. A designation as an NME remains in effect until it is revoked by the ITA.

continues



continued

Separate Rates: Both Jilin and Shandong have requested separate company-specific rates. These companies have stated that they are privately owned companies with no element of government ownership or control. To establish whether a firm is sufficiently independent from government control to be entitled to a separate rate, the ITA analyzes each exporting entity. Under the separate rates criteria, the ITA assigns separate rates in NME cases only if the respondents can demonstrate the absence of both *de jure* and *de facto* governmental control over export activities.

Absence of De Jure Control: The respondents have placed on the record a number of documents to demonstrate absence of *de jure* government control, including the *Foreign Trade Law of the People's Republic of China* and the *Company Law of the People's Republic of China*. The ITA has analyzed these laws in prior cases and found that they establish an absence of *de jure* control . . . over export pricing and marketing decisions of firms.

Absence of De Facto Control: Shandong and Jilin have each asserted the following: (1) they establish their own export prices; (2) they negotiate contracts without guidance from any governmental entities or organizations; (3) they make their own personnel decisions; and (4) they retain the proceeds of their export sales and use profits according to their business needs without any restrictions. Additionally, these two respondents have stated that they do not coordinate or consult with other exporters regarding their pricing. This information supports a preliminary finding that there is no *de facto* governmental control of the export functions of these companies. Consequently, we preliminarily determine that both responding exporters have met the criteria for the application of separate rates.

Use of Facts Available: The PRC-Wide Rate: U.S. import statistics indicate that the total quantity of U.S. imports of aspirin from the PRC is greater than that reported by Jilin and Shandong Accordingly, we are applying a single antidumping deposit rate—the PRC-wide rate—to all exporters [other than Jilin and Shandong] based on our presumption that the export activities of the companies that failed to respond to the ITA's questionnaire are controlled by the PRC government. The PRC-wide antidumping rate is based on adverse facts available. The exporters that decided not to respond in any form to the ITA's questionnaire failed to act to the best of their ability in this investigation. Thus—we are assigning the highest margin in the petition, 144.02 percent, which is higher than any of the calculated margins. * * *

Normal Value in the Surrogate Country: [The Act] requires the ITA to value the NME producer's factors of production, to the extent possible, in one or more market economy countries that: (1) Are at a level of economic development comparable to that of the NME,

and (2) are significant producers of comparable merchandise. The ITA has determined that India, Pakistan, Sri Lanka, Egypt, Indonesia, and the Philippines are countries comparable to the PRC in terms of overall economic development. We have further determined that India is a significant producer of comparable merchandise. Accordingly, we have calculated NV using mainly Indian values, and in some cases U.S. export values, for the PRC producers' factors of production. * * *

Factors of Production: [W]e calculated NV based on factors of production reported by the companies in the PRC which produced aspirin and sold aspirin to the United States. Our NV calculation included amounts for materials, labor, energy, overhead, SG & A, and profit. To calculate NV, the reported unit factor quantities were multiplied by publicly available Indian and U.S. export price values.

Decision. Based on the calculations of normal value, two producers, Jilin and Shandong, were able to show that their export pricing was not under government control and received separate AD duty rates based on their individual dumping margins (which ranged from 4 to 42 percent). Bulk aspirin imports from all other Chinese exporters received the PRC-wide rate of 144 percent.

Comment. Shortly thereafter, the Court of International Trade reversed parts of the ITA's methodology of obtaining surrogate values for certain factors of production because it was not based on substantial evidence. *Rhodia v. U.S.* 240 F. Supp. 2d 1247 (CIT 2002). The ITA then changed its methods of calculating overhead and labor, with the result that Jilin and Shandong's AD duties were cut to zero, although the PRC-wide rate was not affected. In 2003, a Rhodia representative stated in testimony before the U.S. House of Representatives that at first the new duties had helped it regain customers and become profitable again, but when ITA changed its methodology and the AD duties disappeared, so did its customers. Rhodia's business in the United States had been devastated. And with that, Rhodia closed the last remaining aspirin plant in America and moved it to—you guessed it—China. A few years later another Chinese importer of bulk aspirin, Bimeda, petitioned for a review of the antidumping duty order, asking that the AD duties be removed. Its logic was that since Rhodia had closed its U.S. plant, and there was no longer any aspirin produced in the United States, that there was no longer any "like domestic product"—and therefore AD duties were now inapplicable. The ITA agreed. (69 FR 35286; 69 FR 77726).

Case Questions

1. What are the special problems of determining the dumping margin of goods exported from an NME country?



2. What is the difference between *de jure* and *de facto* control by the government over Jilin and Shandong? Did either exist?

3. Why is the ITA using a surrogate country, India, to determine normal value?

4. What are the functions of U.S. AD duty laws? Explain.
5. While many U.S. jobs were unfortunately at stake in the proceedings, do you not see irony in the fact that U.S. laws were used to protect a French multinational (Rhodia) from low-cost dumping by a Chinese company, all while maintaining higher aspirin prices for American consumers?

UNFAIR IMPORT LAWS:
SUBSIDIES

There are government programs in all countries that grant benefits to local industries and firms to achieve some specific social or economic objective or for the greater social good. They might be tax credits to encourage alternative energy technologies or conservation, grants to the defense industry to aid in the development of new technologies or weapons, or incentives to rebuild old factories. Some subsidies are used to protect critical domestic industries, such as steel, aircraft, or agriculture. For instance, a government that enacts a tax credit for homeowners who install insulation, or energy efficient windows, is subsidizing the purchase and installation of those products to achieve environmental and economic objectives, whether those objectives are conservation or just a boost for makers of insulation and windows.

All nations grant subsidies to virtually all segments of their economies, including manufacturing and agriculture (recall our discussion of agricultural subsidies in Chapter 10). The EU, the United States, and Japan each spend tens of billions of dollars annually on agricultural subsidies alone, including direct payments to farmers. These programs create a problem in international trade relations when they are in the form of subsidies that give an unfair cost/price advantage in foreign export markets.

Subsidies have long been recognized as damaging to the international economy. Subsidized industries can sell their products in foreign markets at prices lower than would otherwise be possible, which distorts trade patterns based on comparative advantage and gives an unfair competitive advantage to subsidized industries. Subsidies might also encourage firms to embark on commercial ventures that, once the subsidy ends, may prove unprofitable or commercially disastrous. A good example is the Concorde supersonic aircraft, which

could fly from Europe to the United States in less than half the time of a regular jet. The aircraft's development by a consortium of European companies was spurred not by demand, but by a host of EU subsidies. In commercial use, the plane turned out to be highly unprofitable. The last Concorde was taken out of service in 2003. Without the subsidy, the plane would likely have proved too costly to have merited production in the first place.

Government subsidies for a program as large and well known as the Concorde, of course, are a matter of public information; however, most subsidies involve industries and products that are smaller, less known, and less glamorous. Just a quick glance at recent subsidy cases shows products such as crepe paper, electric blankets, narrow woven ribbons, furniture, or endless varieties of food, chemicals, or steel products. The fact that a subsidy might exist on an imported product is usually discovered by a competing firm that is affected by the unreasonable or unexplainable low prices foreign competitors offer to customers. Not surprisingly, knowledge of pricing, as well as rumors about government aid programs that affect pricing, fly quickly through most industries. If a subsidy (or dumping, for that matter) is expected, it is usually the affected industry that brings this to the attention of the appropriate government agency in its country.

WTO Agreement on Subsidies and
Countervailing Measures

Subsidies are regulated by the original 1947 GATT agreement and by the 1994 *WTO Agreement on Subsidies and Countervailing Measures (SCM Agreement)*. The *SCM Agreement* defines subsidies, clarifies those subsidies that are permissible and those that are not, and sets out the procedures for resolving subsidy disputes. Countries with subsidy disputes can request consultations with the WTO asking that the subsidy be withdrawn. The following products seem to be those



most often brought to the WTO for resolution (not just those involving the United States): agriculture (e.g., corn, sugar, cheese, cotton, animal feed), lumber, steel, aircraft, buses, aluminum, paper, washing machines, biodiesel fuel, textiles and apparel, automobile parts, wind generators, wines, computer memory, leather, salmon, and footwear.

Later in this chapter we will learn that most countries have their own internal, administrative remedies against unlawful foreign subsidies. These remedies, which we will learn are called “countervailing duty” actions, can be initiated by private firms. First, we look at the basic concepts.

Definition of a Subsidy. A **subsidy** is defined in the *SCM Agreement* as a financial contribution, including any form of income or price support, made by a government that confers a benefit on a specific domestic enterprise or industry. Examples of financial contributions are:

1. Directly transferring money or grants, making loans at less than prevailing commercial interest rates, or providing loan guarantees that allow the company to receive loans at rates more favorable than nonguaranteed commercial loan rates.
2. Not collecting revenue or taxes otherwise due or providing tax credits.
3. Providing investment capital in a private company if the investment decision is inconsistent with the usual practices of private investors.
4. Furnishing goods or services (including the supply of energy or natural resources) other than general infrastructure.
5. Purchasing goods from firms at a higher price than would be paid in the marketplace.

Two key concepts to remember: there must be a *financial contribution* from government, and it must *confer a benefit*. Many WTO panels have addressed the meaning of these terms. Generally, the financial contribution must be made by government on terms that are more favorable than would otherwise be available in the marketplace, and the benefit must make the recipient better off than it otherwise would have been. Some examples will follow below.

WTO Rules Apply to “Specific Subsidies.” The *SCM Agreement* only applies to subsidies considered to be “specific.” Nonspecific subsidies are not prohibited. A **specific subsidy** is one given to a select company or

limited number of companies, to a select industry or group of industries, or to firms in a select geographical region of a country. A subsidy is usually specific *unless* eligibility is automatic upon the meeting of certain neutral, objective criteria. For instance, suppose that tax authorities allow all corporate taxpayers to deduct \$50,000 of the cost of new machinery as an ordinary operating expense in the year of purchase instead of the \$25,000 that had been allowed. Because the criteria for qualifying for the tax reduction is objective and neutral, made generally available to all taxpayers, and does not favor one company or one industry over another, it is not specific and does not fall under WTO rules. Of course, government programs that benefit industry are common. So, clearly, not all specific subsidies are impermissible. For a specific subsidy to violate WTO rules, it must either be a prohibited subsidy or an actionable subsidy.

Prohibited Subsidies. The *SCM Agreement* provides for two types of subsidies: prohibited subsidies and actionable subsidies. **Prohibited subsidies** are impermissible per se and banned under all conditions. Their harmful effects are presumed; no proof is necessary to show that they cause any adverse effects to a foreign country or foreign competitor because they so clearly distort international competition between firms. The two types of prohibited subsidies are export subsidies and import substitution subsidies. An **export subsidy** is made available to domestic firms upon the export of their products or made *contingent on export performance*. Examples of export subsidies might include a grant or tax credit to cover the cost of transportation of goods from a manufacturing site to an ocean port for shipment to foreign customers, a tax credit for energy consumption for use in manufacturing goods for export, or the special tax treatment of income earned on export sales. Another prohibited export subsidy is a loan from a government agency on terms not available from commercial banks, and which is either conditional on the export of goods to a foreign customer or repayable only out of the proceeds of a contract of sale with a foreign customer. All export subsidies are deemed to be specific, as discussed in the last section, because they target a specific group of recipients—exporters. An **import substitution subsidy** is a government subsidy whose payment is contingent on its recipient using or purchasing domestically made goods over imported goods.



Actionable Subsidies. Actionable subsidies, also known as **adverse effects subsidies**, are subsidies that are not automatically prohibited, but may still be “actionable” because of their harmful effect. An actionable subsidy is one that (1) causes material injury to the domestic producers of a like product in the complaining country, (2) violates a trade agreement, or (3) causes “serious prejudice” to the interests of the complaining country. An actionable subsidy exists if the subsidy exceeds 5 percent of a product’s value, if the subsidy covers a firm’s operating losses, or if the government forgives a debt owed to it. Actionable subsidies must also have been the cause of significant price undercutting, price suppression, or lost sales in the same market.

Upstream Subsidies. An **upstream subsidy** is a subsidy bestowed on raw materials or component parts (“inputs”) for use in an exported product. For instance, a subsidy on coal might also be considered a subsidy on steel made in furnaces that burn that coal. A subsidy on European wheat might be considered a subsidy on Italian pasta made from that wheat. Similarly, a subsidy on live swine might be considered an upstream subsidy of processed pork exports. Upstream subsidies are subject to CVD duties if the input product is made available at a below-market price and has a significant effect on lowering the cost of manufacturing the final product.

Countervailing Duty Actions

Subsidies can also be addressed through national administrative proceedings in the country to which the subsidized goods are imported. All trading nations have some administrative process for addressing subsidized imports. These are commonly called countervailing duty actions. A **countervailing duty** (referred to in this chapter as a CVD duty) is a special tariff, levied in addition to the normal tariff, imposed on imports of subsidized goods for the purpose of offsetting the subsidy. The result is that the cost of imported goods is brought back to where it would have been had the goods not been subsidized. The use of a CVD duty discourages subsidization, eliminates market distortions and the harmful effects of the subsidy, and protects domestic industry in the importing country from injury. A CVD action may be brought at the same time as the WTO dispute settlement action. However, only one form of relief is available: either the CVD or some other countermeasure approved by the WTO. All CVD laws must comply with the *SCM Agreement*.

Countervailing Duty Actions in the United States. U.S. CVD laws date as far back as the late 1800s. The laws changed little over the years until recent decades, when they were revised to comply with the requirements of the *SCM Agreement*. CVD actions are administrative, similar to that used in AD duty cases, described earlier. In the United States, an action is begun by the filing of a petition with both the ITA and the ITC. The ITA may initiate an action on its own, but that does not occur frequently. If the ITA finds that a subsidy exists, and the ITC finds that it caused *material injury* to domestic producers, then a CVD order may be awarded. (The standard for material injury is the same as for AD duty actions, described earlier.) It generally takes from 12 to 18 months for an order to be issued.

Subsidies and Nonmarket Economy Countries

For many years, the CVD law did not apply to imports from nonmarket economy countries, including China and Vietnam. The Department of Commerce, which manages the ITA, did not believe that Congress had intended to apply the CVD law to government-controlled, centrally planned, nonmarket economy countries, where many producers and export firms are little more than government agencies acting as private firms. After all, it could be argued that “everything and anything” might be subsidized, so a real determination of a subsidy was impossible. Several federal courts agreed, most recently in *GPX International Tire Corp v. U.S.*, 666 F.3d 732 (Fed. Cir. 2011), and held that the CVD law could not be applied to nonmarket economy countries. Moreover, imposing both AD and CVD duties to the same products would be “double counting” in violation of the *WTO SCM Agreement*. However, by the mid-2000s, China’s economy had undergone many structural changes. There was increasing private ownership of Chinese firms (including American and global foreign investment) and a loosening of state control over many industries. In addition, there was a growing U.S. trade imbalance with China, and increased demands from members of Congress to stop Chinese subsidies. Thus all CVD investigations against Chinese subsidized imports were in jeopardy.

In 2012, the U.S. Congress enacted new legislation (an amendment to the *Tariff Act of 1930*) specifically applying the CVD law to subsidized imports from nonmarket economy countries, primarily focused on China and Vietnam. However, CVDs will not be used



if essentially there is no or little private investment, and if the ITA is unable to measure government subsidies because the economy of that country (and thus its foreign trade organizations) is essentially comprised of a "single entity." The law also contains a special provision to avoid "double counting" in cases where both AD and CVD duties might both be imposed on the same goods. These rules apply to both China and Vietnam.

Exports from Newly Privatized Enterprises. What happens when a state-owned enterprise transitions into private ownership? Do the subsidies once provided when the enterprise was government owned continue to benefit the now privately owned firm? Understand that state-owned enterprises exist not just in nonmarket economies or socialist countries but also in many countries that we think of as being "free market" or "capitalist." These include Western nations like the United Kingdom, Sweden, and France, as well as developing countries such as Mexico, Chile, and Brazil. For

example, government ownership of communications or energy industries is not unusual.

Since the late 1980s, there has been a worldwide trend away from government ownership of industry and toward private investment. Known as **privatization**, the term refers to the process by which a government sells or transfers government-owned industries or other assets to the private sector.

The next case, *United States—Countervailing Measures Concerning Certain Products from the European Communities ("European Steel")*, sees the largest European steel mills go from their days of near-financial collapse in the late 1960s, through a government bailout and the privatization of ownership, decades later. The United States believed that the financial contributions made to the firms while they were government owned were benefits that passed through to the newly privatized companies. This, in turn, continued to permit low-cost steel exports to the United States. The issue ultimately reached the WTO Appellate Body in Geneva.



United States—Countervailing Measures Concerning Certain Products from the European Communities ("European Steel")

Report of the Appellate Body, World Trade Organization, WT/DS212/AB/R (2002)

BACKGROUND AND FACTS

During the 1960s and 1970s, the European steel industry was near financial collapse. With the support of labor groups, the largest firms were kept alive with government money, low-interest loans, and equity investments from European governments. Many mills became government owned. In the early 1980s, the equivalent of tens of billions of dollars of public money was used to keep the mills running. The money financed operations, revitalized equipment, lowered the firms' debt, trained steelworkers, and permitted the export of low-priced steel. The United States responded with a host of trade remedies, including CVD duties. When the political climate changed in Europe, governments decided to sell off their interests to private investors in free-market stock sales. Since 1988, many large steel mills have been privatized, including British Steel (today Corus), Germany's Saar-stahl, France's Usinor, and others. The new privately owned companies continued to sell steel in America.

The International Trade Administration imposed CVD duties on European steel imports despite the fact that the European mills had been privatized. The agency believed that the benefits granted while the companies were government owned continued to "pass through" to the same steel companies (arguing that the companies were still the "same legal person") even after the

change in ownership. After all, it was assumed, the new shareholders received the modern equipment, trained workers, and other assets paid for by the government. The European Communities maintained that the privatizations took place at arm's length and for fair market value, that the government no longer had any ownership interest or control, and thus that public monies were no longer subsidizing steel production. The EC argued that the U.S. "same person" rule violates the *WTO Agreement on Subsidies and Countervailing Measures [SCM Agreement]*. Consultations between the governments failed, and in 2001, the EC requested that the WTO Dispute Settlement Body convene a dispute panel. After the decision of the panel, the United States appealed to the Appellate Body.

REPORT OF THE APPELLATE BODY * * *

[W]e find that the Panel erred in concluding that "[p]rivatizations at arm's length and for fair market value must lead to the conclusion that the privatized producer paid for what he got and thus did not get any benefit or advantage from the prior financial contribution bestowed upon the state-owned producer." [emphasis Panel's] Privatization at arm's length and for fair market value may result in extinguishing the benefit. Indeed, we find that there is a rebuttable presumption that a



benefit ceases to exist after such a privatization. Nevertheless, it does not necessarily do so. There is no inflexible rule requiring that investigating authorities, in future cases, automatically determine that a "benefit" derived from pre-privatization financial contributions expires following privatization at arm's length and for fair market value. It depends on the facts of each case. * * *

With all this in mind, we now turn to the administrative practice of the [ITA] that is the source and subject of this dispute Generally, the ITA applies the "same person" method to countervailing duty determinations following a change in ownership. * * *

The Panel stated, and the United States agreed before the Panel and on appeal, that the "same person" method requires the ITA to "consider that the benefit attributed to the state-owned producer can be automatically attributed to the privatized producer without any examination of the condition of the transaction" when the agency determines the post-privatization entity is not a new legal person. It is only if the ITA finds that a new legal person has been created that the agency will make a determination of whether a benefit exists, and, in such cases, the inquiry will be limited to the subject of whether a new subsidy has been provided to the new owners. Thus, under the "same person" method, when the ITA determines that no new legal person is created as a result of privatization, the ITA will conclude from this determination, without any further analysis, and irrespective of the price paid by the new owners for the newly-privatized enterprise, that the newly privatized enterprise continues to receive the benefit of a previous financial contribution. This approach is contrary to the *SCM Agreement* that the investigating authority must take into account in an administrative review "positive information substantiating the need for a review." Such information could relate to developments with respect

to the subsidy, privatization at arm's length and for fair market value, or some other information. The "same person" method impedes the ITA from complying with its obligation to examine whether a countervailable "benefit" continues to exist in a firm subsequent to that firm's change in ownership. Therefore, we find that the "same person" method, as such, is inconsistent with . . . the *SCM Agreement*.

