COMMENTS ON U.S. COMMERCE'S PROPOSAL TO MODIFY REGULATIONS IN COUNTERVAILING DUTY PROCEEDINGS

India would like to take this opportunity to comment on the proposed modifications to the United States' ("U.S.") domestic code on Countervailing Duty ("CVD") determination.

The United States Department of Commerce ("Commerce") proposes to impose countervailing duties on imports from countries undervaluing their domestic currency as a result of government action. The draft regulation identifies the criteria that Commerce would use to determine if CVD should be imposed on a subsidy in the form of currency undervaluation.

India is of the view that trade remedy measures are the wrong tool to address distortions in currency exchange rates. India recognizes the importance of addressing currency undervaluation measures that have an impact on trade. However, India believes that the proposed modifications do not achieve the objective of remedying the adverse effects arising out of currency undervaluation. Further, the proposed modifications create ambiguity in CVD proceedings and fail to reflect the realities of exchange rate determination and valuation.

India would like to express its serious reservations on the Commerce's proposal. India is deeply concerned with the inappropriate methodology devised to remedy the effect of a country's currency practices. In its present form, the proposal appears flawed in considering the outcome of a government's actions on exchange rates a "subsidy" under its rules. In this regard, India believes that the proposed modifications are against internationally accepted international economic rules. Any perceived distortion of currency undervaluation cannot be addressed through the tool of CVD actions. In addition, the proposed modifications appear to be inconsistent with the WTO rules. India believes that the proposal of the U.S. Commerce would significantly impact fiscal policies of trading partners and also the international monetary system.

India's concerns with the U.S. Commerce's proposal are elucidated in detail below. These comments are intended to set out India's views on the impact of the proposed modifications of regulations regarding "benefit" and "specificity" in CVD proceedings in the U.S.

Consistency of the Commerce's proposed rules with WTO disciplines

The General Agreement on Tariff and Trade (GATT) and the Agreement on Subsidies and Countervailing Measures ("SCM Agreement") govern the use of countervailing duties against the import of subsidized products under WTO law. India questions the applicability of the disciplines of the SCM Agreement to measures in the nature of currency undervaluation. India finds the Commerce's characterization of currency practices as a "subsidy" erroneous and inconsistent with the disciplines under the SCM Agreement.

a. Financial contribution

The concept of subsidy captures situations in which something of economic value is transferred by the government or a public body which in turn confers a benefit on the recipient.[1] India is of the view that currency undervaluation is not in the nature of a 'financial contribution' as understood under the SCM Agreement.

U.S.' proposal views currency undervaluation under a unified currency regime as a domestic currency premium.[2] The proposal states that "[t]he receipt of domestic currency from an authority (or an entity entrusted or directed by an authority) in exchange for U.S. dollars could constitute the financial contribution under section 771(5)(D) of the Act"[3] (U.S. Tariff Act, 1930 as amended). From this proposal, India finds that Commerce is viewing financial contribution as an effect of currency undervaluation, arising when the US dollar is exchanged for the domestic currency. This understanding is fundamentally flawed as it conflates the concept of financial contribution and benefit.[4]

Further, the measures that a country can be expected to employ in maintaining an undervalued real exchange rate do not constitute a financial contribution as they do not fall into any of the four categories identified in Article 1.1(a)(1)(i)-(iv) of the SCM Agreement. Mere overpayment resulting from an undervaluation cannot be considered a provision of direct transfer of funds by the government.[5]

Furthermore, the U.S. proposal simply assumes that there exists a financial contribution from the government when US dollars are exchanged for domestic currency. It does not clearly identify the specific type of financial contribution enumerated in section 771(5)(D) of the U.S. Tariff Act that results from currency undervaluation measures. The particular form of financial contribution that Commerce identifies with respect to currency undervaluation will be critical in a subsequent analysis of the benefit arising out of that type of contribution. Consequently, this leaves open the question of how the benefit would be determined under the U.S. domestic law.

b. Benefit

b.1 Consistency of proposal on benefit with SCM Agreement:

U.S. Commerce's proposal seeks to insert a special rule for currency undervaluation in 19 CFR §351.503 concerning 'benefit'. It reads:

(b) **

[1] WTO Agreement on Subsidies and Countervailing Measures [hereinafter "SCM Agreement"] Article 1.

[2] U.S. Federal Register, Vol. 84, No. 102 of Tuesday, May 28, 2019 on Proposed Rules [hereinafter "Federal Register"], p. 24408

[3] *Id.* p.24408.

[4] To hold that the concept of financial contribution is about the effects, rather than the nature, of a government action would be effectively to write it out of the Agreement, leaving the concepts of benefit and specificity as the sole determinants of the scope of the Agreement. *See* Panel Report, United States-Measures Treating Export Restraints as Subsidies, WT/DS194/R, para 8.38.

[5] To hold that the concept of financial contribution is about the effects, rather than the nature, of a government action would be effectively to write it out of the Agreement, leaving the concepts of benefit and specificity as the sole determinants of the scope of the Agreement; *See* Panel Report, United States-Measures Treating Export Restraints as Subsidies, WT/DS194/R, para 8.38.

