THE FAIR CURENCY ACT OF 2007:
QUESTIONS AND ANSWERS
(April 2007)

What changes does the Fair Currency Act (FCA) make in U.S. law?

The FCA improves U.S. trade laws in the following several ways:

1. The countervailing duty law is applied equally to all countries, including non-market-economy countries;

2. Exchange-rate misalignment due to protracted undervaluation by a government of its currency is deemed a prohibited export subsidy that is countervailable under the countervailing duty law;

3. Exchange-rate misalignment is included as a condition to be considered with respect to market disruption by reason of imports from China; and

4. The requirements for the U.S. Department of the Treasury's semi-annual reports on currency manipulation are modernized.

A. *CHANGES TO THE COUNTERVAILING DUTY (CVD) LAW*

What is the U.S. countervailing duty law?

Since 1897 when the first U.S. countervailing duty law was passed, this statute has provided for the imposition of additional duties on imports into the United States for the purpose of counteracting any unfair competitive advantage that foreign manufacturers or exporters have enjoyed on the manufacture or export of their products from subsidies bestowed by the foreign government.

What are the roles of the U.S. Department of Commerce and the U.S. International Trade Commission in the administration of the U.S. countervailing duty law?

In a bifurcated process, the U.S. Department of Commerce calculates the extent to which imports into the United States have benefited from countervailable subsidization, while the U.S. International Trade Commission determines whether the subsidized imports are materially injuring or threatening to materially injure the U.S. domestic industry involved. If both agencies make affirmative determinations, a countervailing duty order against the imports is published.

Who may petition for relief under the U.S. countervailing duty law?

In order to have legal standing to file a countervailing duty petition, U.S. companies and workers must produce a product that is like (that is, either identical to or most similar in characteristics and uses with) the imports in question.

How does the U.S. countervailing duty law relate to the Agreement on Subsidies and Countervailing Measures (SCM Agreement) of the World Trade Organization (WTO)?

The U.S. countervailing duty law implements in U.S. domestic law the international legal obligations of the United States that are set forth in the WTO's SCM Agreement. If another WTO country disagrees with that implementation, it may invoke dispute settlement at the WTO to resolve the matter. If dispute settlement is decided against the United States in a given case, the United States is charged with bringing its measures into conformity with the WTO's provisions.

How does an injured American industry obtain relief under the countervailing duty law?

U.S. companies and workers engaged in producing manufactured goods or agricultural products in the United States, which are like the imported products that are alleged to be (a) subsidized and (b) causing or threatening material injury to their industry, may file a countervailing duty petition. The U.S. Department of Commerce conducts an investigation to determine whether the subject imports are receiving and benefiting from countervailable subsidies provided by the exporting country's government. The U.S. International Trade Commission conducts an investigation to determine whether the subsidized imports have caused or threaten to cause material injury to the U.S. domestic industry. If both countervailable subsidization and import-related injury are found, a countervailing duty order is issued by the U.S. Department of Commerce, and countervailing duties equal to the net subsidies are imposed by U.S. Customs to offset the injurious, unfair subsidization.

How long does it take, once a petition has been filed, before a CVD order is published?

The parallel investigations by the U.S. Department of Commerce and the U.S. International Trade Commission can last as long as 205 to 430 days.

Are countervailing duties punitive?

No. As noted above, countervailing duties are meant to offset injurious, unfair subsidization. It is the U.S. Department of Commerce that calculates the amount of the countervailable subsidization. If this subsidization is significant under the statute, a countervailing duty in the amount of that subsidization is assessed and collected by U.S. Customs from the U.S. importer for entries of the subject merchandise at the direction of the U.S. Department of Commerce. The concept underlying this system is that U.S. importers may continue to import the subsidized product, but either must pay the countervailing duty to negate the injurious effects and unfairness of the subject imports' subsidization or import non-subsidized merchandise from another source. By the same token, the United States is not dictating that the foreign government cease the subsidization, but, consistent with the SCM Agreement of the WTO, is simply acting to counter the injurious, unfair subsidization if the foreign government chooses to persist in

granting the countervailable subsidies. Once the subsidization has been offset by a countervailing duty, trade in the subsidized good is deemed to be fair.

When do countervailing duties take effect?

Following an affirmative preliminary injury determination by the U.S. International Trade Commission and an affirmative preliminary subsidy determination by the U.S. Department of Commerce, importers of record must either post a bond or make a cash deposit of the estimated amount of countervailing duties with U.S. Customs. After an affirmative final subsidy determination and then an affirmative final injury determination by the agencies, importers of record no longer have the less stringent option of posting a bond and must make a cash deposit of the estimated amount of countervailing duties. Final countervailing duty liability for past entries of subject merchandise is determined by the U.S. Department of Commerce in subsequent annual reviews, and the updated calculation of the subsidy amount also sets the cash deposit rate of estimated countervailing duties for future entries until the next annual review is completed.

