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Assistant Secretary for
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U.S. Department of Commerce
1401 Constitution Ave. NW, Room 1870
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Public Document

Re: Modification of Regulations Regarding Benefit and Specificity in Countervailing Duty Proceedings

Dear Assistant Secretary Kessler:

On May 28, the Department published a notice soliciting comments on a "Modification of Regulations Regarding Benefit and Specificity in Countervailing Duty Proceedings" in the *Federal Register*.[1] The Proposed Modification appears to be designed to allow the Department to conclude that a subsidy exists when it finds that a foreign country, with a unified exchange rate, has undervalued its currency.

As discussed below, the Proposed Modification is inconsistent with the statute, the Department's own past decisions, and basic economic reality. Furthermore, the Proposed

[1] *See* 84 Fed. Reg. 24406 (May 28, 2019).

Modification is directly contrary to the clearly expressed Congressional intent that issues of alleged "currency manipulation" be addressed by Treasury, and not through Commerce's administration of the countervailing duty laws. In these circumstances, the proposed modification will lead only to unnecessary litigation and the ultimate rejection of the Department's proposed methodology.

1. The Proposed Modification Is Contrary to the Statute and Inconsistent with the Department's Past Decisions

As the Department is aware, a countervailable subsidy exists under the U.S. countervailing duty laws only when the following three criteria are met: (1) there is a "financial contribution" as defined in the statute, (2) that contribution confers a benefit on the recipient, and (3) the subsidy is specific, as a matter of law or of fact, to an enterprise, industry or group of enterprises or industries.[2] None of these criteria are met, however, in the case of an allegedly undervalued exchange rate.

a. An "Undervalued" Exchange Rate Does Not Constitute a Financial Contribution

Under the statute, a "financial contribution" exists only when there is a "direct transfer of funds" from a government or government-entrusted body, foregone revenue by a government or government-entrusted body, provision of goods or services for less than adequate remuneration by a government or government-entrusted body, or a purchase of goods for more than adequate remuneration by a government or government-entrusted

[2] *See* 19 U.S.C. § 1677(5)(B) and (5A).

body.[3] An "undervalued" exchange rate does not, however, satisfy any of the statutory requirements.

Governments may affect foreign-currency markets in various ways — for example, by directly purchasing or selling foreign-currency holdings, by cutting or raising interest rates, by running budget deficits or surpluses, by purchasing dodgy assets in order to avoid disruption in financial markets, or by providing (or failing to provide) legal structures that promote foreign investment. However, once the currency markets establish an equilibrium exchange rate in light of those actions, the actual conversion of currency by banks or other institutions at the market-determined exchange rate is not government action, and it also does not satisfy the statutory requirements for finding "entrustment or direction" of a private entity within the meaning of 19 U.S.C. § 1677(5)(B)(iii).[4] The fact that the Department believes that the market-determined exchange rate would have been different in the absence of government action does not transform the subsequent conversion of the currency at the market-determined rate into government action.

By the same token, the conversion of one currency into another at the market rate is a purchase and sale of items of equivalent value, and not a "direct transfer of funds" within the meaning of the statute.[5] And, even if the Department were to conclude that the

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[3] *See* 19 U.S.C. § 1677(5)(D).

[4] Among other things, the conversion of currencies is typically a function of private entities and is not the type of activity "that would normally be vested in the government."

[5] The Proposed Modification appears to suggest that the fact that an exporter that converts foreign currency into domestic currency receives funds in the domestic currency means that there is a "direct transfer of funds" within the meaning of the statute. Such an interpretation is, however,
(continued)

foreign- and domestic-currency values were not equivalent, the result would be the same. Under the statute, only purchases of *goods* for more than adequate remuneration are considered potential "financial contributions."[6] Currency is not a "good." Consequently, a government's "purchase" of foreign currency for "more than adequate remuneration" in the domestic currency cannot be a "financial contribution" under the statutory definition.