> (3) *Special rules for currency undervaluation*. In determining whether a benefit is conferred when a firm exchanges United States dollars for the domestic currency of a country under a unified exchange rate system, the Secretary normally will consider a benefit to be conferred when the domestic currency of the country is undervalued in relation to the United States dollar. In applying this rule, the Secretary will request that the Secretary of the Treasury provide Treasury's evaluation and conclusion as to whether the currency of a country is undervalued as a result of government action on the exchange rate and the extent of any such undervaluation.[6]

This proposal, in essence, allows the Commerce to equate the effects of currency undervaluation with the benefit arising out of a subsidy. India would like to express its reservations on the consistency of the proposal with the disciplines under the SCM Agreement and the use of an imprecise REER methodology to calculate benefit.

With respect to the benefit analysis, the proposal glosses over the elements identified in the SCM Agreement that are required to be fulfilled. India realises that Commerce is looking to treat the additional domestic currency received as a result of currency undervaluation as the "benefit". However, this treatment of undervaluation does not appear to be consistent with Article 1.1(b) of the SCM Agreement. The proposal fails to address how Commerce will examine the benefit against a comparable market in which such advantage or benefit would not have been enjoyed.[7] Additionally, India has reservation on the methodology proposed to calculate benefits.

b.2 <u>Calculation of Benefit</u>:

In calculating benefit arising out of an undervalued currency, the proposal plans to employ the "real and effective exchange rate" (REER) or "its equivalent, consistent with IMF methodologies."[8] India submits that this methodology is deficient on various accounts.

First, to calculate benefit the Commerce seeks to compare the prevailing Real Effective Exchange Rate (REER) of the exporter country's currency with its "equilibrium" level. Since the assessment of the "equilibrium" level is subjective, the evidence gathered in this regard about the presence of subsidy also becomes subjective. In effect, Commerce's assessment of subsidy is subjective in nature.

The proposal states that:

> "In determining whether there has been government action on the exchange rate that undervalues the currency, we do not intend in the **normal course** to include monetary and related credit policy of an independent central bank or monetary authority."[9]
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> (emphasis added)

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[6] Federal Register, p.24416

[7] *See* Appellate Body Report, *Canada—Measures Affecting the Export of Civilian Aircraft*, W T/DS70/AB/R (adopted Aug. 20, 1999) para. 149; *See also* Appellate Body Report, Canada-Certain Measures Affecting the Renewable Energy Generation Sector, WT/DS412/AB/R, para. 5.188

[8] Federal Register, p.24408

[9] Federal Register, p.24407

India finds that this part of the proposal is ambiguous and brings in a large element of subjectivity and discretion. For one, the contours of the term "government action" have been left vague. Moreover, the use of the phrase "in the normal course", implies that there could be circumstances in which even governments' monetary and related credit policies could be potentially questioned.

Second, the proposal completely disregards the interplay of the multitude of factors, other than trade, which can have an impact on the exchange rate. The proposal further states that:

> "In general terms, the currency undervaluation benefit calculation requires an identification of what the currency's value should be, absent the undervaluation. To do this, one method is to employ the concept of an equilibrium "real effective exchange rate" (REER) or its equivalent, consistent with International Monetary Fund (IMF) methodologies. For the purposes of this rule, equilibrium REER is defined as the REER that would lead to an appropriate level for external balance over the medium term."[10]

IMF reports indicate that persistent changes in terms of trade (which oil producers usually experience, for instance) and differences in fiscal policies, tariffs, and even financial development can also help explain why REERs can differ across countries.[11] The IMF and economic analysts take such real exchange rate fundamentals into account in estimating the "equilibrium" REER, around which the actual REER should hover if there is no misalignment. Estimating equilibrium REERs can be difficult because prices are somewhat sticky in the short run and the nominal exchange rate is not (at least in countries where exchange rates are market determined).

Further, IMF studies also indicate that technological progress leading to productivity increases in goods commonly traded, called tradables, is considered to be one of those factors. Higher productivity lowers production costs, thus lowering prices of such tradable goods in the higher-productivity country, which then translates into lower tradable goods prices elsewhere through international competition. But not all goods are tradables. Non-tradable sectors, such as housing and many personal services, face minimal international price competition. So the prices of tradable goods will tend to fall relative to those of non-tradable goods. To the extent that non-tradable goods have a large weight in the country's consumption basket, the country's consumer price index will rise relative to the international consumer basket; hence, its REER will tend to appreciate. This mechanism is often referred to as the "Balassa-Samuelson effect."[12] Both theory and data support that much of the REER variations across countries are accounted for by fluctuations in the prices of non-tradables relative to those of tradables, and particularly so among developing countries.