Decision. The Appellate Body found that in CVD actions, national administrative agencies must consider a broad range of criteria on a case-by-case basis in determining whether prior subsidies to a former government-owned company have "passed through" to the newly privatized company. The "same person" test used by the U.S. Department of Commerce violated the *SCM Agreement*.

Comment. In 2003, the ITA announced a new rule based on the presumption that a government subsidy can benefit a company over a period of time, corresponding to the useful life of the assets. However, the presumption is rebuttable if it can be shown that the government sold its ownership of all or substantially all of a company or its assets, retaining no control, and that the sale was an arm's-length transaction for fair market value.

Case Questions

1. What is "privatization" and how might it affect a subsidies case?
2. Why did the ITA conclude that the EC steel mills were the "same legal person"?
3. What factors should be considered in determining whether the European mills were still benefiting from earlier subsidies?

BEYOND UNFAIR: EXTRAORDINARY TRADE REMEDIES

There are two extraordinary, seldom-used remedies that a president and the executive branch can use to protect domestic industry from foreign competition. They are seldom used because it's been widely thought that they are economically unnecessary and difficult to employ in today's global trading system based on rules and international agreements.

Imports that Threaten National Security

No nation wants its national security and defense to be totally dependent on foreign imports for a guaranteed

supply of raw materials or essential defense-related articles. The *Trade Expansion Act of 1962* (Section 232), enacted during the height of the cold war, gives broad and somewhat vague power to the president to take "necessary" action to limit imports that could "threaten or impair the national security." The Department of Commerce (in consultation with the Defense Department) may investigate and report to Congress on the effect of imports on national security. The department considers the projected needs of U.S. defense and "essential" civilian functions, the ability of U.S. industries to provide the materials and products needed, and evaluates the impact of foreign imports on American firms to provide those for the nation. The investigation and reports are based on public hearings and reports. If the president agrees with the investigation that a raw material or article is being imported in such quantities



or circumstances that can impair national security, the president may negotiate with a foreign country or take other action that he or she “deems necessary to adjust” (19 U.S.C. 1862) or restrict those imports. Although investigations and actions are extremely rare, a president in the future could interpret this statute broadly to protect certain U.S. industries when other legal alternatives are not available.

Import Surcharge in a Balance-of-Payments Emergency

In Chapter 9, we saw how WTO rules permit a country, particularly a developing country, faced with a balance-of-payments crisis to take extraordinary corrective action to limit the outflow of foreign exchange by limiting imports. Section 122 of the *Trade Act of 1974* allows a U.S. president to also impose a temporary (up to 150 days unless reauthorized by Congress) “surcharge” on imports, but only up to 15 percent of the value of the goods, or temporary quotas. The legality of a U.S. president to today declare a balance-of-payments emergency would be questionable, in part because it would be difficult for the United States to justify an emergency under WTO rules, because of the status of the U.S. dollar in world currency markets, and because its use could prove to be disruptive to the affected industries and the U.S. economy. Nevertheless, it is still within a president’s statutory power to do so.

ENFORCEMENT AND JUDICIAL REVIEW IN UNFAIR TRADE CASES

At the end of 2016 the U.S. government was actively enforcing 370 AD/CVD orders, of which almost one-half involved foreign steel imports. Some dumping margins reached over 600 percent.

The *Trade Facilitation and Trade Enforcement Act of 2016* now permits the U.S. Customs and Border Protection (CBP) to investigate claims that a U.S. importer may have made materially false statements in an import document or otherwise evaded AD or CVD duties. The civil penalties can be severe, even allowing CBP to require offending importers to deposit AD/CVD duties in advance of future entries. The case can also be recommended for criminal prosecution. Congress also required that future trade agreements of the United

States include provisions for mutual aid and cooperation in combatting AD/CVD evasion.

Preventing Companies from Circumventing the AD/CVD Laws

The term **circumvention**, as used in this chapter, includes any attempt by an exporter or importer to unlawfully or deceptively evade import restrictions or duties, including AD/CVD duties. For example, assume that there is an AD/CVD duty on imports of a specific type of Chinese steel. A company may not simply route that steel to Vietnam for “minor or insignificant” processing and then enter it into the United States while “passing it off” as Vietnamese steel. Similarly, parts or components of merchandise subject to an AD/CVD cannot simply be imported into the United States and then merely subjected to “minor or insignificant” assembly in the United States for the purpose of avoiding AD/CVD duties. It could be said that circumvention is essentially a “shell game” created to evade the law. The term **anti-circumvention** refers to those laws and penalties intended to discourage circumvention. The *Tariff Act of 1930*, as amended, is an American statute intended to discourage circumvention of the AD/CVD laws such as those in the above examples. Other nations, including Australia, India, and the EU, have anti-circumvention laws as well. Of course, if the circumvention is fraudulent, such as submitting a false certificate of origin or customs document, then there are other statutes and severe penalties that would also apply. The term “circumvention” has additional meanings in relation to intellectual property rights and digital trade not covered in this chapter.

Judicial Review

Administrative decisions of the International Trade Administration and the International Trade Commission, and appeals from Customs and Border Protection, are reviewable in the U.S. Court of International Trade. ITA and ITC decisions may be appealed to the court if they are final decisions or if they are negative determinations. A **negative determination** is a decision by the agency either to not initiate an investigation or that a material injury does not exist. If an AD determination involves Canadian or Mexican goods, appeals may be made to a binational arbitration panel established under the *North American Free Trade Agreement*. Appeals from the Court of International trade go to the United States Court of Appeals for the Federal Circuit (CAFC) in Washington, DC.



CONCLUSION

Most readers are familiar with the economic and political arguments over free trade versus protectionism. We made every effort to avoid this and to focus on these issues from a legal perspective. We looked at how U.S. law and administrative procedures permit tariffs to be used, temporarily, as an emergency safeguard against increased imports that threaten serious injury to a domestic industry. We also saw how U.S. law specifically defines dumping and subsidies, and how lawful administrative procedures use precise calculations to measure AD and CVD duty remedies, and then only to prevent material injury to a domestic firm. The rules are agreed-to by trading nations, and to borrow from an analogy, are intended to apply a surgeon's scalpel to trade remedies—not overly broad, politically motivated protectionism that could lead to a trade war. Of course, we also saw how a president has the legal authority from Congress to protect the United States from becoming dependent on supplies of imported raw materials or defense-related products. A president determined to protect what he or she perceives as a vital American “national security” industrial interest can act with broad discretion. We hope, in any future debate over free trade

versus protectionism, that these lessons will better prepare readers to sort through the political rhetoric and to understand the role of the president and the executive branch, the role of an independent agency such as the U.S. International Trade Commission, the function of the World Trade Organization, as well as America's position as a global trade leader.

Anyone interested in additional reading on the law or economics of international trade from a U.S. perspective should consider using the reports and publications of the U.S. International Trade Commission (ITC). It produces authoritative reports that examine trends in international trade and analyze the impact of trade and trade agreements on American industries. Readers who want to know more about bringing and handling unfair trade actions in the United States should consult the *Antidumping and Countervailing Duty Handbook*, published by the ITC (latest edition). The text is an excellent summary and informal resource for business. Another excellent source of information from the ITC is *The Year in Trade: Operation of the Trade Agreements Program* (latest edition). For statistical data on unfair import cases, see *Import Injury Investigations Case Statistics* (latest edition). All three publications are available from the ITC website.

Chapter Summary

1. The terms “safeguard,” “import relief,” and “adjustments to imports” all refer to the WTO-recognized rights of a nation to protect a domestic industry from increasing foreign imports.
2. The *WTO Agreement on Safeguards* provides that a member may apply a temporary safeguard measure (e.g., increase tariffs) to a product only if that product “is being imported in such increased quantities and under such conditions as to cause or threaten to cause serious injury to the domestic industry that produces like or directly competitive products.” WTO safeguards are global safeguards, meaning that they must be applied to imports of specific products without regard to the country of origin.
3. In the United States, the International Trade Commission (ITC), an independent agency of government, investigates safeguard actions and conveys its recommendations to the president. The willingness of the president to protect an industry depends on national interests and the president's own economic and trade philosophies.
4. Trade adjustment assistance is available to workers, firms, and farmers whose jobs are lost to foreign imports or by the relocation of factories to foreign countries.
5. Dumping is the unfair trade practice of selling goods in a foreign country for less than the normal value of domestic like products in the producing or exporting country. It is a form of international price discrimination by exporters. National laws and practices on AD must follow the basic framework of the *WTO Agreement on Antidumping*. AD duties can only be imposed on dumped products by the country of import where the dumping causes



- or threatens material injury to a domestic industry producing like products. Much of the litigation in this area involves determining normal value and the calculation of the dumping margin. In the United States, the International Trade Administration determines the dumping margin, and the International Trade Commission determines if the dumping caused material injury to domestic industry.
6. A subsidy is a financial contribution or benefit conferred by a government to a domestic firm or firms, directly or indirectly, to achieve some industrial, economic, or social objective. Subsidies that are prohibited include export subsidies, import substitution subsidies, and adverse effects subsidies. The *WTO Agreement on Subsidies and Countervailing Measures* permits the country of import to impose CVD duties on illegally subsidized imports to offset the value of the benefit. In the United States, the ITA determines the amount of a subsidy, if any, and the ITC determines material injury.
 7. The United States now applies the U.S. CVD duty law to nonmarket economy countries, including China and Vietnam. This change in policy was due to the growing influx of Chinese imports into the United States, the increasing privatization of Chinese firms, and the demands from members of Congress to stop Chinese subsidies.
 8. Throughout the area of unfair trade law, the decisions of the WTO Appellate Body in Geneva, Switzerland, are becoming increasingly important. In several cases, the United States has had to reform or repeal its laws and administrative practices to comply with WTO rules.
 9. Books and articles on the economics of dumping and subsidies could fill entire libraries. Readers interested in this area should consider furthering their theoretical study of international economics or the economics of international trade.
 10. There are two extraordinary trade remedies that go “beyond” unfair trade: (1) A president has statutory authority to assure that the nation does not become overly dependent on foreign sources of supply for raw materials and articles essential to national security and defense; (2) A president can declare a “balance-of-payments emergency” and temporarily restrict imports. Although these are seldom used statutory powers, it is possible that a president, and his or her executive departments, could interpret these very broadly to restrict imports into the United States. Their use would likely trigger a response at the WTO or litigation in the courts.

Key Terms

safeguards against injury 284	export price 291	specific subsidy 298
global safeguards 285	dumping margin 291	prohibited subsidy 298
escape clause 285	normal value 291	export subsidies 298
market disruption 285	constructed value 292	import substitution subsidy 298
provisional safeguards 285	foreign like product 292	actionable subsidy 299
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Questions and Case Problems

1. U.S. presidents have considerable authority from Congress to protect domestic industry from foreign competition. But that authority has its limits. Are you able to list and describe the range of options under U.S. law that are available to a president who favors the protection of domestic industry and who believes in the strong enforcement of trade laws? Draw your answer from the topics you have studied in this and earlier chapters: Limits on presidential powers (Chapter 8); Authorization for trade enforcement sanctions, such as Section 301 or the “dormant” Section 338 (Chapter 10); WTO dispute settlement mechanisms (Chapter 9); Trade enforcement actions under “Section 301” against countries that violate trade agreements (Chapter 10); Safeguards and unfair trade law remedies (Chapter 11); Section 232 actions to protect materials and industries vital to national security. Describe each option in the president’s “arsenal,” tell what administrative protections are built into the system against arbitrary and capricious action, and what the lawful limits are on each.
2. According to the U.S. Department of Commerce, in 2015 there were \$1.1 billion of “large residential washers” imported from China. Whirlpool, a Michigan manufacturer, filed petitions for AD duties on washers made in China by Samsung and LG (respondents). Commercial washers and stacked washer-dryer units were excluded. The normal tariff rate is 1 percent. The ITC determined that there was a high degree of discounting of all washers and a substantial proportion of sales occurred during sales. Large retailers decide which models to display on the floor. Placement at the end of aisles is considered a favorable location. Most floor space was allocated on the basis of consumer demand and the profitability of individual units. The respondents claimed that the discounted washers are designed, displayed, and usually sold together with full-price dryers, thus offsetting the losses on the washers. The petitioner disagreed. Should the dryers be included in the “domestic like product” and should dryer profits be included when considering the effect of the imports of the subject washers on domestic U.S. producers? See, *Large Residential Washers from China*, No. 731-TA-1306, Pub. 4591 (2016).
3. The 2012 amendments to the CVD statute, cited in this chapter, permits CVD duties on imports from NME countries retroactively to 2006. Wireking, an affected importer, argued that this violated the Ex Post Facto provisions of the Constitution, prohibiting penalties from being imposed retroactively. Was the statute constitutional? Does the CVD statute creates a punitive or civil remedy? What was the intent of Congress: to impose punishment, or at least to impose highly punitive measures, or did Congress intend a civil regulatory scheme? Are the CV duties paid to the government or to the person harmed? Who does the CVD statute really protect? For your answer, see, *Guangdong Wireking Housewares & Hardware Co.*, 745 F.3d 1194 (Fed. Cir. 2014) and the cases cited therein. See also, *GPX International Tire Corp. v. U.S.*, 893 F. Supp. 2d 1296 (2013).
4. During the recession of 2009, the U.S. government financially “bailed out” the American automotive industry. The China Association of Automobile Manufacturers then petitioned the Ministry of Commerce of the People’s Republic of China (MOFCOM) to place AD/CVD duties on imports of U.S.-made SUVs and automobiles. In 2012, MOFCOM ordered over \$5 billion of AD/CVD duties (a rate of up to 21 percent) on the vehicles. The United States sought dispute settlement at the WTO which resulted in the WTO report, *China—Anti-Dumping and Countervailing Duties on Certain Automobiles from the United States*, Report of the Panel, WT/DS440/R (23 December 2014). The United States argued that during the investigation MOFCOM had failed to make specific requests for relevant information from U.S. exporters, and failed to provide the foreign exporters with the “essential facts” of how the dumping margin would be calculated. What information and essential facts would the U.S. companies have needed to respond? How did the panel rule and how was the case resolved?
5. In a U.S. AD investigation, the ITA requests information from foreign producers or exporters on the foreign market value of their product in their home market. Respondents are expected to comply in a timely and accurate manner. May the ITA refuse to consider any data that is not deemed “reliable or usable?” What if it is discovered that mid-level managers working for the foreign producer submitted fraudulent home-sales data to the ITA, or that they concealed home-market pricing information? Should the ITA grant the company a chance to correct the information? See, *Papierfabrik SE v. U.S.*, No. 2015-1489 (Fed. Cir. Dec. 16, 2016).
6. At the end of 2016 China initiated dispute settlement proceedings against both the United States and EU requesting that they cease treating China as an NME country under the dumping laws. *United States—Measures Related to Price Comparison Methodologies*, Request for Consultations, WT/DS515/1 (15 December 2016). What is the status or outcome of this case?
7. In an AD investigation, the ITA finds that the dumping firm was experiencing a downturn in its domestic economic cycle, and that there had been no intent to harm a U.S. industry. Can AD duties still be applied?



8. A foreign shoe manufacturer sells shoes to a wholly owned subsidiary company in a foreign market at \$20. The subsidiary sells to an independent distributor at \$40, who sells to a retailer at \$80.00. The retailer sells the shoes to a consumer for a price of \$160. In comparing the export price to the normal value, which price should the ITA use, and why? Which allowances or adjustments to the export price, if any, can the ITA make? Give several examples.
9. What makes an import practice “unfair”? Is that a legal or “political” definition? What remedies are available under U.S. law to protect domestic industries from unfair import competition?
10. Describe the different functions of the ITA and the ITC in regulating import competition. Why do you think that Congress split their respective functions into two separate agencies?

Managerial Implications

Your firm is a U.S. manufacturer of optic transistors (OTs) for use in robotic applications. A few years ago, the United States entered into an OT trade agreement with Asian countries reducing tariffs on most OTs made worldwide. Over the past two years, foreign imports of OTs have risen by over \$100 million per year, and now account for 60 percent of the U.S. market. During this time you noticed a drop in your firm’s share of the U.S. market for OTs from more than 25 percent to less than 20 percent. In addition, your firm’s total sales are in decline, its inventories are at their highest levels, and you have had to postpone hiring new employees. One of your better customers informs you that it can purchase comparable OTs for 25 percent less than yours from a supplier in Taiwan. Furthermore, you learn that the government of Taiwan assists OT manufacturers by rebating taxes on the value of OTs they export. To complicate your problems, you have been experiencing difficulty cracking export markets, and countries

where robots are assembled, such as Korea, Singapore, and Taiwan, have been restricting your firm’s imports through a maze of complex regulations. Also, to receive import licenses, these regulations require you to disclose important manufacturing and design techniques. You are also concerned that your design patents will not be protected there, because there is no enforcement of Korean patent protection laws. Korea has imposed quotas on OTs that make it virtually impossible to export to that market.

Considering your work in the last three chapters, what remedies are available to your firm under U.S. law that would help protect its U.S. market? What are the available remedies that the U.S. government has to help improve market access to your customers who manufacture robots in Asia? What factors (economic, political, or other) will affect the outcome of the case? How might these legal implications affect your global business strategy? Discuss.

Ethical Considerations

1. Few would think that the United States would permit the import of goods made by forced, prison, or indentured labor. Yet for decades, since the 1930s, this has been permitted by American law in cases where there was sufficient “consumptive demand” in the United States and if these goods were in short supply. The U.S. Department of Labor (Bureau of International Labor Affairs) is required by law to monitor, combat, and maintain a list of products made by forced labor, and some of this information is available in an online searchable database. Examples are indentured children locked in garment factories in South America, children sold into bonded labor to produce dried fish products in the Pacific Rim, children confined and forced to mine for gold in Africa, children making toys after being put into “work study” programs
- by corrupt teachers in Asia. Some reports are of military personnel and civilian convicts used to produce unfairly low-priced products for export. It was not until the passage of the *Trade Enforcement and Facilitation Act of 2015* that the “consumptive demand” exception was removed and the United States began greater policing and enforcement of the law.
- a. Under what ethical theory do you think the United States could have justified the “consumptive demand” exception in its trade laws? Do you feel this was appropriate?
- b. Your firm designs and sells branded clothing and apparel worldwide. It relies on contract manufacturing by suppliers for cutting, sewing, and assembling finished goods through an established supply chain.