How long do countervailing duties remain in effect?

The duration of a countervailing duty order and how long countervailing duties continue to be assessed and collected depend upon the facts in each case. The statute provides for several types of administrative reviews, each of which can lead to revocation of the countervailing duty order and cessation of the imposition of countervailing duties on subsequent entries of the affected merchandise. Thus, a countervailing duty order will be revoked partially or completely (1) if a foreign producer or exporter and its foreign government are able to establish in three consecutive annual reviews by the U.S. Department of Commerce that the countervailable subsidization has ceased or is no longer significant for whatever reason (such as termination of the subsidy programs by the foreign government or a decision by the foreign producer or exporter not to avail itself of the subsidies); (2) if, in a sunset review (conducted automatically every five years by the U.S. Department of Commerce and the U.S. International Trade Commission), it is found that countervailable subsidization or resultant material injury to the U.S. industry is not likely to continue or resume if the order is revoked; or (3) if a changed-circumstances review by one or the other agency at the request of any interested party concludes that the order is no longer needed (as when the last company in a U.S. industry goes out of business).

Are the countervailing duty rates adjusted during the life of a countervailing duty order?

Yes, countervailing duty rates can be adjusted. Interested parties – including the foreign government, exporters, and importers as well as petitioners – have the right to request an annual review by the U.S. Department of Commerce for this purpose of entries over the prior year. If a particular subsidy practice has increased or decreased, the countervailing duty rate will be adjusted accordingly.

Aren't countervailing duty orders a form of protectionism?

No. It is actually countervailable subsidies themselves, most flagrantly export-contingent subsidies, that are protectionist by virtue of their hampering healthy, unimpeded trade that is responsive to the dictates of the marketplace. Countervailable subsidies have long been recognized as distortive of supply and demand, destructive of fair competition, and incompatible with free trade. Inefficient industries sustained by governmental subsidies prosper at the expense of fit, otherwise competitive companies that are not subsidized. Far from being protectionist, therefore, countervailing duties serve as a legitimate, internationally accepted mechanism to correct the imbalances that protectionist subsidies generate.

Would there be any special procedures or requirements under the FCA for a currency complaint compared to other subsidy investigations?

No. An allegation of an undervalued currency would be investigated and decided in the same way as any other prohibited export subsidy. The FCA simply establishes statutorily that exchange-rate misalignment (defined as the undervaluation of a foreign currency as a result of protracted large-scale intervention by or at the direction of a governmental authority in the exchange market) is a subsidy due to its being a governmental financial contribution that benefits the recipient and is a prohibited countervailable export subsidy due to its being export-contingent. In the course of a countervailing duty proceeding, it would remain for the U.S. Department of Commerce to measure the extent of any exchange-rate misalignment based upon the factual circumstances of the given case.

Isn't the FCA's treatment of exchange-rate misalignment a form of China-bashing?

No. By its terms, in keeping with the Most-Favored-Nation (MFN) principle of the WTO's General Agreement on Tariffs and Trade (GATT), the FCA's section on subsidies pertains in a non-discriminatory manner to undervalued exchange-rate misalignment by <u>any</u> member state of the WTO, not just by China and not just by non-market-economy countries. It addresses an unfair practice <u>per se</u>, not any particular trading partner. Equally with all other WTO members, China bound itself under public international law to the WTO's multilateral SCM Agreement when China joined the WTO in December 2001. Furthermore, in accord with the SCM Agreement, in its protocol of accession China agreed to terminate all of its export-contingent subsidies as well as certain other subsidies by the time of its entry into the WTO in December 2001. The FCA's provisions treating undervalued exchange-rate misalignment as a prohibited countervailable export subsidy are designed to implement in U.S. domestic law the WTO's public international legal rules that are understood to authorize the countervailing of such export-contingent currency undervaluation.

Isn't the FCA's designation of exchange-rate misalignment as a prohibited countervailable export subsidy unfair to American consumers?