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[10] Federal Register, p.24408

[11] Luis A.V. Catão, 'Why Real Exchange Rates?' IMF's Finance and Development Quarterly of September 2007, Vol. 44, Number 3 available at https://www.imf.org/external/pubs/ft/fandd/2007/09/basics.htm [accessed 27 June 2019]

[12] *See* Balassa,B.(1964), 'The Purchasing Power Doctrine : A Reappraisal'; *See also Samuelson, P.A.(1964), ' Theoretical Notes on Trade Problems', Review of Economics and Statistics, 46,145-154.*

However, in the absence of an agreed model, it is not clear how it is proposed to arrive at an equilibrium REER. Further, the phrase "or its equivalent" makes it even more open-ended. This makes the proposal subjective.

It is also not clear how Commerce will differentiate between deviation from the equilibrium REER due to structural reforms and specific export promotion measures. The proposal seems to reduce various policy actions that affect exchange rates, whether fiscal or otherwise, to a binary, of whether it amounts to undervaluation or not. The proposal completely disregards the interplay of the multitude of factors, other than trade, which can have an impact on the exchange rate. Further, in the explanation of the two-step benefit analysis, the phrase "relevant time period" is not defined, which would mean that the investigation could cover any time frame.

In light of the above, India is of the view that U.S. Commerce's understanding of undervaluation as a factor of trade distortion is deficient and the current proposal, based on this understanding, does not advance a suitable recourse to rectify trade distortions arising out of such currency practices.

c. <u>Specificity</u>

The Commerce's proposal seeks to introduce a provision in 19 CFR §351.502 to determine the specificity of subsidies arising out of currency undervaluation. It reads:

> "(c) *Traded goods sector*: In determining whether a subsidy is being provided to a "group" of enterprises or industries within the meaning of section 771(5A)(D) of the Act, the Secretary may consider enterprises that primarily buy or sell goods internationally to comprise such a group."[13]

The U.S.' treatment of currency undervaluation seems to suggest that a government's intervention to undervalue its currency is equivalent to an export subsidy. If it is considered to be an export subsidy, it would be deemed specific. According to India, it is not clear whether undervaluation can be treated as an export subsidy under the SCM Agreement.

An export subsidy is a subsidy that is "contingent on export performance."[14] This contingency may exist in law or in fact, whether solely or as one of several conditions. India draws attention to the standard for demonstrating the contingency of a subsidy according to which the mere fact that the subsidies are granted to enterprises which export shall not for that reason alone be considered to be an export subsidy.[15] Thus, the U.S.' proposal to treat currency undervaluation as specific and contingent on firms that export is incorrect.

India is of the view that any government measure that has the effect of undervaluing domestic currency will be inherently non-specific. The Commerce's proposal appears to create an artificial specificity where the government action is otherwise, by its very nature, non-specific. The ambit of such "group" of enterprises has also been left vague

[13] Federal Register, p.24416
[14] Article 3.1(a) SCM Agreement
[15] *Id.* Footnote 4, SCM Agreement.

and wide. Article 2.1 of the SCM Agreement suggests that enterprises that are "known or particularized" and have some mutual common relationship or purpose would satisfy the requirement of specificity.[16] Considering the entire group of enterprises that primarily buy or sell goods internationally would thus not satisfy the legal standard of being specific to certain enterprises.

The Commerce's proposal considers that currency undervaluation available to a variety of industries and enterprises throughout a particular country's economy is not different from other subsidies that the Commerce already countervails.[17] However, the proposal does not offer any explanation on the similarity between other subsidies and currency undervaluation. India is of the view that currency undervaluation is fundamentally different from a legal understanding of a subsidy in international trade.

Therefore, in India's view, the characterization of currency undervaluation as a "subsidy" is incorrect. While there may exist a benefit accruing as a result of exchanging US dollars with domestic currency, there appears to be no financial contribution being provided by the government. The alleged benefits of the undervaluation are available across the entire economy and is not limited to certain enterprises.

Conclusion

Using trade rules to address a government's currency practice is unprecedented and an uncalled for measure. Treating currency practices as a subsidy is misconceived, and may not be accurate if based on existing estimates of "undervaluation" generated by equilibrium REER. The difficulty in such treatment arises especially since undervaluation may occur due to a number of non-trade related reasons, such as managing foreign currency reserves, fulfilling the balance of payment obligations and maintaining financial stability.

India recognizes the effects of currency undervaluation and understands the need to devise mechanisms to combat such effects; however, India believes that the International Monetary Fund (IMF) is the appropriate forum to deal with exchange rates and currency manipulation. This is clear from the provision of Article XV:2 of GATT 1994 which indicates that it is the IMF and not the WTO, which has the authority over problems concerning monetary reserves, balance of payments and foreign exchange arrangements.

India finds Commerce's understanding of undervaluation contentious in the context of determining trade implications. It does not advance a suitable recourse to rectify trade distortions arising out of such currency practices. India opoposes this proposed change in U.S. policy as it is not an objective way of estimating subsidies and also interferes with the country's sovereign right of stabilizing its currency.

[16] Appellate Body Report, *United States–Definitive Anti-Dumping and Countervailing Duties from China*, WT/DS379/AB/R, para 373; Appellate Body Report, *United States–Countervailing Measures on Certain Hot-Rolled Carbon Steel Flat Products from India*, WT/DS436/AB/R, para 4.365.

[17] Federal Register, p.24413