As a separate matter, even when an exchange rate is affected by government action, there is no logical linkage between specific exports and the actual conversion of currency at the government-affected rate. It is, for example, entirely possible for an exporter to undertake transactions in a foreign currency without ever converting the foreign-currency amounts into the exporter's domestic currency. When an exporter makes its export sales, there may be a transfer of funds in a foreign currency from the *foreign purchaser* to the exporter. And, those foreign-currency funds may be assigned "too high" a domestic-currency value in the exporter's internal accounting records due to the "undervalued" exchange rate. But, if the funds remain in a foreign-currency account, there is no transfer of domestic-currency funds to the exporter from a government (or from a government-

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contrary to the statutory scheme. As the Department is aware, the statute classifies sales of goods to the government, but not sales of services to the government, as potential "financial contributions." *See* 19 U.S.C. § 1677(5)(D)(iv). An interpretation that allowed any government payment to a seller to be considered a "direct transfer of funds" would improperly render the statutory provision excluding sales of services to the government from the definition of "financial contribution" meaningless.

[6] *See* 19 U.S.C. § 19 U.S.C. § 1677(5)(D)(iv).

entrusted body) or any other basis for finding a financial contribution under the statutory definition.

Of course, it is possible that an exporter might choose to convert some of its foreign-currency holdings into its domestic currency at the allegedly favorable rate. But, because money is fungible, it may not be possible to identify the foreign-currency holdings with export transactions, especially when the exporter has other sources of foreign-currency earnings. Even if the exporter converts the proceeds from a specific export sale into its domestic currency, there may be no logical linkage between the export and the conversion, since the exporter could theoretically have converted other foreign-currency holdings and left the proceeds of the export sale in the foreign currency.

Finally, even when there is a conversion of currency, the actual conversion itself does not implicate the government action required to find a financial contribution. Instead, any currency conversion would reflect a choice by the exporter as to how to manage its cash holdings, and not any action by the government in setting the exchange rate. To find a financial contribution in such circumstances would unfairly discriminate between entities that used foreign currency for exports, imports, and foreign investments in precisely the same manner, if one happened to leave foreign-currency receipts from exports in a foreign-currency account while the other converted those receipts into the domestic currency and then re-converted them to the foreign currency when needed to pay for imports or foreign investments.

b. An "Undervalued" Exchange Rate Does <u>Not Confer a Benefit on the Recipient</u>

An individual exporter may engage in a variety of transactions in a foreign currency — including exports of finished goods, imports of raw materials and other inputs, purchases of machinery, technology licensing, and foreign investments. As a result, there is no *a priori* basis for concluding that the existence of an "undervalued" exchange rate provides any actual net benefit to an exporter. A producer with both domestic and export sales may easily use more foreign currency in import purchases than it receives in export sales. Furthermore, even if the exporter has only export sales, its total foreign-currency purchases (including purchases of materials, machinery, and technology) may dwarf its foreign-currency sales. In such circumstances, an "undervalued" currency would impose net costs on the foreign exporter — not provide net benefits — because the exporter would use more foreign currency for its purchases than it would receive for its export sales.

This effect is not limited to situations in which the exporter itself purchases inputs in a foreign currency. The same result may occur when the domestic suppliers of the exporter themselves use imported inputs. For example, an exporter may use only domestically-sourced items as its primary material input. But, if its suppliers use imported materials, machinery, and technology to produce those items, an undervalued exchange rate will increase their costs in the domestic currency. To the extent that those increased costs are passed on to their customers, the "undervalued" exchange rate will drive up the costs for downstream producers who use only domestically-supplied inputs in their operations. Furthermore, any increase in the effective domestic-currency price of imports as a result of an "undervalued" exchange rate should, in a competitive market, allow suppliers of equivalent domestically-supplied items to increase the prices for their products, thus further increasing the costs to downstream producers.