You are asked by your firm's CEO to prepare a corporate ethics statement on procurement of goods or materials produced by forced, prison, or indentured labor. What would you include in that statement? You may consult Chapter 19 and outside sources for additional information.

- c. There are several nongovernmental and intergovernmental organizations devoted to fair labor issues. Which ones do you think would be good sources of information?
- d. What ideas do you have to assure that abuses are not happening upstream in your supply chain with foreign suppliers?
- e. What are the U.S. government's enforcement powers under the 2015 statute, and what powers do law enforcement agencies have to stop these imports?

2. Your firm is a paper converter. It converts paperboard into various articles for use in homes and restaurants for food preparation, sale, and storage. Its products are pizza boxes, ice cream boxes, bakery and deli boxes, and paper plates as well as boxes and trays for use in fast-food operations. You purchase paperboard from both domestic and foreign sources. Recently, a Chinese supplier has begun offering paperboard at extremely low prices—far lower than what you have been paying domestically. One of your colleagues at your firm calls the offer “too good to be true.” You have always had reliable sources of supply, but the offer is very tempting. Why might the foreign exporter be cutting prices to U.S. customers? What information do you think you need before committing to a purchase? Specifically, what pricing information do you need? If it turns out that the products are being “dumped” in the U.S. market, what would be the result and how might it affect your firm and your purchasing decision? Do you think it is fair or unfair for an exporter to dump its goods in a foreign market? Evaluate the statement, “Selling at a low price can't be unfair.”



CHAPTER 12

Imports, Customs, and Tariff Law



Importing is the entering of goods into the customs territory of a country. All commercial shipments must go through an administrative **entry process** supervised by national customs authorities and informally referred to as “clearing customs.” The purpose of the entry process is for customs authorities to determine whether any import prohibitions or restrictions apply to the goods, whether the goods are subject to any other laws or regulations affecting their entry (e.g., such as product labeling, etc.), and whether any tariffs or import duties are due. This requires that the importer and the customs authorities know the tariff classification, customs value, and country of origin of the goods. This chapter begins by explaining these concepts. Later in the chapter we discuss the use of several tariff-saving devices, such as customs drawbacks and foreign trade zones. The chapter concludes with a review of customs enforcement issues, including civil and criminal penalties for customs violations.

Many of the broad concepts discussed here are applicable to importing in almost any country because many rules are uniform or “harmonized” internationally. However, because customs and tariff law is based on national law and regulation, we focus on specific rules and case law from the United States, particularly in the country-specific area of enforcement and penalties. This area should be particularly helpful to importers in the United States as well as to exporters in other countries who are shipping goods to the United States. In discussing U.S. imports, we will frequently mention the role of the U.S. Bureau of Customs and Border Protection, the customs regulatory authority in the United States. We will refer to this bureau as “U.S. Customs” or simply “Customs.”

As you study this chapter, remember that importing is too often viewed from the perspective of a single, isolated transaction. You might be tempted to think in terms of an individual or small firm that imports only occasionally. However, importing is often a part of a global company’s larger operation and international business strategy. Imagine a leading apparel designer that ships garments to the United States that

were assembled in Honduras, from parts of clothing that were cut and sewn at plants in Hong Kong, from fabric that had been woven in China. Imagine an automobile company that ships car to the United States from assembly plants in Mexico that used component parts sourced from Japan or Europe. Outside the manufacturing context, consider an importer of Swiss watches, Danish cheese, or French wine that might import foreign brands for national distribution. These are simple examples of how importing can be an integral part of a firm’s global or international business strategy, linking all entities and processes along a global supply chain. Customs and tariff laws will have a great influence on strategic and operational decisions. They can determine the countries where raw materials are purchased and where factories are built. They can even influence the engineering, packaging, labeling, and pricing of the final product. Naturally, due to the complexity of customs and tariff laws and the range of civil and criminal penalties, we caution readers to seek the assistance of a licensed customs broker or customs attorney in more complex commercial transactions.

In this chapter, you will read court decisions from the U.S. Court of International Trade and from the U.S. Court of Appeals for the Federal Circuit. Judicial review of the rules and decisions of U.S. Customs and Border Protection is in the Court of International Trade. This is a specialized federal court located in New York City. Appeals from this court are to the U.S. Court of Appeals for the Federal Circuit in Washington, D.C. The “Federal Circuit” has nationwide jurisdiction over all international trade, patents, trademarks, and a wide variety of administrative law appeals. The use of a single, specialized court for customs and trade issues, with appeal to a single appellate court, provides uniformity of the law. If the many federal district courts and federal appellate courts around the country were deciding these cases, then the same goods might receive different tariff treatment at each U.S. port of entry according to the case law of that district or circuit. The term **port of entry** refers to any place when customs or immigration

authorities permit the entry of goods or people. Ports of entry are usually sea or ocean ports, river ports, airports, or other types of inland ports.

DUTIABLE STATUS OF GOODS

The **dutiable status** of goods (in this chapter, the term “goods” may also be called “articles” or “items”) refers to the legal status of imported goods at the time of entry for purposes of compliance with the tariff and customs laws. Dutiable status is determined by three factors: (1) the *classification and numerical coding* of the article, (2) the *customs value* of the article, and (3) the *country of origin* of the article. In other words, importers must know what it is that they are importing, what it’s worth, and where it came from according to law. It is the importer’s responsibility to use reasonable care to determine the dutiable status of an import, to accurately report it to customs authorities, and to provide the necessary documentation to verify the information. The time to begin thinking about an article’s dutiable status is not when the goods arrive at the port of entry—which is far too late. Dutiable status—which ultimately determines the tariff rate, possible quotas, country of origin marking and labeling, and more—should be considered in the earliest planning stages. It gives the importer and product manager essential information for determining product costs, pricing, marking and labeling, and it may even affect a product’s design characteristics and choice of suppliers. The first step in determining the dutiable status of an item is to locate it in the tariff schedule of the country of import.

The Harmonized Commodity Description and Coding System

A **tariff schedule** is a listing of specific items, coded numerically and described by name or use. The tariff rate for each item is given according to the country of origin. An example might be, “*Heading 9506.99.60 ... Articles and equipment for general physical exercise, gymnastics, athletics, other sports*” at 4 percent duty.”

The tariff schedule of virtually all nations is based on the *Harmonized Commodity Description and Coding System* (the “harmonized system”), an international agreement developed by the World Customs Organization (WCO), an intergovernmental organization located in Brussels with 180 member nations. The harmonized system standardizes the nomenclature used to identify,

describe, and classify goods. The WCO administers the numbering and descriptions of goods listed in the schedule, reviews changes in technology and new products, and revises the harmonized schedules every five years. The most recent was effective in 2017.

Because of the harmonized system, goods that fall into a certain classification in one country should be similarly classified in all countries. Of course, customs authorities and even courts in different countries may arrive at different classifications for the same goods (as in the last example, the meaning of “equipment for physical exercise” might be considered something different in different countries). But the uniformity of descriptions and numerical coding at least provides a common nomenclature and understanding. Although the schedule does show the tariff rates for every item, the rates are not set by the harmonized system. Tariff rates for each country can be very different and are determined by each country’s tariff schedule. Each country’s schedule of goods can be found in its national legislation and is published and made available to the public.

Harmonized Tariff Schedule of the United States. The United States enacted the *Harmonized Tariff Schedule of the United States* (referred to as HTSUS or “tariff schedule”) in 1989 (see Exhibit 12.1). In the United States, the tariff schedule is maintained by the International Trade Commission. It is not published in the *U.S. Code* but is available online directly from the ITC or through a link on the U.S. Customs and Border Protection’s Website. The harmonized schedule of the European Union is called the *Combined Nomenclature (CN) of the European Union* and is published in the *Official Journal of the European Union*. Although the European Union utilizes the harmonized tariff code and has a common external tariff rate and trade policies, each of the EU countries maintains its own customs enforcement agency. The Canadian version of the harmonized schedule is called the *Customs Tariff* and is administered by the Canada Border Services Agency.

Organization of the HTSUS. The HTSUS divides products into several thousand tariff classifications, ranging from basic commodities and agricultural products to manufactured goods. It is organized into 22 sections and 99 chapters, each covering different kinds of goods and arranged in a progression from crude materials, livestock, and agricultural products through manufactured goods such as vehicles, aircraft,



Exhibit 12.1

Harmonized Tariff Schedule of the United States (2017)						
Annotated for Statistical Reporting Purposes						
30 63-20						
Heading/ Subheading	Stat. Sub- hs	Article Description	Unit of Quantity	Rates of Duty		
				General	Special	2
6306		Tarpaulins, awnings and sunblinds; tents; sails for boats, sailboards or landcraft; camping goods:				
		Tarpaulins, awnings and sunblinds:				
6306.12.00	00	Of synthetic fibers (669) _____	kg	8.8%	Free (AU, BH, CA, CL, CO, IL, JO, KR, MA, MX, OM, P, PA, PE, SG)	90%
6306.19		Of other textile materials:				
6306.19.11	00	Of cotton (369) _____	kg	8%	Free (AU, BH, CA, CL, CO, IL, JO, KR, MA, MX, OM, P, PA, PE, SG)	90%
6306.19.21		Other _____		5.1%	Free (AU, BH, CA, CL, CO, E*, IL, JO, KR, MA, MX, OM, P, PA, PE, SG)	40%
	10	Of artificial fibers (669) _____	kg			
	20	Other (899) _____	kg			
6306.22		Tents:				
		Of synthetic fibers:				
6306.22.10	00	Backpacking tents _____	No. kg	Free		90%
6306.22.90		Other _____		8.8%	Free (AU, BH, CA, CL, CO, IL, JO, KR, MA, MX, OM, P, PA, PE, SG)	90%
	10	Screen houses _____	kg			
	30	Other (669) _____	kg			
6306.29		Of other textile materials:				
6306.29.11	00	Of cotton _____	kg	8%	Free (AU, BH, CA, CL, CO, IL, JO, KR, MA, MX, OM, P, PA, PE, SG)	90%
6306.29.21	00	Other _____	kg	2.9%	Free (AU, BH, CA, CL, CO, E*, IL, JO, KR, MA, MX, OM, P, PA, PE, SG)	40%
6306.30.00		Sails _____		Free		30%
	10	Of synthetic fibers _____	kg			
	20	Of other textile materials _____	kg			
6306.40		Pneumatic mattresses:				
6306.40.41	00	Of cotton _____	kg	3.7%	Free (AU, BH, CA, CL, CO, IL, JO, KR, MA, MX, OM, P, PA, PE, SG)	25%
6306.40.49	00	Of other textile materials _____	kg	3.7%	Free (A, AU, BH, CA, CL, CO, D, E, IL, JO, KR, MA, MX, OM, P, PA, PE, SG)	25%
6306.90		Other:				
6306.90.10	00	Of cotton _____	kg	3.5%	Free (AU, BH, CA, CL, CO, IL, JO, KR, MA, MX, OM, P, PA, PE, SG)	40%
6306.90.50	00	Of other textile materials _____	kg	4.5%	Free (AU, BH, CA, CL, CO, E*, IL, JO, KR, MA, MX, OM, P, PA, PE, SG)	78.5%

(continues)

Exhibit 12.1 (continued)

Harmonized Tariff Schedule of the United States (2017)

General Note 3
edited for student use

3 Rates of Duty. The rates of duty in the "Rates of Duty" columns designated 1 ("General" and "Special") and 2 of the tariff schedule apply to goods imported into the customs territory of the United States as hereinafter provided in this note:

(a) Rate of Duty Column 1.

- (i) Except as provided in subparagraph (iv) of this paragraph, the rates of duty in column 1 are rates which are applicable to all products other than those of countries enumerated in paragraph (b) of this note. Column 1 is divided into two subcolumns, "General" and "Special", which are applicable as provided below.
- (ii) The "General" subcolumn sets forth the general or normal trade relations (NTR) rates which are applicable to products of those countries described in subparagraph (i) above which are not entitled to special tariff treatment as set forth below.
- (iii) The "Special" subcolumn reflects rates of duty under one or more special tariff treatment programs described in paragraph (c) of this note and identified in parentheses immediately following the duty rate specified in such subcolumn. These rates apply to those products which are properly classified under a provision for which a special rate is indicated and for which all of the legal requirements for eligibility for such program or programs have been met. Where a product is eligible for special treatment under more than one program, the lowest rate of duty provided for any applicable program shall be imposed. Where no special rate of duty is provided for a provision, or where the country from which a product otherwise eligible for special treatment was imported is not designated as a beneficiary country under a program appearing with the appropriate provision, the rates of duty in the "General" subcolumn of column 1 shall apply.

(iv) Products of Insular Possessions. *omitted*

(v) Products of the West Bank, the Gaza Strip or a qualifying industrial zone. *omitted*

(b) Rate of Duty Column 2. Notwithstanding any of the foregoing provisions of this note, the rates of duty shown in column 2 shall apply to products, whether imported directly or indirectly, of the following countries and areas pursuant to [statute] or to any other applicable section of law, or to action taken by the President thereunder:

Cuba North Korea

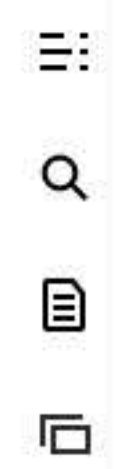
(c) Products Eligible for Special Tariff Treatment.

(i) Programs under which special tariff treatment may be provided, and the corresponding symbols for such programs as they are indicated in the "Special" subcolumn, are as follows:

Generalized System of Preferences.....	A, A* or A+
United States-Australia Free Trade Agreement.....	AU
Automotive Products Trade Act.....	B
United States-Bahrain Free Trade Agreement Implementation Act.....	BH
Agreement on Trade in Civil Aircraft.....	C
North American Free Trade Agreement:	
Goods of Canada, under the terms of general note 12 to this schedule.....	CA
Goods of Mexico, under the terms of general note 12 to this schedule.....	MX
United States-Chile Free Trade Agreement.....	CL
African Growth and Opportunity Act.....	D
Caribbean Basin Economic Recovery Act.....	E or E*
United States-Israel Free Trade Area.....	IL
United States-Jordan Free Trade Area Implementation Act.....	JO
Agreement on Trade in Pharmaceutical Products.....	K
Dominican Republic-Central America-United States Free Trade Agreement Implementation Act.....	P or P+
Uruguay Round Concessions on Intermediate Chemicals for Dyes.....	L
United States-Caribbean Basin Trade Partnership Act.....	R
United States-Morocco Free Trade Agreement Implementation Act.....	MA
United States-Singapore Free Trade Agreement.....	SG
United States-Oman Free Trade Agreement Implementation Act.....	OM
United States-Peru Trade Promotion Agreement Implementation Act.....	PE
United States-Korea Free Trade Agreement Implementation Act.....	KR
United States-Colombia Trade Promotion Agreement Implementation Act.....	CO
United States-Panama Trade Promotion Agreement Implementation Act.....	PA

Source: International Trade Commission, Washington, D.C. (2017) Always consult the latest schedule.

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and even spacecraft and their component parts. Chapters are broken down into headings, subheadings, tariff items, and in some countries such as the United States, to ten digits (to allow for detailed compiling of statistical data on imports).

Chapter:	first two digits
Heading:	first four digits
Subheading:	first six digits
Tariff item:	first eight digits
Statistical break:	ten digits

Look at Exhibit 12.1. What is the classification shown for lightweight tents made of synthetic fibers, such as nylon, used for backpacking?

Chapter 63:	"Other made up textile articles"
Heading 6306:	"Tarpaulins, awnings and sunblinds; tents; sails for boats ... camping goods"
Subheading 6306.22:	"Tents: Of synthetic fibers"
Tariff item 6306.22.10:	"Backpacking tents"

Rates of Duty. The rate of duty is listed next to each tariff item. As shown in Exhibit 12.1, the schedule is divided into two columns. Column 1 contains the general rate of duty. The general rate is the tariff rate applicable to imports from countries with whom the United States has "normal trade relations." The special rate of duty is the tariff rate applicable to imports under one or more tariff preference programs, such as those for developing countries under the *Generalized System of Preferences*, or for trade within a free trade area. Column 2 rates are the original rates from the *Smoot-Hawley Tariff Act of 1930*, as amended, that today are applicable only to countries not granted normal trade relations. Prior to the 1990s, the Column 2 rates had applied to goods from communist countries. As of 2017, only goods from Cuba and North Korea fell into this category (which face additional and more severe trade restrictions). Column 2 tariff rates are so high that imports from these countries become cost-prohibitive. This is determined by Congress.

Tariffs are most often based on *ad valorem*, specific, or compound rates. The most common is the **ad valorem tariff rate**, based on a percentage of the value of the articles imported. A **specific tariff rate** is a specified dollar amount per piece, or unit of weight or measure. A **compound tariff rate** is a combination of both *ad valorem* and specific rates.

Tariff Classification of Goods

The first step in determining the dutiable status of an article is to determine its tariff classification using the **General Rules of Interpretation (GRI)**, found at the beginning of the tariff schedule. Using the rules requires specialized training and experience, or the services of a professional customs broker or customs attorney. This section gives only an overview, and most references to specific GRI numbers are omitted in this chapter.

Begin by finding the section, chapter, and *four-digit heading* for the article you are, or will be, importing. Choose the heading that most completely and specifically describes the article. The alphabetical index at the end of the schedule might be a helpful start.

Consider Exhibit 12.1. Heading 6306 includes "*Tarpaulins, awnings and sunblinds; tents; sails for boats ... camping goods*." If the article is specifically and completely stated in the heading, as are "tents," then you may proceed to look at the six-digit subheading and eight-digit tariff item levels. Thus "backpacking tents" would be classified as tariff item 6306.22.10.

The GRI also requires that you consult the legally binding notes found at the beginning of each section and chapter. They give the meaning of specific terms used in headings and subheadings (such a defining a man's "suit" or a woman's "ensemble" when used in reference to sets of apparel), and explain what might be included or excluded from a section, chapter, or heading. For instance, Chapter 94 covers "*Furniture, bedding, mattresses ...*" but the chapter notes state that the chapter does not cover "*pneumatic or water mattresses ... dentists' chairs ... toy furniture ...*"

Later in this section we will look how to classify goods that can conceivably be classified in two or more headings or subheadings.

Common and Commercial Meaning of Tariff Terms. Articles are described in the tariff schedule in several ways: by name (an *eo nomine* provision), by a description of its physical characteristics, by a description of its component parts, or by its use. Terms used to describe an article in the schedule are interpreted according to their *common and commercial meaning*, unless a different *scientific meaning* is more applicable. Both U.S. Customs and the courts rely on dictionaries, encyclopedias, industry trade literature (from companies and industry trade association), scientific authorities, as well as photographs, videos, and actual product samples submitted to them. Import professionals also

consult the *WCO Explanatory Notes*, which are subscription-based (nonbinding) guidelines for interpreting the schedule published by the World Customs Organization.

It's said that classifying an article is a "two-step" process. The first step is to determine the meaning of specific terms in the tariff provisions. As judicial

opinions explain, this is a "question of law." The second step is to see if the merchandise in question falls within the meaning of those terms. This is said to be a "question of fact." The following case, *Otter Products, LLC v. United States*, illustrates the problem of classifying an item that most of us know, but that is not specifically described in the schedule.