No. Export-contingent subsidies that are granted only if a foreign company exports its products are universally recognized as having no redeeming quality as far as the global trading system is concerned. It is for this reason that export-contingent subsidies are not only countervailable (as are some domestic subsidies that are not tied to exportation), but also – except as provided in the WTO's Agriculture Agreement – are prohibited by the WTO's SCM Agreement. While it is generally assumed that a product that has qualified for an export-contingent subsidy is sold at a price discounted by the amount of the export subsidy, that pass-through of the export subsidy in the form of a lower price for the export will not occur if the exporter decides to enjoy the proceeds of the export subsidy in some other way. In this situation, the subsidy serves only to boost the revenues of the foreign producer with no benefit to American consumers. Furthermore, even if the export subsidy is passed through by the exporter in the form of a reduced price for the exported product, any advantage gained by American consumers is short-term at best. As observed earlier, governmental subsidization of exports carries the longer-term risks of propping up inefficient companies in the exporting country. When the negative repercussions of this artificial support include injury to U.S. companies and workers, revenues and jobs are lost at considerable cost to the U.S. economy and national security. In the final analysis, American consumers and consumers everywhere are best served through healthy competition by unsubsidized companies that are competitive on their own merits. When weaker competitors use artificial advantages to injure stronger competitors, the consumer loses.

Is there a strong case that exchange-rate misalignment is a prohibited countervailable export subsidy under the WTO's rules?

Yes. The question of whether exchange-rate misalignment is a prohibited countervailable export subsidy has never been the subject of dispute settlement at the World Trade Organization, and so it is not possible to know with certainty what a dispute settlement proceeding's outcome on this issue of first impression would be. Nevertheless, the WTO's SCM Agreement is very clear as to what criteria must be satisfied for a measure to be deemed a prohibited countervailable export subsidy, and there are very solid grounds for concluding that exchange-rate misalignment meets these criteria. In particular, as next discussed in turn with reference to Articles 1, 2, and 3 of the SCM Agreement, exchange-rate misalignment meets the three WTO legal tests for a prohibited export subsidy: it (1) entails a governmental financial contribution that (2) bestows a benefit upon the recipient, and so is a subsidy, and (3) is specific and so a countervailable subsidy by virtue of being contingent upon exportation.

First, is there a financial contribution by the foreign government?

Yes. A governmental financial contribution takes place when a foreign government engages in protracted large-scale intervention in the exchange market by requiring that foreign currency in its territory be converted at an undervalued rate into its national

currency. In the case of China, for example, its intervention in the exchange market since 1994 has resulted in an undervaluation of the yuan by an estimated 40 percent or more. In effect, the Chinese government's sterilization of massive quantities of U.S. dollars has prevented market forces from increasing the value of the yuan vis-à-vis the U.S. dollar. Rather than a rate of exchange of approximately 8 yuan to the U.S. dollar, the rate of exchange should be approximately 5 yuan to the U.S. dollar. As a practical matter, therefore, for every U.S. dollar exchanged in China, the Chinese government ensures that the exporter receives 8 yuan rather than 5 yuan. The differential of 3 more yuan per U.S. dollar constitutes a clear financial contribution by the Chinese government.

Second, is there a benefit to the exporter?

Yes. To continue the example involving China, when an exporter in China exchanges its earned U.S. dollars for yuan, the additional 3 yuan received for each U.S. dollar are a clear benefit to the Chinese exporter.

Third, is the subsidy derived from exchange-rate misalignment contingent upon exportation of the product?

Yes. Again with respect to the instance of China, the Chinese company can only enjoy the benefit of the Chinese government's financial contribution of 3 yuan per U.S. dollar by exporting merchandise from China and being paid in U.S. dollars for that merchandise.

But how does this arrangement satisfy the WTO's test that, to be prohibited, a subsidy must be "specific" and tied to exports and not generally available?

Article 2.3 of the SCM Agreement provides, "Any subsidy falling under the provisions of Article 3 shall be deemed to be specific." Export subsidies such as misaligned exchange rates fall under Article 3, which prohibits "subsidies contingent, in law or in fact, whether solely or as one of several other conditions, upon export performance . . . ." (footnote omitted.)

How can exchange-rate misalignment be contingent upon exportation when all conversions between an undervalued foreign currency and the U.S. dollar are made at the same rate of exchange, whether the transaction pertains to exportation or not?

Using China as an illustration, it is true that all conversions between the yuan and the U.S. dollar are made at the yuan's undervalued rate, such as when U.S. companies invest in China and Chinese companies invest in the United States or when U.S. tourists visit China and Chinese tourists travel to the United States. The fact remains, however, as a practical matter that a Chinese company is not eligible for this subsidy on the basis of yuan-denominated sales in the Chinese home market, but must export its products to the United States, be paid in U.S. dollars, and then in compliance with Chinese law exchange those U.S. dollars into yuan. Only in this manner can a Chinese company benefit from the yuan's undervaluation. The same is true when U.S. tourists buy goods and pay for