Otter Products, LLC v. United States

70 F. Supp. 3d 1281 (2015) Court of International Trade

BACKGROUND AND FACTS

Otter Products LLC imported protective cases for smart-phones, branded as the "Otterbox Commuter" and "Defender" series. The cases have a clear plastic screen cover, rigid outer plastic shell that fits snugly, and a flexible silicone component. A case does not have to be opened to use the phone. Customs classified the articles in Chapter 42 under Subheading 4202.9900 that included "*Trunks, suitcases, vanity cases, attaché cases, briefcases ... and similar containers ...*" at 20 percent duty. Otterbox argued that the items should be classified in Chapter 39 under Subheading 3926.90.9980 as "*other articles of plastic*" at 5.3 percent duty. Otterbox protested, paid the duties, and filed with the Court of International Trade. The court agreed with Otterbox and the government (defendant) appealed.

KELLY, JUDGE

Where subject merchandise arguably falls under the phrase "similar containers" the court uses an *ejusdem generis* analysis "to determine the scope of the general word or phrase." See, *Avenues in Leather, Inc. v. United States*, 423 F.3d 1326, 1332 (Fed.Cir.2005). In order for the Commuter and Defender Series cases to fall under the general phrase "similar containers," "the merchandise must possess the same essential characteristics or purposes that unite the listed exemplars preceding the general term or phrase." *Id.* (citations omitted)

The court's analysis begins with the meaning of the phrase "similar container." The *Oxford English Dictionary* defines the word "container" to mean "... that which contains, esp. a receptacle designed to contain or store certain articles. ..." It also defines "similar" as "1. Of the same substance or structure throughout; homogenous; esp. *similar parts*. 2.a. Having a marked resemblance or likeness; of a like nature or kind." Similarly, *Merriam-Webster* defines "container" to mean "an object (such as a box or can) that can hold something...." Thus, in order to be a "similar container" the court finds that merchandise must be a receptacle or object, which resembles or is of a like nature or kind to the listed exemplars, and is designed or has the capability to contain, store, or hold certain articles. Moreover

... as the parties agree, four essential characteristics or purposes, organizing, storing, protecting, and carrying, unite the listed exemplars in Heading 4202 and are relevant to the analysis of whether a good is a "similar container" to those exemplars.

As stated, determining the parameters of the word container is only a first step for the court's analysis, which now turns to a discussion of whether the subject merchandise organize, store, protect, and/or carry. Of these four essential characteristics, only one, "protecting," is clearly shared with the subject cases. Indeed, the parties do not dispute that the subject cases "protect."

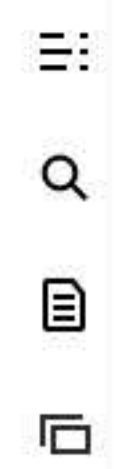
The Defender and Commuter Series cases do not organize or store under the common meaning of those terms. The cases do not organize electronic devices in even a rudimentary fashion. The organizational capacity of the backpacks and beach bags in the case the government cites for this prospect cannot be equated to the cases at issue here. Further, Defendant's argument that the electronic devices are stored when they are set aside on a desk, not only demands a philosophical approach to the word "store," but also fails to explain why the subject cases have any involvement in the storing. One could "store" in this way without a case at all.

Defendant's discussion of the cases ability to carry has some merit. Defendant argues that the cases "carry" because they "are designed to securely hold certain electronic devices while the user is mobile." Moreover, Defendant points out that the Defender Cases are "equipped with a holster into which the case holding the electronic device is securely inserted and the holster has a clip attached to it so that it may be affixed to a belt."

The product here is not a holster, it is a protective case that can be attached to a belt clip holster. The protective function and the minimal carrying function is simply not enough to convince the court the cases are "similar containers."

For the above stated reasons, the court finds that [Otter Products] has satisfied its burden to establish that the Commuter and Defender Series cases are not classifiable

continues



continued

in Heading 4202. The subject merchandise is properly classified under Subheading 3926.90.9980, HTSUS. * * * [The court did not consider other possible headings, because the government never contested Heading 3926.]

Decision. Judgment is affirmed for Otter Products. The cases cannot be classified under Heading 4201 because they are not listed by name, and because they are not “similar containers” to the other items listed therein but have different characteristics and purposes.

Comment The court’s decision was affirmed by the Court of Appeals for the Federal Circuit in *Otter Products, LLC v. United States*, No. 2015-1866 (2016).

Case Questions

1. What are the questions of law that the court must decide? What are the questions of fact?
2. How does the court define “similar containers” and what sources does it rely on?
3. How might tariff classification affect new product design? Explain.
4. How could you see this case affecting classifications of other items? How would you classify a “smart” cover for a tablet? Would it make a difference if the tablet cover has a zipper?

Classification by Use. The schedules frequently classify articles by use. An example is a detergent additive for gasoline described as a “*preparation used to keep the carburetor ... clean*.” Similarly, the classification of cars, trucks, and vans is determined by use: “*motor vehicles for the transport of goods*” are classified in a different heading than “*motor vehicles principally designed for the transport of persons*.” When an article has several different uses, the principal use controls. In the United States, **principal use** is the ordinary use to which articles of the same class and kind as those being imported are usually put and which is greater than any other single use of the article. An article may be classified according to its actual use—the use to which that article is actually put. The actual use must be noted in U.S. customs documentation at the time of entry, the imported article must actually be used in that manner, and the use must be verifiable for three years after entry.

The Rule of Relative Specificity. If an article can be classified under two or more headings or subheadings, it must be classified under the one that most specifically—most narrowly—describes the article with the greatest degree of accuracy and certainty (GRI 3a). This is common with goods that are made of several materials or components. This is known as the **rule of relative specificity**.

A description by name or use is more specific than a description of a class or category of goods. For example, tools used by a hairstylist would be classified as “*shavers and hair clippers with self-contained electric motor*” under Heading 8510 because this description is more specific than “*electromechanical tools for working in the hand with self-contained electric motor*” under 8508. The following case, *Carl Zeiss, Inc. v. United States*, discusses the rule of relative specificity and is one of the most frequently cited cases in this area of the law.



Carl Zeiss, Inc. v. United States

195 F.3d 1375 (1999) United States Court of Appeals (Fed. Cir.)

BACKGROUND AND FACTS

Zeiss imported ZMS 319 microscopes, stands, and accessories, including a camera—all specially tailored for neurosurgical use. Customs classified the ZMS 319 under Heading 9011 for “*stereoscopic compound microscope with a means for photographing the image*.” Zeiss disagreed, arguing that the article should be classified under Heading 9018 for “*Instruments and appliances used in medical, surgical, dental or veterinary sciences, including scintigraphic apparatus, other electro-medical apparatus*

and sight-testing instruments.” Zeiss filed a protest and then brought this action in the Court of International Trade. The court held for the government, and Zeiss appealed.

LOURIE, CIRCUIT JUDGE

Absent contrary legislative intent, HTSUS terms are to be construed according to their common and commercial meanings, which are presumed to be the same. A court may rely upon its own understanding of the terms used and may consult lexicographic and

continues



continued

scientific authorities, dictionaries, and other reliable information sources. One who argues that a tariff term should not be given its common or dictionary meaning must prove that it has a different commercial meaning that is definite, uniform, and general throughout the trade.

We agree with the government that the merchandise is *prima facie* classifiable under the 9011 Heading “compound optical microscopes.” *Webster’s International Dictionary* defines an “optical microscope” as “a microscope in which light rays are seen directly by the observer as distinguishable from one [such] as an electron microscope) in which some transformation or system of indirect viewing is used.” *Webster’s Third International Dictionary* 1584 (1976). It further defines a “compound microscope” as “a microscope consisting of an objective and an eyepiece mounted in a draw-tube and focused by means of screw arrangements.” *Id.* at 467. See also, *The Random House Unabridged Dictionary* 420 (2d ed. 1987) ... There is no dispute that the ZMS 319 OPMI® microscope conforms to these definitions.

Furthermore, Heading 9011 is an *eo nomine* classification provision, not a use provision, as it describes the merchandise by name, not by use. It would be improper to narrow this provision to include those microscopes used in industry and research, but to exclude those microscopes used in medicine and surgery; a use limitation should not be read into an *eo nomine* provision unless the name itself inherently suggests a type of use. “[A]n *eo nomine* designation, with no terms of limitation, will ordinarily include all forms of the named article.” *Hayes-Sammons Chemical Co. v. United States*, 55 C.C.P.A. 69, 75, (1968). Therefore, the fact that the ZMS 319’s exclusive use is surgical is irrelevant to the question whether it falls under the *eo nomine* provision “compound optical microscope.”

Lastly, the [lower] court found that Zeiss had not proved that the term “compound optical microscope” has a well-known signification in trade and commerce that is different from its common meaning. On appeal, Zeiss only argues that its own product has a separate “commercial identity.” However, the fact that the ZMS 319 is designed, marketed, and used as a surgical instrument does not establish a separate commercial meaning for the HTSUS heading term. Thus, the court properly construed the term “compound optical microscope” in accordance with its common meaning and properly determined that the ZMS 319 fell within Heading 9011.

Although we agree with the government that the ZMS 319 is classifiable under Heading 9011, we agree with Zeiss that the ZMS 319 is also *prima facie* classifiable under the 9018 heading for instruments

used in medical and surgical sciences, for there is no dispute that the ZMS 319 is such an instrument. Having determined that the ZMS 319 is *prima facie* classifiable under both Headings 9011 and 9018, we must now determine which is the preferred heading for classification.

When a product is *prima facie* classifiable under two or more headings, “[t]he heading which provides the most specific description shall be preferred to headings providing a more general description.” GRI 3(a). Under this rule of “relative specificity,” “we look to the provision with requirements that are more difficult to satisfy and that describe the article with the greatest degree of accuracy and certainty.” [citations omitted]

The government responds that ... the description “compound optical microscopes” is narrower and more specific than “instruments used in medical or surgical sciences....”

We agree with the government that the ZMS 319 should be classified under Heading 9011 because the description “compound optical microscopes” more specifically describes the merchandise than “instruments used in medical or surgical sciences.” The term “compound optical microscopes,” even while encompassing microscopes with different specifications and uses, suggests specific structural requirements, viz, that it be “compound” and “optical.” That provision, therefore, is narrower than “instruments and appliances used in medical or surgical sciences,” which encompasses a wide variety of non-microscopic merchandise and does not suggest any structural features at all.

Decision. Affirmed for the government. Customs properly classified the ZMS 319 under Heading 9011 as a “compound optical microscope.” Items are to be construed according to their common and commercial meaning. The ZMS 319 meets the common dictionary meaning of compound microscope, and an *eo nomine* classification includes all forms of the named article, including this one adapted for surgery. Because the ZMS is also classifiable under F9018 as a “medical appliance,” the court must then decide into which category the article fits. Heading 9011 for compound microscopes is narrower, more specific, and describes the article with more accuracy and certainty.

Case Questions

1. What sources does the court rely on to determine common and commercial meaning?
2. Why is “compound microscope” an *eo nomine* term, and what does the court mean when it says, “that includes all forms of the named article?”
3. Which of the two headings is more specific, and why?



Composite Goods. Articles made of different materials or components are considered **composite goods** in the GRI. If two or more headings or subheadings each describe only certain materials or components in composite goods, the article must be classified under the heading that describes the material or components that give the article its **essential character**. This method is helpful to determine the classification of assembled products, foodstuffs, and mixtures blended together (assuming that there is no classification that fits entire article).

Consider the Apple Watch that is worn like a wrist watch but has a radio transceiver that can communicate with an Apple iPhone. Customs considered whether the watch should be classified as a “wrist watch” under Heading 9102, or as “other apparatus for the transmission or reception of voice, images or other data” under Heading 8517. In its ruling, Customs stated “[A]lthough the Apple Watch is capable of displaying basic timekeeping information ... the Apple Watch is primarily designed to display, manipulate, and store data. ... The fact that the Apple Watch is worn like conventional

wrist watches of Chapter 91 merely indicates a different physical configuration of an article that is ... designed to extend the functionality of a paired mobile device.” As a result, Customs held that the watch substantially differed from “wrist watches” and cannot be classified under Heading 9102. Customs explained that “the Apple Watch is properly described as a composite good because it consists of electrical components of independent, individual function that are attached to each other to form an inseparable whole.” Citing the GRI, Customs classified the articles according to the single component that imparts its essential character—in this case it was the radio transceiver, under Heading 8517. (HQ H260060)

In the following case, *Better Home Plastics Corp. v. United States*, 916 F. Supp. 1265 (Ct. Int’l. Trade 1996), the court had to determine whether a shower curtain set was classified under the heading for “Curtains” or under the heading for “Tableware, kitchenware, other household articles and toilet articles, of plastics.” Notice how the court applies the GRI and the essential character test to “goods put up in sets for retail sale.”



Better Home Plastics Corp. v. United States

916 F.Supp.1265 (1996) Court of International Trade

BACKGROUND AND FACTS

Plaintiff, Better Home Plastics Corp., imported shower curtain sets consisting of an outer textile curtain, an inner plastic liner, and plastic hooks. The liner prevented water from escaping and was color coordinated to match the curtain. The curtain was decorative and semitransparent, permitting the color of the plastic liner to show when in use. Customs classified the merchandise under the provision for the set’s outer curtain at a duty of 12.8 percent, under Heading 6303 for “Curtains and interior blinds; curtain or bed valances” and Subheading 6303.92 as “Other ... Of synthetic fibers.” Better Home argues that classification of the set should be based on the set’s inner plastic liner under Heading 3924 for “Tableware, kitchenware, other household articles and toilet articles, of plastics,” and item 3924.90.10 for “Curtains and drapes” at a duty of 3.36 percent *ad valorem*.

DICARLO, CHIEF JUDGE

Goods put up in sets for retail sale, which cannot be classified according to the most specific heading, are classified by the “component which gives them their

essential character.” GRI 3b. Better Home Plastics contends the court must apply the essential character test, in classifying the applicable merchandise. Application of the test, Better Home Plastics asserts, would mandate classification of the set on the basis of its inner plastic liner pursuant to Subheading 3924.90.10 ...

Defendant contends the essential character of the curtains is embodied in the textile curtain. Defendant raises numerous arguments to support its position, particularly that (1) the plastic liner is replaceable at 1/3 to 1/4 the price of the set; (2) the consumer purchases the set because of the decorative function of the outer curtain, and not for the protection afford by the liner; and (3) the liner is only employed for the limited period that someone is utilizing the shower, whereas the decorative outer curtain is employed, at a minimum, when the bathroom is in use, and as much as 24 hours a day. Defendant also contends Better Home Plastics’ invoice description supports Customs’ classification. Pursuant to the invoice description, the set is sold as “Fabric Shower Curtain and Liner.” Therefore, defendant argues, this description serves as an admission that the curtain provides the essential character of the set. * * *

continues

continued

Although the court agrees that the curtain in the imported set imparts a desirable decorative characteristic, nonetheless ... it is the plastic liner that provides the indispensable property of preventing water from escaping the shower enclosure. The liner (1) prevents water from escaping when the shower is in use; (2) protects the fabric curtain from mildew and soap scum; and (3) conceals the shower and provides privacy when the shower is in use. Further, the plastic liner can serve its intended function without the outer curtain and contributes to the overall appearance of the set. The outer curtain, in contrast, merely furthers the set's decorative aspect. The court therefore concludes the essential character of the set is derived from the plastic liner.

Defendant's other contentions are also unpersuasive. The manner in which the set is invoiced does not definitively determine which component provides the essential character of the set. The invoice description is intended to characterize the shipped item; it is not a declaration of the relative importance of its component parts. Finally, while the court takes into consideration the relative cost of the component parts, this point alone is not dispositive, nor very persuasive against the competing arguments.

It is the essential character of the set—derived in part from the plastic's ability to repel water—that denotes the set's utility, purpose, and accordingly, character. Inclusion of the textile curtain within the classification for the plastic liner does little to change the qualities or the basic nature of the set in meeting this purpose.

The court finds Better Home Plastics has overcome the presumption of correctness accorded to Customs, and the shower curtain sets were improperly classified under Subheading 6303.92.00, HTSUS. In addition, the court agrees with Better Home Plastics' proposed classification of the sets under Subheading 3924.90.10.

This decision is limited to its facts, i.e., that the set at issue is at the low end of the shower curtain market. The court does not offer an opinion on the proper classification of sets targeted to a different market segment.

Decision. When articles are made up of component parts, or are in sets, and their parts are referred to in two equally specific headings, then the rule of relative specificity does not apply, and their classification must be determined by which part gives the article its essential character. In this case, the shower liner imparted the essential character to the set.

Comment. Judge DiCarlo's opinion was affirmed by the U.S. Court of Appeals in *Better Home Plastics Corp. v. U.S.*, 119 F.3d 969 (Fed. Cir. 1997).

Case Questions

1. What is the "essential character" test, and how was it applied here?
2. At the end of the opinion the court clarifies that its decisions is limited to shower curtains at the "low end of the market." Why might that have made a difference?

Tariff Engineering. Tariff engineering is the process of modifying or engineering a product prior to importation, or importing it at an earlier stage of manufacturing, for the purposes of obtaining a lower rate of duty. The general rule established by the U.S. Supreme Court long ago is that an article is to be classified according to its condition at the time it is imported. An 1881 case involved duties on imported sugar that were determined on the basis of its color. In approving of tariff engineering, the Supreme Court stated that "if the manufacturer uses ... bleaching processes in order to make his sugars more saleable, why may he not omit to do so in order to render them less dutiable; nay, why may he not employ an extra quantity of molasses for that purpose?" *Merrit v. Welsh*, 104 U.S. 694 (1881).

Importers frequently redesign products, or make them of different materials, or change minor specifications in order to fall into a certain tariff classification. The courts have clearly stated that the issue is not whether an article was made or manufactured to obtain a lower tariff, but whether the article, as imported, falls within the

tariff classification and description sought to be applied. Tariff engineering therefore permits importers to enter their goods at any step in the manufacturing or assembly process in order to obtain a lower rate of duty even though further postimportation work or processing will be done in the United States. For example, assume you want to import a finished product with an import duty of 12 percent, but the import duty on each of the component parts runs from duty-free to 5 percent. Why not consider the option of importing the components and assembling the finished product in the United States?

Of course, there are some limits to tariff engineering. There cannot be fraud or deception, the article as imported cannot be a "fictional" product or imported by "disguise and artifice," and the goods must be correctly described on the entry documents. In *Heartland By-Products, Inc. v. United States*, 264 F.3d 1126 (Fed. Cir. 2001), the importer added molasses to sugar syrup in Canada and removed it after the syrup was imported into the United States. The syrup with molasses entered free from U.S. tariff-rate quotas on sugar syrup imports.



Customs maintained that there had been no other purpose for adding molasses except to avoid the quota, that the molasses was a “foreign substance,” and that adding it was not a “genuine step” in the manufacturing process. Because the molasses was later returned to Canada to be reused for the same purpose, Customs maintained that the process was done for “disguise or artifice” to circumvent the customs laws. There was no evidence that Heartland ever falsified or concealed the identity of its sugar syrup, its method of manufacture, or its use. The Court of Appeals agreed with Customs’ argument and upheld its reclassification of the syrup.

Customs Valuation

The customs value, often called **dutiable value**, of goods entered into any country must be reported by the importer-of-record to national customs authorities at the time of entry. Customs value is the transaction value of the goods. In the United States, **transaction value** is the *price actually paid or payable* for the merchandise when sold for export to the United States, plus the following amounts if not included in the purchase price: (1) packing and container costs, (2) selling commission paid by the buyer (importer) to or for *an agent of the seller*, (3) the value of any “assist” as defined below, (4) any royalty or license fee that the buyer is required to pay as a condition of sale, and (5) the proceeds of any subsequent resale of the merchandise that accrues to the *seller*.

Transaction value *does not* include international freight charges, insurance or customs brokerage fees, inland freight after importation, charges for assembling or maintaining the goods after importation, or import duties. It also does not include commissions or fees paid to an *agent of the buyer* as a “finder’s fee” for helping to find a supplier and procure the goods.

If, as a condition of purchasing goods, an importer is required to make certain payments to foreign parties other than the seller, those payments may be included in transaction value. Examples include separate payments (i.e., license fees) made to the holders of copyrights, trademarks, or patents for the privilege of importing merchandise subject to those rights, and design and engineering fees paid to foreign firms separately from payments to the actual producer of the product. For instance, if a firm imports blue jeans manufactured in Hong Kong and as a condition of sale makes royalty payments to the designer of the jeans in Paris, the royalty would be included in the transaction value of the merchandise.

Production Assists. These are goods, services, or intellectual property furnished by the importer to a foreign producer, free or at a reduced price, for use in producing merchandise for import into the United States. The value of an assist must be included in transaction value when the goods are imported into the United States. For example, if a U.S. apparel importer provides sewing machines (i.e., the “assist”) free to a foreign sewing contractor, then the value of their use in sewing the apparel must be included in transaction value when the apparel enters the United States. Other production assists include the value of component parts supplied, tools, engineering and design services, or the value of artwork and sketches performed outside the United States and that are necessary for production. Production assists might be provided when a foreign firm needs special equipment or machinery to manufacture custom or specially designed goods. It might reduce costs by putting to use underutilized equipment belonging to the importer, while taking advantage of the foreign producer’s low-cost labor or economies of scale. Assists might also allow the importer some greater control over the quality of the finished product. Assists are often used in **contract manufacturing**—a business arrangement in which the production of goods is contracted or “outsourced” by one firm to a manufacturing firm, often overseas.

RULES OF ORIGIN

Imagine that it is 1989 and your trading company has firm commitments from buyers in the United States to take all of the ostrich chicks that you can provide during the next year. After considerable searching and time spent traveling the world, you find an ostrich hatchery in England. You enter into a sales contract with the hatchery, with payment to be made under a confirmed letter of credit. Your bank pays the seller cash on the documents, and the chicks arrive peeping and squawking at a U.S. port of entry. On the entry documents you list the chick’s country of origin as England. An astute customs inspector realizes that the chicks could not possibly have “originated” there and corrects the country of origin to South Africa where the eggs obviously originated. You agree that the fertilized eggs originated in South Africa but argue that their incubation and hatching in England amounted to a “substantial



have “normal trade relations” as discussed in earlier chapters). For example, trade between the United States and Europe or between the United States and China is non-preferential trade. These rules are also used to calculate antidumping and countervailing duties, and to enforce trade embargoes and quotas. **Preferential rules of origin** are those applicable to: (1) goods traded within a free trade area or customs union, (2) goods imported from countries that receive special tariff treatment pursuant to a trade agreement (such as the *WTO Agreement on Government Procurement*), or (3) goods imported under a trade preference programs for developing countries. (In Exhibit 12.1, notice the column for “Special” rates of duty and the codes for each preference found in the General Notes on exhibit Page 2.) Although there are different rules of origin, and despite the fact that they can be complex and arcane, there are certain basic concepts that we will discuss.

U.S. Non-Preferential Rules of Origin

The general rule applicable to most non-preferential trade is that the country of origin of an article imported into the United States is the country in which the article was wholly obtained. *Wholly obtained* means that it was wholly the “growth, product, or manufacture” of one country. In other words, the country of origin is that single country where an article was wholly and completely produced or manufactured entirely from raw materials originating in that country. Examples are metals extracted from the earth or vegetables grown in a country. A leather handbag is wholly obtained from a country only if the leather is from an animal born and raised there, all other components or materials originate there (other than minor or insignificant components), and all of the production and assembly takes place there. Of course, as we’ve seen, few products today are wholly made in one country entirely from materials derived there. Nevertheless, there can be only one country of origin for customs purposes.

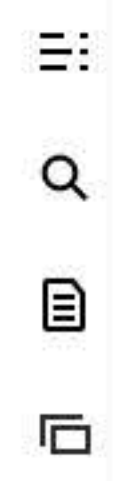
Articles Substantially Transformed. If an article is *not* wholly the growth, product, or manufacture of one country, but has been produced in multiple countries, then the country of origin is that country where the article last underwent a substantial transformation into a new and different article of commerce. Suppose, for example, that stainless steel bars are made in Korea and shipped to Germany where they are turned into fine cutlery. The cutlery will then enter the United States under the tariff rate for German cutlery and be labeled

“Made in Germany” if the processing in Germany amounted to a substantial transformation that created a new and different article of commerce with a new name, character, or use.

In the United States, the definition of “substantial transformation” has been determined on a case-by-case basis by U.S. Customs and by the courts on appeal. U.S. courts have long held that a **substantial transformation** occurs when the original article loses its identity as such and is transformed into a new and different article of commerce having “a new name, character, or use” different from that of the original item. In 1908, the U.S. Supreme Court ruled that imported cork had not been substantially transformed when it was dried, treated, and cut into smaller sections for use in bottling beer. The Court stated, “Something more is necessary There must be a transformation; a new and different article must emerge, having a distinctive name, character or use. This cannot be said of the corks in question. A cork put through the claimant’s process is still a cork.” *Anheuser-Busch Brewing Association v. United States*, 207 U.S. 556 (1908). Since then, courts have applied this phrase to many different types of products and manufacturing operations.

An article’s name is generally considered to be only one of several factors to take into account. Greater emphasis is usually placed on whether the character—sometimes said to be the “essential nature”—of the product or its use has changed. In *National Juice Products Association v. United States*, 628 F. Supp. 978 (Ct. Int’l. Trade 1986), a U.S. company imported evaporated orange concentrate and blended it with water, orange oils, and fresh juice in the United States to make the frozen orange concentrate you might purchase in a supermarket. The court held that the original, imported evaporated orange concentrate imparted the “essential character” to the completed orange juice and thus was not substantially transformed into a product of the United States, and therefore had to be labeled as a product of a foreign county.

The courts will look at the totality of facts in each case to determine if there is a substantial transformation. These include whether there was a change in the “name, character, and use” of the components, the extent and nature of the operations performed, the value added during processing relative to the value of the imported components, and whether tariff classification of the finished article is different from that of the components. The case *Energizer Battery v. United States*, Slip Op. 16-116 (Ct. Int’l Trade 2016) involved the assembly



of flashlights in Vermont from parts originating primarily in China. U.S. Customs held that the completed flashlights originated in China. The importer appealed because Chinese-made flashlights would not qualify for sale to the U.S. government under the *Buy American Act*. The court noted that the assembly, testing, and boxing in Vermont took approximately seven minutes. None of the parts were changed in shape or composition. The name of each part, such as “switch lever” or “lens ring,” remained the same. The use of each component remained the same. The components were specifically designed for use in these particular flashlights and

arrived ready for assembly. A high proportion of parts were screws, washers, nuts, and wires precut to lengths. The court disregarded the importer’s claim that “none of the components could function as a flashlight prior to assembly and that they become integral parts of a new product ...” and after considering all of the facts concluded that “Given the relative simplicity of the assembly process ... the imported parts do not undergo a substantial transformation.” The flashlight originated in China.

The following case, *Ferrostaal Metals Corp. v. United States*, involved steel from Japan that was galvanized in New Zealand prior to its import into the United States.



Ferrostaal Metals Corp. v. United States

664 F. Supp. 535 (1987) Court of International Trade

BACKGROUND AND FACTS

Plaintiff attempted to enter steel products at the Port of Seattle. These products consisted of unpainted steel sheets that had originated in Japan but had been hot-dip galvanized in New Zealand. Plaintiff’s entry documents identified New Zealand as the country of origin. Customs ruled that the country of origin was Japan and that the steel could not be entered due to an agreement between the United States and Japan. Customs contended that hot-dip galvanizing of Japanese steel sheets in New Zealand was merely a “finishing process” carried out to improve certain performance characteristics of the steel sheets and not a process that results in a substantial transformation so as to change the country of origin. The plaintiff disagreed and brought this action for review.

JUDGE DICARLO

Substantial transformation is a concept of major importance in administering the customs and trade laws. In addition to its role in identifying the country of origin of imported merchandise for purposes of determining dutiable status, or, as in this case, the applicability of a bilateral trade agreement, substantial transformation is the focus of many cases involving country of origin markings ... (citations omitted)

The essence of these cases is that a product cannot be said to originate in the country of exportation if it is not manufactured there. The question, therefore, is whether operations performed on products in the country of exportation are of such a substantial nature to justify the conclusion that the resulting product is a manufacture of that country. “Manufacture implies a change, but every change is not manufacture ...”

There must be transformation; a new and different article must emerge, ‘having a distinctive name, character, or use.’ ” *Anheuser-Busch Brewing Assn. v. United*

States, 207 U.S. 556 (1908). The criteria of name, character, and use continue to determine when substantial transformation has occurred, and the prior cases of this court and our predecessor and appellate courts provide guidance in the application of this test.

Whether galvanizing and annealing change the character of the merchandise depends on the nature of these operations and their effect on the properties of the materials. To produce one of the types of imported sheet the sheet must be heated to 1,350 degrees F, at which point recrystallization of the grains of steel occurs. The sheet is then brought down to 880 degrees F, before galvanizing begins. At 880 degrees F, the sheet enters a pot of molten zinc and is dipped. The molten zinc reacts immediately with the solid steel, and begins a process known as “alloying.” Alloying constitutes a chemical change in the product, characterized by the formation of iron-zinc alloys at the interface between the steel and the zinc. The galvanized steel sheet emerging from the bath has a mixed zinc-steel surface with an identifiable atomic pattern. The formation of a galvanized surface is an irreversible process which provides electrochemical protection to the sheet. As a result of the galvanic protection, the steel will last up to twenty years, or ten times as long as ungalvanized steel ...

The alloy-bonded zinc coating affects the character of the sheet by changing its chemical composition and by providing corrosion resistance. The court also finds that the hot-dip galvanizing process is substantial in terms of the value it adds to full hard cold-rolled steel sheet. The evidence showed that the Japanese product is sold for approximately \$350 per ton, while the hot-dipped galvanized product is sold for an average price of \$550 to \$630.

Taken as a whole, the continuous hot-dip galvanizing process transforms a strong, brittle product which

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cannot be formed into a durable, corrosion-resistant product which is less hard, but formable for a range of commercial applications. Defendant's witness stated that the imported sheet has a "different character from the standpoint of durability." The court finds that the annealing and galvanizing processes result in a change in character by significantly altering the mechanical properties and chemical composition of the steel sheet.

The name criterion is generally considered the least compelling of the factors which will support a finding of substantial transformation. Nonetheless, the satisfaction of the name criterion in this case lends support to plaintiffs' claim. The witnesses for both parties testified that the processing of full hard cold-rolled steel sheet results in a product which has a different name, continuous hot-dip galvanized steel sheet.

The court also considers relevant whether the operations underlying the asserted transformation have effected a change in the classification of the merchandise under the [tariff schedule]. Change in tariff classification may be considered as a factor in the substantial transformation analysis. Here this factor supports a substantial transformation.

Based on the totality of the evidence, showing that the continuous hot-dip galvanizing process effects changes in the name, character, and use of the processed steel sheet, the court holds that the changes constitute a substantial transformation and that hot-dipped galvanized steel sheet is a new and different article of commerce from full hard cold-rolled steel sheet.

Decision. Japanese steel that had been galvanized in New Zealand prior to its importation into the United States was substantially transformed so that it had become a product of New Zealand and thus was not subject to voluntary restraint agreements between the United States and Japan.

Comment. "Voluntary restraint agreements," such as those described in this case to restrict steel imports from Japan, are no longer used as a method of limiting imports of foreign goods into the United States, as they do not fall under the permissible rules of the WTO. Nevertheless, this case serves well to illustrate the use of the substantial transformation test in tariff cases. The case is still cited frequently in determining the country of origin in other cases.

Case Questions

1. Why is the process of galvanizing steel important to the court's decision?
2. Consider the process of hot-dip galvanizing described here. Would you agree that the operations performed on the steel in New Zealand created a product with a new name, character, or use? Why or why not?
3. Of the three factors generally referred to—name, character, use—which seem to be the most or least important?
4. What other factors does the court consider in addition to a change in the name, character, and use of the product?

U.S. Preferential Rules of Origin

Preferential rules of origin are found in the trade agreement or tariff program that creates the preference, and so the rules can differ from program to program. For example, the rules for determining whether an article originated in a developing country under the *Generalized System of Preferences* are different than the rules applicable to imports under the *Africa Growth and Opportunity Act*. The *North American Free Trade Act* has specific rules of origin and are discussed in Chapter 14.

In order to qualify for a tariff preference, an item imported into the United States must be "wholly obtained" from a country qualifying for a trade preference. But if the imported item consists of materials from more than one country, or results from processes in more than one country, then one or a combination of the following rules of origin apply: (1) the tariff-shift rule, (2) the domestic or regional value content rule, and (3) specific processing requirements.

The Tariff-Shift Rule. The **tariff-shift rule** states that the country of origin is the last country in which all "inputs" (raw materials, component parts, etc.) into the finished article underwent a *required change in tariff classification*. It is frequently, although not only, used in trade preference programs. For example, under NAFTA, if certain inputs from Europe are combined or processed in Canada, and that process results in a change in tariff classification to those inputs, then the finished article is considered to have originated in Canada if the inputs underwent a change from one tariff classification to a new classification as defined in the NAFTA agreement. The finished article can then qualify for tariff-free treatment when sold in Mexico or the United States.

The tariff-shift rule has the advantage over other rules because it is more objective and more certain. It can also be the basis of internationally accepted rules because most countries use the harmonized tariff classifications on which the rule is based. The rule is favored by WTO experts working on international rules of

origin. U.S. Customs has actually considered adopting it in lieu of the more subjective substantial transformation test discussed earlier.

The Domestic or Regional Value Content Rule. The other common preferential rule of origin is the **domestic or regional value content test**, a type of value-added test described earlier. This requires that some minimum percentage of the value of materials and direct processing operations be performed in a country in order for it to have “originated” there. For example, the U.S. preference program for Caribbean countries requires that at least 35 percent of the value of materials and/or labor be added there in order for the article to enter the United States at the lower Caribbean rate. The regional value content test is used to determine whether a vehicle originates in North American under NAFTA.

Specific Processing Rules. These rules state that an item originates in a country if it was subjected to specific forms of manufacturing or processing in that country. For example, the rules of origin of a trade agreement may state that certain chemicals from one country that are subjected to a chemical reaction in a second country become a product of the second country. Specific rules like this are also used in the textile industry.

WTO Agreement on Rules of Origin

It is well known that some importers forgo taking advantage of lower preferential tariff rates because of the cost of compliance, and because the rules of origin are so complex and sometimes inconsistent. Some importers fear that improper country of origin documentation can lead to penalties and fines. Everyone agrees that exporters and importers worldwide would benefit greatly from standardized and simplified rules of origin.

The *WTO Agreement on Rules of Origin* (1995) is a long-term project to achieve this goal. As of this writing, the WTO was in the process of developing new, uniform rules. Under one proposed rule, the country of origin for goods originating in all WTO countries would be determined by a tariff-shift rule, similar to that discussed.

European Union Rules of Origin. Non-preferential rules of origin in the EU have been similar to the subjective substantial transformation test used in the United States. However, with the 2016 adoption of the new *Union Customs Code*, the EU is moving toward using more objective rules, including the tariff-shift, value-added, and specific processing rules for its non-preferential rules. In the EU, these are now called “List Rules.”

Marking and Labeling of Imports

Every article of foreign origin imported into the United States must be legibly, indelibly, and permanently marked in English in a conspicuous place and in such a manner as to indicate the name of the country of origin of the article to the **ultimate purchaser** in the United States (unless it falls within an exception, below). The ultimate purchaser is the last person in the United States who receives an article in the form in which it was imported. If an imported article is to be sold at retail in the same form as it was imported, then the retail customer is the “ultimate purchaser.”

If an imported article is converted, processed, or combined with other articles or ingredients in the United States so that it undergoes a substantial transformation resulting in a new article of commerce with a new name, character, or use, as defined by the *Gibson-Thomsen* case, then the new article need not be labeled with a foreign country of origin.

Special Marking Requirements for Assembled Articles. Specific marking rules apply where an article is imported into the United States after having been assembled in a foreign country from components originating in different countries. If the assembly amounted to a substantial transformation, the imported article may be marked or labeled as “assembled in” the country of final assembly, or assembled in the country of final assembly “from components of [country or countries of all components].” Assume that electronic and other components are substantially transformed by assembly in China into a cell phone that is shipped to the United States. The parts are supplied from factories located in a dozen countries. Here the only practical form of marking would be “Assembled in China” or “Made in China.” As in the Energizer flashlight case just discussed, the substantial transformation test also applied to assemblies of foreign components in the United States.

Articles Not Requiring Marks. The following categories of products are a few that do not require marking: (1) products incapable of being marked (works of art, unstrung beads, nuts, bolts, cigarettes, eggs, feathers, livestock, and vegetables), (2) products that cannot be marked without injury, (3) crude substances, (4) articles produced more than 20 years prior to importation, (5) articles imported solely for the use of the importer and not intended for resale (e.g., personal articles purchased abroad by a tourist), and (6) certain products of the United States that are exported (e.g., for repairs) and returned. When an item is exempt from marking



requirements, the immediate container in which it is sold to the consumer must be marked. To illustrate, imported carpentry nails need not be marked, but the box in which they are sold to the consumer must be.

Federal Trade Commission “Made in U.S.A.” Rules. In the United States, the Federal Trade Commission (FTC) and U.S. Customs have overlapping jurisdiction with regard to country of origin claims. However, there are several differences. First, while Customs rules apply only to product marking, the FTC rules apply to all claims, including those on product catalogs, packaging, and all forms of advertising. Second, while U.S. Customs enforces the trade and tariff laws, the FTC’s statutory authority is to prevent misleading or deceptive claims or practices. Thus, while Customs oversees *foreign* country of origin marking (e.g. “Made in China”), the FTC regulates the use of the term “Made in U.S.A.” For example, assume that an article is substantially transformed in the United States into a new and different article of commerce, and therefore no foreign country of origin marking is needed when the finished product is offered for sale in the United States. That alone does not mean that the product can be marked, described, or advertised as “Made in the U.S.A.” unless it meets additional FTC rules.

There is no rule that requires a U.S.-made product to be marked or labeled as such. Except for special rules applicable to automobiles, textile, wool, and fur products, U.S. content need not be disclosed. However, a seller may not claim that a product is “Made in U.S.A.” unless *all or virtually all* of the materials, processing, or component parts are made in the United States and their final assembly or processing took place there. All significant parts and processing that go into the product must be of U.S. origin. The product can contain only negligible foreign content. For instance, the FTC has held that a gas barbecue grill assembled entirely from U.S. parts could be labeled as “Made in U.S.A.” despite the fact that the knobs were of foreign origin. The knobs were said to make up a small portion of the product’s total cost and an insignificant part of the final product. A 2015 California statute provides that a product can be marked or described as “Made in the U.S.A.” if “not more than 5 percent of the final wholesale value of the manufactured product” is made outside of the United States.

The FTC “Made in U.S.A.” rules apply also to other more indirect forms of marketing and promotion that may be deceptive. In one case, a company packaged its Chinese-made product in a package covered with an American flag and eagle. Despite the statement “Made

in China,” which appeared in small print on the bottom and side panels of the package, the FTC held that the labeling was deceptive.

Qualified Claims. Even where an article cannot be marked or described as “Made in U.S.A.,” it may still bear a qualified claim if the claim is not deceptive. For example, a marking or product description may refer to a specific process or part, such as “Designed by XYZ in California, Assembled in China” or “Made in China, Seat of Italian Leather.”

OTHER CUSTOMS LAWS AFFECTING U.S. IMPORTS

This section examines two other programs affecting the import/export operations of international companies: drawback provisions allowing a refund of duties paid and foreign trade zones. These are tariff-saving programs created by law to encourage the import/export trade. Most developing countries have similar programs for their importers and exporters.

Drawbacks

A **drawback** is a refund of duties already paid on imported goods when the goods (or other goods manufactured from the original goods) are reexported or destroyed. Drawbacks are recognized by many countries around the world. The most common type in the United States is the **manufacturing drawback**, designed to encourage U.S. manufacturers to export. A manufacturing drawback is a refund of duties and taxes paid on merchandise that is imported, subjected to manufacture or production, and then exported within five years. U.S. firms are becoming increasingly sophisticated in using manufacturing drawbacks. For instance, duties paid on imported yarn will be refunded to the importer who exports a finished fabric made from that yarn. Similarly, a poultry farm that imports chicken feed can receive a drawback on duties paid on the imported feed when the chickens are slaughtered and exported. Drawbacks allow the exporter to purchase materials from low-cost foreign suppliers without having to pay prohibitively high duties. There are no drawbacks allowed in trade between Canada, Mexico, and the United States.

A **same-condition drawback** is a drawback of duties paid on imported goods that are reexported in the “same condition” as they were imported, provided they were not significantly altered. For example, nuts

and bolts can be entered in bulk, cleaned, sorted, and repackaged with foreign-language labeling. On export, the drawback applies. Many trading companies utilize same-condition drawbacks.

A **substitution drawback** of duties paid on imported goods may be received by a U.S. firm that imports goods and then exports other goods of the “same kind and quality.” Substitution drawbacks usually deal with fungible goods or agricultural commodities. Assume a U.S. manufacturer imports soda ash, pays import duties, and then sells it to a U.S. customer. Later, it exports the same quantity of U.S.-made soda ash to a foreign buyer. The importer can receive a drawback on duties paid on the imported soda ash.

A **rejected merchandise drawback** is allowed for imported merchandise that was shipped without consent, is defective, or does not conform to specifications or to samples (e.g., zippers that do not zip). The merchandise is returned to U.S. Customs within three years and either destroyed or reexported.

Obtaining a drawback requires close cooperation between the firm and U.S. Customs. The procedures, time limits, documentation, and accounting requirements for drawbacks are complex and exact, and many companies use drawback consultants for advice or help in structuring drawback transactions. Some firms utilize specially developed software to help track and document a drawback transaction. Civil penalties are imposed for violating the provisions of the law. Many firms do not file for drawbacks for fear of being assessed a penalty for clerical errors.

Foreign Trade Zones

Foreign trade zones (FTZs) are legally defined sites—warehouses and manufacturing facilities—operated pursuant to legislation and under government license, that are legally “outside” the customs territory of the country they are in. They are a duty-deferral and duty-saving device. Imported goods may be brought into an FTZ without being subjected to tariffs until such time as the goods are released into the stream of commerce of that country.

FTZs are used widely around the world, and are monitored by, and under the control of, the customs authorities of that country. In the United States, FTZs operate under a license from the U.S. Foreign Trade Zone Board and according to regulations of the board and of U.S. Customs and Border Protection. Foreign trade zones must be within a 60-mile radius of a U.S. port of entry. FTZs may be operated by a state or local government,

airports or seaport, or specially chartered private companies who lease space to private firms for their use.

Creative Uses for Foreign Trade Zones. Originally, FTZs were intended to encourage U.S. firms to participate in international trade by providing a “free port” into which foreign-made goods could be transported, stored, packaged, and then reexported without the payment of import duties. Today, FTZs are used for many different purposes, ranging from warehousing to manufacturing. Goods may be assembled, exhibited, cleaned, manipulated, manufactured, mixed, processed, relabeled, repackaged, repaired, salvaged, sampled, stored, tested, or destroyed. Manufacturing may only be done in certain zones approved by the FTZ board, and any processing that results in a change to the tariff classification or substantial transformation of goods must also have Customs’ permission. Retail sales are prohibited. The length of time that goods can be held in a zone is not limited. Duties on foreign goods are not due until the goods are “entered for consumption” into the United States. Foreign goods that are entered into an FTZ and then substantially transformed into a new product can be entered into the United States at the tariff rate applicable to the new product or to the original goods, whichever is less. Goods may be reexported from a zone without the payment of duties.

The flexibility offered to an importer through the use of FTZs provides many opportunities for creative importing strategies. For example, firms can ship goods to their zone duty-free and warehouse them for later entry and sale in the United States pending buyer’s orders or more favorable market conditions. Foreign goods can also be held for exhibition and display in the zone for unlimited periods without the payment of duties. Foreign goods that arrive damaged or defective may be destroyed without the payment of duties. Goods in an FTZ are not subject to quotas and may remain in the FTZ until the quota opens and their entry is permitted. Title to goods held in an FTZ may be transferred to another party without the payment of duties.

Assume you want to source articles from several countries and bring them to the United States to be repackaged under your brand for resale to a foreign customer. If this is done in an FTZ, there will be no duties owed at the time your original articles entered the FTZ. As another example, if a commodity is dutied by weight, it may be brought into an FTZ for drying and subsequently entered without the excess weight caused by the moisture. Perhaps the most unusual use of an FTZ is the Cape Canaveral FTZ in Florida. There, foreign payloads

have been imported into the FTZ and made ready for a space launch, and then “reexported” to space without the payment of U.S. import duties! Approximately 250 general-purpose foreign trade zones and 500 subzones exist in the United States. The industries with the most production activity include oil refining, automotive, electronics, pharmaceutical, and machinery sectors.

In addition to general-purpose zones, firms are able to establish their own special-purpose subzones. Subzones can be placed anywhere in the United States with U.S. Customs approval. The following case, *Nissan Motor Mfg. Corp. U.S.A. v. United States*, arose out of Nissan’s importation of equipment into an automotive manufacturing subzone in Tennessee.



Nissan Motor Mfg. Corp., U.S.A. v. United States

884 F.2d 1375 (1989) United States Court of Appeals (Fed. Cir.)

BACKGROUND AND FACTS

Nissan operated a foreign trade zone subzone at its automotive manufacturing and assembly plant located in Smyrna, Tennessee. Nissan imported production machinery for use in the subzone consisting of industrial robots, automated conveyor systems, and a computerized interface. The machinery was to be assembled and tested in the zone, and if it proved unsatisfactory it was to be replaced, redesigned, or scrapped. Customs ruled that production equipment was not “merchandise” as defined under the FTZ act and was therefore dutiable. Duties were assessed at \$3 million, and Nissan filed a protest. On denial, the Court of International Trade ruled that the equipment was dutiable, and this appeal was filed.

CIRCUIT JUDGE ARCHER

The activities performed by Nissan in the foreign trade zone subzone with the imported equipment are not among those permitted by a plain reading of the statute. Section 81c provides that merchandise brought into a foreign trade zone may be “stored, sold, exhibited, broken up, repacked, assembled, distributed, sorted, graded, cleaned, mixed with foreign or domestic merchandise, or otherwise manipulated, or be manufactured...”

The act does not say that imported equipment may be “installed,” “used,” “operated” or “consumed” in the zone, which are the kinds of operations Nissan performs in the zone with the subject equipment. Alternative operations of a different character should not be implied when Congress has made so exhaustive a list.

Nissan relies upon the case of *Hawaiian Independent Refinery v. United States*, 460 F. Supp. 1249 (Cust. Ct.1978) in support of its position. The merchandise there involved was crude oil which was entered into a foreign trade zone for manufacture into fuel oil products. This, of course, is an activity delineated by the act and entry into the zone was exempted from Customs duties. Thereafter, a portion of the crude oil was consumed in the manufacturing process and Customs assessed duty on the theory that there had been

a “constructive” entry into the Customs territory of the United States. In holding that the assessment was improper, the Court of International Trade did not have to deal with the question at issue here of whether the initial entry into the zone was exempt. Clearly, in that case the crude oil was exempt at the time of entry. Thus, the Court of International Trade properly concluded that the *Hawaiian Independent Refinery* case was not dispositive of this case.

We are convinced that the Court of International Trade correctly determined that the importation by Nissan of the machinery and capital equipment at issue into the foreign trade zone subzone was not for the purpose of being manipulated in one of the ways prescribed by the statute. Instead it was to be used (consumed) in the subzone for the production of motor vehicles. Under the plain language of the 1950 amendment to the act and the legislative history of that amendment, and Customs’ published decision interpreting the act as amended, such a use does not entitle the equipment to exemption from Customs duties. Accordingly, the judgment of the Court of International Trade is affirmed.

Decision. The decision of the lower court was affirmed. Machinery entered into a foreign trade zone for use in the manufacture and assembly of automobiles is not “merchandise” under the act and may not be entered duty-free.

Case Questions

1. What purposes do FTZs serve? Why did Congress establish them?
2. What were the advantages to Nissan by assembling automobiles in an FTZ? How many can you list?
3. Why could Nissan not bring manufacturing equipment into its zone duty-free? Do you think this case applies to office chairs or personal computers? Explain.
4. Assume that you import merchandise subject to annual quotas. You have a shipment arriving, but the quota has filled. How might an FTZ help you?



THE ADMINISTRATION OF U.S. CUSTOMS AND TARIFF LAWS

The customs and tariff laws of the United States are administered and enforced by the U.S. Bureau of Customs and Border Protection, an agency within the Department of Homeland Security. The creation of the Department of Homeland Security in 2003 was a part of the largest reorganization of the American government in more than 50 years. The reorganization eliminated the U.S. Customs Service (which had been in the Department of the Treasury) and the Immigration and Nationality Service, and transferred those functions to the newly created Department of Homeland Security. Customs' responsibilities are to stop terrorists and terrorist weapons, as well as illegal drugs and drug traffickers, from entering the United States; to assess and collect the tariff revenue of the United States; and to enforce the customs and immigration laws at the border. The latter includes regulating the entry of products under quota or embargo, enforcing the country of origin labeling statutes, administering foreign trade zones, and performing other functions. As a law enforcement agency, U.S. Customs combats smuggling and investigates tariff fraud cases. Customs has the authority to bar the entry of goods that violate patent, trademark, or copyright laws, or that violate the food and drug laws.

The U.S. Border Patrol today is part of U.S. Customs. Customs has overlapping authority in the enforcement of customs and immigration laws with U.S. Immigration and Customs Enforcement (ICE), also within Homeland Security. While Customs' responsibilities are primarily at borders and points of entry to the United States, ICE has immigration responsibility elsewhere in the country. Customs also shares some responsibilities with other agencies in enforcing U.S. export laws. Some U.S. Customs officers are assigned to U.S. embassies or offices in foreign countries to assist in the administration of U.S. customs laws.

Customs is divided into seven geographic regions; the regions are divided into districts, each headed by a district director. Customs offices are located at the ports of entry, including major seaports, airports, inland ports, and border crossings. Within each district are *field import specialists*, who make initial determinations as to the entry of goods. They can seek advice from *national import specialists*. Some officers are specialists in particular types of products, such as textiles. The district director supervises all imports within the

district and makes sure that imported goods are entered in accordance with the rules of the agency and decisions of the courts.

The Formal Entry

The **formal entry** refers to the administrative process required to import goods into the customs territory of a country. Goods have officially "entered" the United States only when the following requirements have been met.

1. The goods have arrived at a U.S. "port of entry."
2. The goods are not of a type that is not permitted entry or from an embargoed country.
3. Delivery is authorized by Customs after inspection and release.
4. Estimated duties have been paid or a customs bond posted.

The process begins upon the arrival of the merchandise at a U.S. port of entry. Goods not processed for entry within 15 days are sent to a warehouse as "unclaimed freight." The goods may be entered by the owner, purchaser, consignee (the party to whom the goods are shipped or to be delivered), or licensed customs broker. A **customs broker** is an authorized agent, licensed by federal law, to act for and on behalf of importers in making entry of goods. (A broker is not needed to import goods for personal use.) More than 90 percent of all entries are made by customs brokers. A customs broker must possess a written power of attorney from the party making entry. Nonresident individuals and foreign corporations may make entry, but they are bound by much stricter rules. The entry process is not merely transporting the goods into the United States; it includes the filing of customs documents and the payment of duties.

Required Documentation. When goods are entered, the entry documents must be filed within five days. The documents necessary to enter goods generally include the following items:

1. An entry manifest or merchandise release form (see the *Entry/Immediate Delivery Form* in Exhibit 12.2)
2. U.S. Customs *Entry Summary Form* (Exhibit 12.3)
3. Proof of the right to make entry (a bill of lading, air waybill, or carrier's certificate)
4. The commercial invoice obtained from the seller (or a pro forma invoice, if the commercial invoice is temporarily delayed by the seller)
5. Packing slips to identify the contents of cartons



Exhibit 12.2

U.S. DEPARTMENT OF HOMELAND SECURITY
Bureau of Customs and Border Protection

Form Approved
OMB No. 1551-0024
Exp. 09/31/2012

ENTRY/IMMEDIATE DELIVERY

19 CFR 142.3, 142.16, 142.22, 142.24

1. ARRIVAL DATE 060908	2. ELECTED ENTRY DATE	3. ENTRY TYPE CODE/NAME 01 ADT/S	4. ENTRY NUMBER 649-2342260-6		
5. PORT 1512	6. SINGLE TRANS. BOND X 891	7. BROKER/IMPORTER FES NUMBER 6177968	8. IMPORTER NUMBER 12-34567		
9. CONSIGNEE NUMBER		10. IMPORTER OF RECORD NAME SAMS			
11. ULTIMATE CONSIGNEE NAME Importer's Company Anytown, NC 28090		12. CARRIER CODE 111			
13. VESSEL CODE/NAME LUPTRANDA		14. LOCATION OF GOODS CODE(S)/NAME(S) 1362			
15. U.S. PORT OF UNLADING 1704		16. MANIFEST NUMBER	17. S. O. NUMBER		
18. TOTAL VALUE \$3331		19. DESCRIPTION OF MERCHANDISE Bedding			
20. ITIL/ARS CODE	21. ITIL/ARS NO.	22. MANIFEST QUANTITY	23. H.S. NUMBER	24. COUNTRY OF ORIGIN	25. MANUFACTURER NO.
I	22069456995		6304.92.60107	DE	DEBETLANE4044KRA
M	22069456995	5			
H	48502287				
26. CERTIFICATION					
I hereby make application for entry/immmediate delivery. I certify that the above information is accurate, the bond is sufficient, valid, and current, and that all requirements of 19 CFR Part 142 have been met.					
SIGNATURE OF APPLICANT X Importer's Custom Broker					
PHONE NO. DATE					
27. BROKER OR OTHER GOVT. AGENCY USE					
28. CBP USE ONLY					
☐ OTHER AGENCY ACTION REQUIRED, NAMELY:					
☐ CBP EXAMINATION REQUIRED.					
☐ ENTRY REJECTED, BECAUSE:					
DELIVERY AUTHORIZED: SIGNATURE DATE					
PAPERWORK REDUCTION ACT STATEMENT: An agency may not conduct or sponsor an information collection and a person is not required to respond to this information unless it displays a current valid OMB control number and an expiration date. The control number for this collection is 1551-0024. The estimated average time to complete this application is 15 minutes. If you have any comments regarding the burden estimate you can write to U.S. Customs and Border Protection, Office of Regulations and Rulings, 799 9th Street, NW, Washington DC 20226.					
CBP Form 3461 (10/09)					

6. Other documents required by special regulations (e.g., certificate of origin, quota visa, certificate of quality or inspection, etc.)

Within ten working days, the importer must file these completed documents with Customs at the port of entry.

The information on the form is used to determine the amount of duties owed, to gather import statistics, and to determine if the goods conform to other U.S. regulations.

The Commercial Invoice. A seller must provide a separate invoice for each commercial shipment entering

Exhibit 12.3

DEPARTMENT OF HOMELAND SECURITY
U.S. Customs and Border Protection

ENTRY SUMMARY

Form Approved OMB No. 1551-0022

1. Filer Code/Entry No. 2343260-6		2. Entry Type		3. Summary Date 6/24/08	
4. Surety No. 891		5. Bond Type BBB-9		6. Port Code 1512	
7. Entry Date		8. Country of Origin DE		9. Import Date 06/06/08	
10. Exporting Country DE GERMANY		11. Export Date 06/06/08		12. U.S. Port of Unloading 1704 ATLANTA	
13. Foreign Port of Lading Frankfurt		14. Importer No. 12-34567		15. Reference No.	
16. Importer of Record Name and Address Same		17. City Anytown		18. State NC	
19. Zip 20000		20. Description of Merchandise		21. HTSUS No. A. HTSUS No. B. ADACVD No.	
22. Grossweight A. Grossweight B. Manifest Qty.		23. Net Quantity in HTSUS Units		24. Entered Value A. Entered Value B. CHGS C. Relationship	
25. HTSUS Rate A. HTSUS Rate B. ADA/CVD Rate C. IRC Rate D. Visa No.		26. Duty and I.R. Tax Dollars Cents		27. Line No.	
28. VAL 4039.98		29. VAL 709.00		30. VAL 3331.98	
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the United States. The **commercial invoice** is required for all shipments intended for sale or commercial use in the United States. The invoice must provide all pertinent information about the shipment, in English, and be signed by the seller. One invoice can be used for installment shipments to the same consignee if the shipments arrive within ten days of each other. The invoice must include the following information:

- Names of the port of shipment and the destined port of entry
- Name of buyer and seller or consignee
- Common or trade name for the goods and their detailed description
- Country of origin
- Currency of payment
- Quantity and weight of the goods shipped
- Value of the goods accurately and correctly stated, including a breakdown of all itemized charges such as freight, insurance, packing costs, the costs of containers, any rebates and commissions paid or payable, and the value of any production assist
- A packing list stating in detail what merchandise is in each individual package
- Special information for certain classes of merchandise (e.g., bedspreads must indicate whether they contain any embroidery, lace, braid, or other trimming)

Payment of Duties. If import duties are assessed on the goods, the importer must deposit estimated duties with Customs at the time of filing the entry documents or the entry summary form. The duties must be in an amount determined by Customs, pending a final calculation of the amount actually owed. Payment to a customs broker does not relieve the importer of liability to pay the duties. The liability for duties constitutes a personal debt of the importer, and a lien attaches to the merchandise. In lieu of paying duties immediately, an importer may post a customs bond. This is more convenient for companies needing immediate delivery of their goods. A customs bond can be purchased for a single shipment or for all shipments over the course of a year and up to the amount stated in the bond. The purpose of the bond is to ensure the payment of duties on final calculation. In some cases, goods can be released for transportation or storage *in-bond*, meaning that the payments of duties are suspended until the goods are released for sale or use in the United States.

Informal Entries. Personal and commercial shipments valued at \$2,500 or less may be cleared through an **informal entry** process. A surety bond is not required for informal entries, and import duties are payable immediately at the time of entry. Mail entries less than \$2,500 may be processed through the U.S.

Postal Service, in which case the goods are forwarded to a U.S. Customs mail branch for clearance.

As of 2016, shipments valued at \$800 or less may be imported by any one person, on any one day without the payment of duties (provided the shipment is not one of several that were sent separately for the purpose of evading a tariff). This will mostly affect travelers to the United States and business-to-consumer e-commerce.

Liquidation and Protest

In a normal import transaction, assuming no errors or penalties are at issue, the entry will be liquidated. **Liquidation** is the final computation and assessment of the applicable duty on entered goods by Customs. This “closes the book,” making the entry complete. If Customs accepts the entry as submitted on the importer’s documents, liquidation occurs immediately. However, when Customs at the port of entry determines that additional duties are owed, a **notice of adjustment** is sent to the importer. The importer must respond to the notice, or the duty will be assessed as corrected. If a question or dispute arises concerning the goods themselves, as in the case of technical or unusual products, or in complex cases, the case may be referred to an import specialist familiar with that type of product. A courtesy notice is sent to importers advising them of the liquidation, although this notice is not legally effective. If actual duties owed exceed the estimated duties paid at the time of entry, the importer must pay them within 15 days of the posting of the notice of liquidation.

Protesting Liquidations. An importer that wants to dispute a liquidation made by Customs may file a protest with Customs within 90 days at the port where the goods were entered. An importer may not file a protest where no change was made by Customs to the entry as filed by the importer. Customs has 30 days to respond in cases where the goods have been denied entry; otherwise it has two years to act. Appeals can be made to Customs headquarters in Washington, D.C.

Enforcement and Penalties

The Bureau of Customs and Border Protection has broad powers to establish regulations, carry out investigations, and impose penalties. All care must be used in complying with customs requirements, and many experienced importers will tell you that they make every effort to ensure the customs documents they submit are truthful and error-free.



The basic enforcement and civil penalty provisions of the customs laws are found in Title 19, Section 1592 of the *U.S. Code*. The offenses set out here are civil violations calling for civil penalties imposed administratively by Customs. Criminal violations are addressed elsewhere in the U.S. criminal code. Section 1592 begins by setting out an importer's basic responsibility: "No person may enter or attempt to enter any merchandise into the United States by means of any written document, electronic transmission of information, oral statement, or other act that is both material and false or which omits any material information affecting the entry."

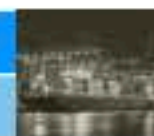
Making Materially False Statements to Customs. An act or statement is "material" if it refers to the identity, quality, value, source, or country of origin of the merchandise, or if it affects the rate of duty charged or the item's right to be imported into the United States. The most common, and often most serious, false statements involve undervaluation, incorrect descriptions, and misstatements as to country of origin. For instance, a statement to a Customs officer that cigars carried on your return flight from Honduras are of Honduran origin, when they are actually of Cuban origin, is materially false. Similarly, submitting a commercial invoice for a shipment of imported goods showing their value at less than that actually paid is materially false. Incorrect country of origin labeling on merchandise is a common false statement, usually resulting from a failure to properly understand customs law. An omission of material fact qualifies as a materially false statement.

A false statement can be material even if it does not actually cause a change in the rate of duty. Identifying an imported fabric as "100 percent cotton" when in fact

it is made of a blend of cotton and silk would be material (and false) even though it may or may not actually result in a change in the rate of duty collected. The violation occurs whether the false statement was made intentionally or negligently. There is no violation if the falsity resulted from simple clerical errors or reasonable mistakes of fact outside the control of the importer (such as where a foreign supplier unexpectedly includes merchandise in a sealed container that you were not aware was being shipped to you, and you had no way to find out), as long as the errors are not part of a pattern of negligent conduct. The penalty, however, does depend on whether the offense resulted from negligence, gross negligence, or fraud.

Negligent Violations. A negligent violation is one in which the importer fails to use *reasonable care, skill, and competence* to ensure that all customs documents and statements are materially correct and all laws are complied with. It might result because the importer failed to accurately ascertain the facts or information required by Customs when making an entry. It could also result from a misinterpretation of customs regulations or a mistake in completing the customs documents. Negligence penalties can seem pretty severe: If duty has been lost, the penalty can be *the lesser of* the value of the goods or two times the loss of duty. If no duty is lost, then the penalty can be as high as 20 percent of the value of the goods, depending on whether there were mitigating or aggravating circumstances.

In the following case, *United States v. Golden Ship Trading Co.*, the importer was found negligent in misstating the country of origin of T-shirts, even though she based her information on assurances made by her supplier.



United States v. Golden Ship Trading Co.

2001 WL 65751 (2001) Court of International Trade

BACKGROUND AND FACTS

J. Wu entered three shipments of T-shirts purchased from Hui, who claimed that he operated a factory in the Dominican Republic. Hui furnished information necessary for the importer's broker to prepare the import documents and to obtain a permit for entry of wearing apparel into the United States (which was required at the time). Wu declared the country of origin of the T-shirts as the Dominican Republic. Customs discovered that Hui produced the body of the T-shirts

in China and shipped them to the Dominican Republic, where sleeves were attached and "Made in Dominican Republic" labels inserted. The finished shirts were then transshipped to the United States. According to law, merely attaching the sleeves did not make the shirts a product of the Dominican Republic. Chinese-made shirts could not have been imported without a textile visa, which Hui may not have been able to obtain. The government alleged that Wu acted without due care in determining the country of origin and sought penalties

continues



continued

of \$44,000. Wu did not dispute that the country of origin was China but denied that she was negligent and claimed that Hui had duped her.

BARZILAY, J.

Section 1592(e) describes the burden of proof that each side bears in a penalty action based on negligence. The United States bears the burden of establishing that the material false act or omission occurred; the burden then shifts to the defendant to demonstrate that the act did not occur as a result of negligence. *See*, 19 U.S.C. § 1592(e)(4). In this action, Customs has adequately demonstrated that the material false act occurred.

Since the court holds that the statements on the entry papers were both material and false, the only remaining issue is whether Ms. Wu has carried her burden that “the act or omission did not occur as a result of negligence.” To decide if the mismarking was the result of Ms. Wu’s negligence the court must examine the facts and circumstances to determine if Ms. Wu exercised reasonable care under the circumstances.

Ms. Wu admits she relied on the information provided by the exporter and accepted his representations that the Dominican Republic was the country of origin of the tee-shirts because “all the documents that the exporter provided prior to entry stated the country of origin was the Dominican Republic.” Further, she claims that she was the victim of the exporter’s fraudulent scheme which was so elaborate that even Customs had difficulty discovering it. Ms. Wu points out that the exporter did have a T-shirt factory in the Dominican Republic and that the factory did perform some manufacturing operations on the imported T-shirts. Ms. Wu also claims “figuring out which (T-shirts) qualified as country of origin Dominican Republic and which did not require an entire team of Customs investigators, special agents and import specialists. Obviously, the exporter’s fraud in this case was well-concealed.” Furthermore, she contends, if Customs had difficulty investigating and uncovering the exporter’s falsifications, how could Ms. Wu, with far fewer resources and less expertise, be expected to know that the entry papers falsely reflected the country of origin of the imported T-shirts. Therefore, Ms. Wu claims, she was justified in relying on the exporter’s entry information.

The court finds that Ms. Wu failed to exercise reasonable care because she failed to verify the information contained in the entry documents. Under the regulation’s definition of reasonable care, Ms. Wu had the responsibility to at least undertake an effort to verify the information on the entry documents. There is a distinct difference between legitimately attempting to verify the entry information and blindly relying on the exporter’s assertions. Had Ms. Wu inquired as to the origin of the imported T-shirts or, at minimum, attempted to check the credentials and business operations of the exporter, she could make an argument that she attempted to exercise reasonable care and competence

to ensure that the statements on the entry documents were accurate. Instead, Ms. Wu applies circular reasoning to prove she was not negligent. She assumes she would not have been able to discover that the exporter was misrepresenting the county of origin and therefore was not negligent even though she made no attempt to verify. The critical defect with Ms. Wu’s argument is that it removes the reasonable care element from the negligence standard. The exercise of reasonable care may not have guaranteed success, but the failure to attempt any verification undercuts the argument that she would have been unable to determine the truth.

Ms. Wu failed to “exercise” reasonable care because she utterly failed to attempt to verify the exporter’s information. Indeed, Ms. Wu admits, and the evidence is uncontroverted, that she relied solely on the word of the exporter.

Q. What information did you rely on when you signed this document that indicates that the single country of origin of the imported items was the Dominican Republic?

A. I believe [sic] Pedro. He said he sent me all the documents and the documents said it’s made in the Dominican Republic so I just signed them.

Furthermore, Ms. Wu openly admits she did not inquire at all about the origin of the imported merchandise.

Q. Did you discuss with Mr. Hui (the exporter) where the fabrics from the T-shirts were made?

A. I never asked. I don’t [sic] know how to ask. I never asked it.

Although it is apparent Ms. Wu did not directly research the authenticity of the exporter’s claims, she argues that she employed the services of a licensed customs house broker and relied on the broker’s expertise to properly prepare the import documents. However, Ms. Wu did not attempt to verify or ascertain the correctness of the information prepared by the broker.

Q. Did you discuss with the broker where he got the information from?

A. I did not discuss it with him.

Even though Ms. Wu did not attempt to verify the country of origin, she still signed and certified the accuracy of the information contained in the entry documents. Ms. Wu’s reliance on the exporter and the broker does not remove the obligation to exercise reasonable care and competence to ensure that the statements made on the entry documents were correct.

The court finds that Ms. Wu’s failure to attempt to verify the entry document information shows she did not act with reasonable care and did, therefore, attempt to negligently introduce merchandise into the commerce of the United States in violation of 19 U.S.C.

continues



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§1592(a)(1)(A) and, therefore, must pay a civil penalty for her negligence pursuant to 19 U.S.C. §1592(c)(3)(B).

With regard to the amount of the penalty, the court directs the parties to attempt to settle the matter by consultation guided by the court's opinions in *United States v. Complex Machines Works Co.*, 83 F. Supp. 2d 1307 (1999) and *United States v. Modes, Inc.*, 826 F. Supp. 504 (1990) regarding mitigation.

Decision. Wu did not exercise reasonable care because she failed to verify the information contained in the entry documents. Customs could assess a penalty that took into account the mitigating circumstances of the case. Once the government proved the false act

occurred, the burden shifted to Ms. Wu to prove that she was not negligent.

Case Questions

1. What was Wu's motivation in stating that the shirts were made in the Dominican Republic?
2. What is the burden of proof? Must the United States prove that Wu was negligent, or must Wu prove that she was not?
3. Can the importer (Wu) rely on the statements of the third party (here, the shirt exporter) to avoid responsibility?

Gross Negligence. An importer commits gross negligence if there is *clear and convincing evidence* that the act or omission was done with actual knowledge or reckless disregard for the relevant facts and with disregard for the importer's obligations under the law. The penalty is approximately twice that for negligent violations, up to the value of the goods.

Civil Fraud. Civil customs fraud is far more serious than negligence. A fraudulent violation exists where there is clear and convincing evidence that the importer *knowingly* (or with wanton disregard for the facts) made a materially false statement or omission while entering or attempting to enter goods into the United States. Examples are intentionally giving a phony description of the goods, understating their value by submitting a fake seller's invoice, concealing money paid to the seller, or altering the country of origin listed on a document. Although the act must have been done knowingly, it does not matter whether the importer intended to evade paying import duties. The maximum civil penalty is equal to 100 percent of the value of the goods, reduced for mitigating circumstances or where the fraud did not result in a loss of duty to the government. In many cases, Customs may seize the merchandise and either have it destroyed or sold at auction.

Crimes. Criminal penalties for customs fraud and smuggling are set out in Title 18, Chapter 27, of the *U.S. Code*, which specifies a range of criminal activities, including the use of false or fraudulent customs documents, destroying invoices on imported goods to cover up a fraud, making false statements to a Customs officer, smuggling, conspiracy, money laundering, and many other acts. The law provides a maximum sentence

of two years' imprisonment, a fine, or both, for each violation and forfeiture of the goods that were the subject of the fraud. Anyone who knowingly and willfully, and with the intent to defraud the United States, clandestinely or secretly smuggles or attempts to smuggle goods into the country without customs clearance can receive up to a 20-year prison sentence. Special criminal offenses apply to drug smuggling and to travelers entering the United States with merchandise in their baggage or on their person.

Aggravating and Mitigating Circumstances. Customs will consider aggravating and mitigating factors in determining the amount of a penalty. Aggravating factors include withholding evidence, providing misleading information, prior improper shipments, and illegal transshipments to hide the actual country of origin. Mitigating factors include erroneous advice from a Customs official, cooperating with the investigation, bringing the error to Customs' attention and voluntarily paying the duty, or a prior good shipment record.

Enforced and Informed Compliance. U.S. Customs takes a two-pronged approach to enforcement of the customs laws: enforced compliance and informed compliance. **Enforced compliance** refers to the active investigation of customs violations and the prosecution of violators. **Informed compliance** refers to "softer" mechanisms designed to place the burden of voluntary compliance on importers. Compliance with the customs laws is much like compliance with the income tax laws. Enforcement depends on the willingness of the majority of U.S. importers, like taxpayers under the income tax laws, to voluntarily comply. Congress recognized this when it passed the *Customs Modernization and Informed Compliance Act*



of 1993 (called the *Mod Act*). It introduced the doctrine of informed compliance, which shifted to the importer a major responsibility to comply with all customs laws and regulations. It requires that importers, customs brokers, and carriers use reasonable care in complying with the law, in handling all import transactions, and in preparing all documentation for entered goods. “Reasonable care” means more than simply being careful. It means that those handling import transactions must be properly trained and that companies must establish internal controls over import operations to ensure compliance. When requirements are not understood, the importer should consult a licensed broker, customs law attorney, or U.S. Customs itself. Importers are expected to have enough information and knowledge to comply with the law. This includes having accurate information about the type of merchandise being imported, its value and origin, the identity of the seller, and so forth. It also requires importers to have a working knowledge of customs statutes, regulations, and rulings and U.S. Customs procedures.

The Reasonable Care Checklist. Customs understands that a “black-and-white” definition of reasonable care is impossible because interpretation of the concept depends on individual circumstances. As an aid to importers, Customs publishes a “checklist” to give less experienced importers a better understanding of their obligation to use reasonable care. The checklist is not a law or regulation; it merely helps importers to understand what is expected of them. Importers who fail to meet the reasonable care requirements on the checklist may be subjected to penalties for negligence. Exhibit 12.4 contains 20 edited provisions from more than 50 in the original document entitled, *What Every Member of the Trade Community Should Know About: Reasonable Care (A Checklist for Compliance)*, 2004.

Reporting Errors to Customs before an Investigation. Congress has enacted a statute to encourage importers to voluntarily report their own possible violations of the customs laws. This is called a **prior disclosure**. If an importer admits its mistake and informs Customs of a possible violation *before* learning that it is being investigated, the penalties are limited. The importer must completely disclose the materially false statements or omissions and the circumstances of the violation. Any unpaid duties must be remitted within 30 days. However, an attorney should be consulted before doing so. Some prior disclosures have

reportedly saved companies many millions of dollars in potential fines.

The Statute of Limitations. The government is barred from bringing any action to collect an import duty after five years from the date of the violation involving negligence or gross negligence or five years from the date of discovery of a violation involving fraud.

Record-Keeping Requirements. Importers are required to keep records of all import transactions for five years from the date of entry and to give Customs access to those documents on demand. The records include all documents “normally kept in the ordinary course of business,” including sales contracts, purchase orders, government certificates, letters of credit, internal corporate memoranda, shipping documents, correspondence with suppliers, and any other documents bearing on the entry of the merchandise. It is highly recommended that corporate importers establish a customs records compliance program to avoid penalties. The willful failure to keep records about the entry is punishable by the lesser of a \$100,000 fine or 75 percent of the value of the merchandise. Even negligent record-keeping is punishable by fines up to \$10,000 or 40 percent of the value of the goods, whichever is less. There is an exception if the records were destroyed by an act of God. Concealment or destruction of records carries an additional \$5,000 fine or up to two years’ imprisonment or both. U.S. Customs conducts audits to verify business records. Inspections can take place on reasonable notice to the importer. Documents can be seized by court order.

Enforcement of Penalty Actions. In any action to collect a penalty, U.S. Customs acts as plaintiff in bringing suit in the Court of International Trade. Quite often, Customs will ask the court to consider all theories of culpability—negligence, gross negligence, and fraud—hoping to win on one or the other theory. The burden of proof in court depends on the violation. Fraud and gross negligence must be proved by “clear and convincing evidence.” In negligence cases, the government must prove only that the act or omission occurred; the burden then shifts to the defendant-importer to show that it did not occur as a result of negligence. (Note that this rule does not apply to importers seeking review of a protest to recover duties paid. In that case, the importer brings the action and U.S. Customs is the defendant).



Exhibit 12.4

Reasonable Care Checklist

1. If you have not retained an expert to assist you in complying with U.S. Customs requirements, do you have access to the Customs Regulations (Title 19 of the *Code of Federal Regulations*), the *Harmonized Tariff Schedule of the United States*, and the GPO publication *Customs Bulletin and Decisions*? Do you have access to the Customs Internet Web site, *Customs Electronic Bulletin Board*, or other research service to permit you to establish reliable procedures and facilitate compliance with customs laws and regulations?
2. Have you consulted with a customs "expert" (e.g., lawyer, broker, accountant, or customs consultant) to assist in preparation of documents and the entry of the merchandise?
3. If you use an expert to assist you in complying with U.S. Customs requirements, have you discussed your importations in advance with that person and have you provided that person with full, complete, and accurate information about the import transactions?
4. Has a responsible and knowledgeable individual within your organization reviewed the customs documentation prepared by you or your expert to ensure that it is full, complete, and accurate?
5. Are identical transactions or merchandise handled differently at different ports or customs offices within the same port? If so, have you brought this to the attention of the appropriate customs officials?
6. Have you established reliable procedures within your organization to ensure that you provide complete and accurate documentation to U.S. Customs?
7. Have you obtained a customs ruling regarding the importation of the merchandise?
8. Do you know the merchandise that you are importing and have you provided a detailed and accurate product description and tariff classification of your merchandise to U.S. Customs? Is a laboratory analysis or special procedure necessary for the classification?
9. Have you consulted the tariff schedule, U.S. Customs' informed compliance publications, court cases, or U.S. Customs rulings to assist you in describing and classifying the merchandise?
10. If you are claiming a free or special tariff treatment for your merchandise (e.g., GSP, HTS Item 9802, NAFTA, etc.), have you established a reliable program to ensure that you reported the required value information and obtained any required or necessary documentation to support the claim?
11. Do you know the customs value of the imported products? Do you know the "price actually paid or payable" for your merchandise?
12. Do you know the terms of sale; whether there will be rebates, tie-ins, indirect costs, additional payments; whether "assists" were provided, commissions or royalties paid? Have all costs or payments been reported to U.S. Customs? Are amounts actual or estimated? Are you and the supplier "related parties," and have you disclosed this to U.S. Customs?
13. Have you taken reliable measures to ascertain the correct country of origin for the imported merchandise? Have you consulted with a customs expert regarding the country of origin of the merchandise?
14. Have you accurately communicated the proper country of origin marking requirements to your foreign supplier prior to importation and verified that the merchandise is properly marked upon entry with the correct country of origin?
15. If you are importing textiles or apparel, have you developed reliable procedures to ensure that you have ascertained the correct country of origin and assured yourself that no illegal transshipment (rerouting through a third country for illegal purposes) or false or fraudulent documents or practices were involved? Have you checked the U.S. Treasury's published list of manufacturers, sellers, and other foreign persons who have been found to have illegally imported textiles and apparel products? If you have obtained your textiles from one of these parties, have you adequately verified the country of origin of the shipment through independent means?
16. Is your merchandise subject to quota/visa requirements and, if so, have you provided or developed a reliable procedure to provide a correct visa for the goods upon entry?
17. Have you determined or established a reliable procedure to permit you to determine whether your merchandise or its packaging bear or use any trademarks or copyrighted matter or are patented and, if so, that you have a legal right to import those items into, and/or use those items in, the United States?
18. If you are importing goods or packaging materials that contain registered copyrighted material, have you checked to ensure that it is authorized and genuine? If you are importing sound recordings of live performances, were the recordings authorized?
19. Have you checked to see that your merchandise complies with other government agency requirements (e.g., FDA, EPA/ DOT, CPSC, FTC, Department of Agriculture, etc.) prior to or upon entry and procured any necessary licenses or permits?
20. Have you checked to see if your goods are subject to a Commerce Department dumping or countervailing duty determination and reported that to U.S. Customs?

Source: "What Every Member of the Trade Community Should Know About: Reasonable Care (A Checklist for Compliance)," U.S. Customs and Border Protection, 2004.



Binding Rulings

Imagine you work for a trading company in the United States and have an opportunity to sell imported women's "boxer shorts" to a leading U.S. department store chain. They would like you to quote "your best price," delivered with duties paid. If you underestimate your costs, you will end up eating your shorts on the deal. You learn that some women will wear the boxers as short pants, while others will wear the shorts as underwear. The question is whether Customs will consider the boxers to be "outerwear," which is dutied at 18 percent, or "women's slips and briefs," which are dutied at less than 12 percent. Importers faced with a situation like this may make a written request for a **binding ruling**, also called a *ruling letter*, from Customs in advance of an entry. A binding ruling represents the official position of Customs with respect to the *specific transaction for which it was issued*. It is binding on Customs personnel until revoked. Customs does not publish public notice in advance of a ruling, and there is no opportunity for the public to comment on the issue. Rulings are important to importers, especially those dealing in new or unusual merchandise that they have not imported before. They relieve the recipient of a ruling of the uncertainty over the tariff rate and how the product will be treated by Customs.

U.S. Customs maintains an online, searchable database of agency rulings from 1989 to present, called the *Customs Rulings Online Search System* (CROSS). Importers can use the system to find rulings on articles similar to theirs. It contains links to the tariff schedule, Customs Bulletins, Informed Compliance, the Code of Federal Regulations, and other citation. Although a ruling is only binding to the party to whom it is addressed, rulings found in CROSS do provide guidance. However, no one should rely on a ruling issued to someone else because rulings on similar products can seem inconsistent and unpredictable. A request for a ruling should contain all relevant information, and where applicable the importer should send a sample of the article. The ruling letter is issued only on the basis of the exact facts given and ensures that the products described will be entered according to the terms set out in the letter. Customs' goal of a 90-day response period is often exceeded, and some can take up to nine months. Rulings are published in an official agency publication, *Customs Bulletin and Decisions*.

CONCLUSION

Most Americans recognize the enforcement predicament the U.S. Bureau of Customs and Border Protection faces: The agency must protect the borders of the United States from a range of dangers while considering the needs of American importers and exporters for expedited customs entry and delivery and the impact of cargo delays on the U.S. economy. The agency has shared responsibility with other federal agencies for protecting the borders from terrorist threats, including the potential smuggling of weapons of mass destruction; for interdicting illegal immigration; and for detecting the smuggling of drugs and other contraband. Given the immense numbers of ocean containers and international flights arriving at U.S. ports every day, most Americans recognize the immense job the agency has been given. The agency understands the need to balance security with the economic needs of U.S. importers and foreign exporters to enter their shipments with as little delay as possible. Americans also recognize that the effective and efficient enforcement of the customs laws and the movement of cargo are largely dependent on their cooperation and partnership with customs officials.

All businesspeople must be concerned about complying with the customs and tariff laws of the countries in which they import or export. Enforcement actions and penalties for violations can be severe. Individuals and firms must adhere to the concept of informed compliance. This means that importers and exporters must use reasonable care in handling entries and must either be adequately trained or rely on trained professionals. Many multinational firms employ specialists in using the rules of origin.

Finally, customs compliance does not mean that importers should not plan their business strategies to take advantage of opportunities in the customs and tariff laws. To the contrary, tariff laws, like many other types of tax laws, are intended to encourage and reward certain business decisions. Multinational companies that structure their global operations to take advantage of incentives in the customs or tariff laws or that source materials and products made in certain countries that have tariff preferences under U.S. law, for example, are simply taking advantage of business opportunities legally provided by Congress. Customs laws will affect the location of plants



and facilities built by multinational companies, where they source their materials or component parts, how they move goods from country to country, and how

they structure their overall global operations. Careful customs planning is essential to the success of any international business plan.

Chapter Summary

1. Judicial review of rulings and decisions of U.S. Customs and Border Protection is before the U.S. Court of International Trade, a specialized court in New York City. Appeals from that court are to the U.S. Court of Appeals for the Federal Circuit in Washington, D.C.
2. A formal entry is the administrative process required to import goods into the customs territory of a country. The goods may be entered by the owner, purchaser, consignee (the party to whom the goods are shipped or to be delivered), or a licensed customs broker.
3. The *Customs Modernization and Informed Compliance Act* introduced the doctrine of informed compliance, which shifted a major responsibility to comply with all customs laws and regulations to the importer. It requires that importers use reasonable care in complying with the law, in handling all import transactions, and in preparing all documentation for entered goods. Reasonable care means more than simply being careful. It means that those handling import transactions must be properly trained, that companies must establish internal controls over import operations to ensure compliance, and that professional advice must be sought when needed.
4. Binding rulings from the Customs Service are an important tool in properly and safely planning import transactions in advance.
5. Most trading nations of the world utilize the schedule of the *Harmonized Commodity Description and Coding System* for classifying products. In the United States, the *Harmonized Tariff Schedule* is a federal statute that includes virtually all goods sold in commerce and lists the tariff rate for each according to the country of origin. The U.S. schedule is maintained by the International Trade Commission.
6. Tariffs, restraints on imports, and other import controls are applied to goods according to their dutiable status. The dutiable status of goods is determined by the classification of the article, the transaction value of the article, and the country of origin of the article.
7. Goods are classified in the *Harmonized Tariff Schedule* either by name, by description of the article's physical characteristics, by a description of their component parts, or by a description of the article's use. Goods classified by name are defined by the common meaning of the name, unless it is clear that Congress had intended the commercial or scientific name to apply. Anyone attempting to research the classification of an article in the HTSUS must follow the rules set out in the *General Rules of Interpretation*. Where an article may be classified under more than one heading, it must be classified under the one that most specifically describes the item. If two or more headings each describe only certain materials or components of the article, the article must be classified under the heading that describes those materials or components that give the article its essential character.
8. The dutiable value of the goods is the transaction value. This is the cost of the goods adjusted for certain elements of cost set out in the statutes and regulations such as packing costs, assists, or royalty fees.
9. Rules of origin are the national laws and regulations of administrative agencies, usually customs authorities, which are used to determine the country of origin of imported products. There are few areas of customs law that are so complex and difficult for importers to understand. One of the reasons for the complexity is that there are so many different rules applicable to imports from different countries. The general rule is that the country of origin of an imported article is that country where it was wholly and completely produced, manufactured, or obtained entirely from raw materials originating in that country. Where goods are not wholly the product of one country, such as goods assembled in more than one country, importers must rely on the substantial transformation test or tariff-shift rules set out in the customs statutes and regulations.



10. Foreign trade zones are legally defined sites within a country that are subject to special customs procedures and under the supervision of U.S. Customs. Imported goods may be brought into an FTZ without being subjected to tariffs until such time as the goods are released into the stream of commerce in the United States. They offer importers and exporters the opportunity for creative business planning to reduce tariff liability.

Key Terms

importing 308	dutiable value 318	same-condition drawback 324
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port of entry 308	production assists 318	rejected merchandise drawback 325
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principal use 314	substantial transformation 320	notice of adjustment 330
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composite goods 316	regional value content test 323	enforced compliance 333
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	manufacturing drawback 324	binding ruling 336

Questions and Case Problems

1. Use the *Customs Rulings Online Search System (CROSS)* on the website of U.S. Customs and Border Protection to find rulings that might help in determining the following classifications:

a. You intend to obtain a saw blade produced in England and then ship it to China to be assembled with a handle that is manufactured in China. The finished article is a laser guided saw that is then packaged in China for export. Without considering the tariff classifications, what do you think is the country of origin of the saw and why? What “tests” do you apply? Is it sufficient that the “blade” was made into a “saw?”

b. You intend to import vodka that is produced in Denmark. The strength of the vodka when imported will be at least 80 percent by volume. In the United States, the vodka will be diluted with water, sugar, and flavor to produce flavored vodka with 35 percent alcohol by volume. What is the correct country of origin for labeling purposes? Why?

c. You intend to import raw, frozen calamari (squid) from China, Vietnam, and Peru into the United States, where it will be defrosted and tenderized. The tenderization process entails placing the imported squid into a solution of ice water and salt, citric acid, sodium citrate, and potassium carbonate. The squid is kept cold while in the solution for 15 to 18 hours. The process does not change the size or shape of the calamari, but makes it whiter and plumper. Then it is rinsed before being refrozen and repacked for sale. Can your calamari be labeled “Product of U.S.A.?” Why or why not?
2. Assume your cellphone is assembled in China from parts that originate in dozens of countries. What factors must you be able to prove to U.S. Customs in order to mark the phone as “Assembled in China?”
3. Allstar imported a polyester fleece textile product that is similar to a blanket, but has sleeves for arms. It was in one size only, measuring 71 × 54 inches, with sleeves 28 inches long. There was no closure and it was open in the back. The article is referred to in advertising as a “blanket with sleeves” that allows users to “keep hands free.” It is marketed for use while reclining or seated,



including on an airplane or outside during a sports game. Allstar believed that the article should be classified under Subheading 6301.40.00 as “Blankets and traveling rugs: Other” at 8.5 percent tariff rate. Customs classified the articles under Subheading 6114.30.30 as “Other garments, knitted or crocheted: Of man-made fibers: Other” at 14.9 percent tariff rate. What do you think, are these garments or “enhanced” blankets? On what basis do you make your classification decision? Although these subheadings are *eo nomine* provisions, do you think the “use” of the article is relevant to its identity? *Allstar Marketing Group, LLC v. U.S.*, Slip Op. 17-15 (2017). See also, *GRK Canada, Ltd. v. U.S.*, 761 F.3d 1354 (Fed. Cir. 2014).

4. CamelBak imported backpacks used for outdoor activities and designed to deliver “hands-free” water on-the-go. Each of the subject articles is a textile bag with padded shoulder straps and an insulated plastic reservoir for beverages, flexible tubing, a bite valve, and a cargo compartment designed to hold food, clothing, and supplies. The reservoir holds 35 to 100 ounces of liquid, and the cargo compartment holds 300 to 1,680 cubic inches, depending on the style of pack. Both Customs and CamelBak agreed that the article fell under Heading 4202 for “insulated food or beverage bags ... backpacks ... sports bags.” CamelBak believed that the articles should be classified as composite goods under GRI 3b (comprised of a sports bag and insulated hydration component), that the hydration component gave the article its essential character, and therefore the correct subheading was for “insulated food or beverage bags” at a rate of 7 percent. Customs did not think the articles were composite goods and entered them as backpacks under the subheading for “travel, sports and similar bags” at a rate of duty of 17.8 percent. CamelBak filed a protest. The Court of International Trade agreed with Customs, stating that “there

is nothing about [adding a beverage compartment] that makes the backpack not a backpack.” CamelBak appealed. What was the result? Were these composite goods? If so, how does GRI 3 apply? Or were these just backpacks with an improved design? *CamelBak Products, LLC v. U.S.*, 649 F.3d 1361 (Fed. Cir. 2011).

5. Inner Secrets entered 2,000 dozen boxer-style shorts from Hong Kong. The boxer shorts were made of cotton flannel in a plaid pattern, with a waistband, a side length of 17 inches, and two small nonfunctional buttons on the waistband above the fly. Two seams were sewn horizontally across the fly, dividing the fly opening into thirds. The boxers did not have belt loops, inner or outer pockets, or fly closures. They were marketed under the label “No Excuses.” Customs classified the garments as outerwear shorts under Subheading 6204.62.4055: “Women’s or girls’ suits, ensembles, suit-type jackets and blazers, dresses, skirts, divided skirts, trousers, bib and brace overalls, breeches and shorts Trousers, bib and brace overalls, breeches and shorts ... of cotton ... 17.7%.” Customs based its decision on its determination that the boxers will be worn by women as outer clothing. Inner Secrets maintains that the items are not outerwear, as Customs claims, but are actually underwear properly classified under Subheading 6208.91.3010: “Women’s or girls’ singlets and other undershirts, slips, petticoats, briefs, panties, nightdresses, pajamas, negligees, bathrobes, dressing gowns and similar articles ... of cotton ... 11.9%.” Inner Secrets filed a protest with the agency, which was denied. Inner Secrets brought this action with the Court of International Trade. What is the proper classification of the boxers? How would a camisole worn under a sport jacket or a slip worn as a dress be classified? *Inner Secrets v. United States*, 885 F. Supp. 248 (Ct. Int’l. Trade 1995). See also, *St. Eve International v. United States*, 267 F. Supp. 1371 (Ct. Int’l. Trade 2003).

Managerial Implications

You are attending a product development meeting at your company, a U.S. manufacturer of outdoor equipment. Your firm designs and manufactures tents, bivy sacks, backpacks, and other outdoor equipment and accessories. Your tents include expedition-quality, three- and four-season tents, lighter tents for backpacking, and larger tents used for camping and recreation. Most tents sleep from one to six people. While some sewing and construction is done at your U.S. plant, much of your work is contract manufactured for you in China. The Chinese firm maintains an inventory of the fabrics and hardware you use and supplies of your trademarked labels to sew in. The quality, reliability, and delivery of the Chinese firm has always been good, and you have no other foreign suppliers.

Today’s meeting was called to discuss the opportunity to quote a tent design and prices to Z-Mart Sporting Goods, potentially your largest customer. They want only one tent of your quality and brand name, and they are leaving most of the tent design up to you. However, it must sleep three or four people and leave enough head-room to dress. It can be either a heavier three-season or lighter four-season tent, so you have some flexibility there. Most importantly, it cannot retail for more than \$400 or they’re not interested. Their retail price is double their total wholesale cost. That means you cannot price the tent for one penny more than \$200, including the cost of the tent, import duties, overhead, and all transportation and insurance to Z-Mart’s warehouse. To do business with Z-Mart, and still make a profit, your CEO demands that



every penny of costs be shaved. He estimates that if the tariff rate is any more than 5 or 6 percent, then Z-Mart's target price will be difficult to meet. He schedules the next meeting for tomorrow and asks you to make a presentation on how U.S. tariff and customs law will affect costs. He wants to know the following (Hint: As you proceed, you may want to review the above facts):

1. Generally speaking, what factors will determine the U.S. tariff rate on your tents?
2. To import the tent at the lowest rate, what class and kind of tent should it be? What should be its "principal use"?
3. What textile material should the tent be made from to achieve the lowest tariff?
4. Access the Customs Rulings Online Search System and search for your tent. Are you able to locate any actual classification rulings that might give you some guidance? Would you advise the CEO to obtain a ruling?

5. Based on your research what are the key design characteristics necessary to import the tents at the lowest tariff rate possible? Specifically, what are the requirements for square-foot floor space, height, weight, and carry size?
6. Although a search for new suppliers is impossible at this time, your CEO wants to know if the United States gives any tariff preferences for tents originating in certain countries. Are your tents eligible for a tariff preference under the GSP for developing countries? The Caribbean Basin Initiative? Israel? Singapore? What is the rate from Australia?
7. At the last minute, Z-Mart calls your CEO to ask if you can produce "pickup truck tents"—tents that fit into the bed of a pickup truck. He asks if you think they will be classified as "tents" or as "parts and accessories of motor vehicles" in Heading 8708. Can you find a previous customs ruling that you can cite to him?

Ethical Considerations

Fair trade is a worldwide movement based broadly based on the theory that trade between rich and poor should be based on notions of social and economic justice. It also advocates that small farms and farm workers in developing countries receive a fair price in return for their agricultural and handicraft products. Although the fair trade movement dates to the 1940s, it became popular in parts of Europe in the 1960s and more recently has taken hold in the United States. Fair trade is supported by consumers willing to pay a small additional price for goods knowing that the indigenous producers of the goods, living and working under the poorest conditions, receive a fair price for their product. Some fair trade farms consist of small cooperatives, with individual families farming only a couple of acres. Typical fair trade products include coffee, tea, bananas, wine, herbs and spices, honey, rice, and cocoa. Standards, minimum prices, inspections, and certifications of producers and traders are the responsibility of private, nonprofit organizations. Fair trade standards also require that certified farms practice sustainable farming techniques, follow rules on the use of pesticides and recycling, refrain from using child labor, and encourage farm children to attend school. These advances are made possible by the higher prices participants receive for their products.

By the early 2000s, labeling standards for fair trade-certified products became standardized so that consumers could recognize fair trade products in stores. Participants in fair trade include the workers and producers themselves, the brokers and traders who deal in the products, the retailers and vendors in richer countries, and consumers. Some of the most important fair trade organizations are the Fairtrade Labelling

Organizations International, the European Fair Trade Association, the International Fair Trade Association, and TransFair USA.

1. Would you be willing to pay a slightly higher price for sugar, coffee, fruits, and basic commodities, knowing that their producers, farmers in Central America or Africa, were paid an internationally established "fair price" for their labors? Do you believe that consumers will make ethical choices in the marketplace, or strictly economic ones?
2. Fair trade is based on the guarantee of a fair price. How is a "fair price" determined? What is the role of independent fair trade organizations in establishing price?
3. Critics suggest that fair trade does not address the root causes of poverty. Some economists argue that low prices for basic commodities, like coffee, result from oversupply. Moreover, fair trade also does not guarantee access to investment or technology. Do you think the fair trade movement can be successful in rooting out poverty in developing countries?
4. Although fair trade products account for a tiny volume of world trade relative to the total volume, they do focus concern on the plight of poor farmers, farm workers, and producers in agrarian regions. Some of America's largest and best-known retailers are selling fair trade products, including Sam's Club, McDonald's, Dunkin' Donuts, Starbucks, and many grocery chains. Based on your research and outside reading, what do you think the impact of fair trade programs can be?