As a result, the measurement of the net impact of an "undervalued" currency is necessarily a complex undertaking that requires a comprehensive analysis of the effect of the exchange rate not only on exports of the finished product, but also on the cost of all inputs (imported and domestic) used by the producer and all of its upstream suppliers. This would mean require examining, *inter alia:* purchases of raw materials, machinery, and technology by the producer and by all of its domestic input suppliers; oil, gas, and coal purchases by electricity suppliers; oil purchases by gasoline suppliers (and the impact on transportation costs for inputs and shipments); and so on. And this analysis would have to be extended through the entire supply chain. Furthermore, the competitive impact of the increased prices for imports on the ability of other domestic suppliers to raise their prices would also have to be assessed. In the absence of such an analysis, the existence of a net benefit to an exporter from an "undervalued" exchange rate cannot be presumed.

c. An "Undervalued" Exchange Rate Is Not Specific to an Industry or Group of Industries

A single unified exchange rate that applies to all currency-exchange transactions for a given country would appear, on its face, to be generally available to all entities that hold or want to hold the currency, and thus not "specific" to any particular enterprise, industry, or group of enterprises or industries. To avoid that conclusion, the Proposed Modification suggests that an "undervalued" exchange rate can be deemed "specific" if the exporters in the country under examination are considered a single "group" of enterprises or industries. There are, however, several fundamental problems with that suggestion.[7]

Most importantly, classifying all exporters as a group of enterprises or industries is contrary to the statutory scheme. As the Department has observed,

> Under the statutory scheme, subsidies to exporters are countervailable as export subsidies…. That scheme is set on its head by treating exporters as a "group" for purposes of finding a domestic subsidy under section 771(5A)(D) of the Act.[8]

In short, the Proposed Modification's suggestion that exporters as a whole constitute a "group" for purposes of the countervailing duty statute is contrary to both the statute and to the Department's established practice.

2. <u>The Proposed Modification Is Contrary to Congressional Intent</u>

For more than 35 years, the Department has consistently held that an allegedly undervalued unified exchange rate does not constitute a countervailable subsidy.[9] That

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[7] For example, as discussed above, it is entirely possible for exporters to keep the proceeds of their export transactions in a foreign currency, without ever utilizing the "undervalued" exchange rate. As a result, there is no reason to assume that exporters represent a meaningful "group" for purposes of analyzing the impact of the alleged undervaluation.

[8] *See* Memorandum from Team to R. Lorentzen re Countervailing Duty Investigation: Certain Coated Paper Suitable for High-Quality Print Graphics Using Sheet-Fed Presses from the People's Republic of China New Subsidy Allegation – Currency, Aug. 30, 2010, at 5; Memorandum from Team to R. Lorentzen re Countervailing Duty Investigation: Aluminum Extrusions from the People's Republic of China, Subsidy Allegation – Currency, Aug. 30, 2010, at 5.

[9] *See, e.g.*, *Carbon Steel Wire Rod from Poland; Preliminary Negative Countervailing Duty Determination*, 49 Fed. Reg. 6768, 6771 (Feb. 23, 1984) ("{W}e do not assess countervailing duties against countries which devalue their currency.").

position was most recently reaffirmed by the Department in two separate decisions in 2010 and 2011.[10]

Significantly, Congress has been very much aware of the Department's longstanding practice.[11] It has specifically considered legislation that would have overturned Commerce's practice and required "currency manipulation" to be treated as a countervailable subsidy.[12] In the end, however, Congress decided to assign authority to address exchange rate "manipulation" to the Treasury Department, and not to Commerce.[13] Furthermore, although Congress has reenacted the relevant provisions of the countervailing duty statute, it has not altered the definition of subsidy to overturn Commerce's longstanding practice.[14]

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[10] *See Aluminum Extrusions from the People's Republic of China: Final Affirmative Countervailing Duty Determination*, 76 Fed. Reg. 18521 (Apr. 4, 2011), and accompanying Issues and Decision Memorandum at cmt. 33; *Certain Coated Paper Suitable for High-Quality Print Graphics Using Sheet-Fed Presses from the People's Republic of China: Final Affirmative Countervailing Duty Determination*, 75 Fed. Reg. 59213 (Sept. 27, 2010), and accompanying Issues and Decision Memorandum at cmts. 5-7

[11] For example, during consideration of the proposed Currency for Fair Trade Act, H.R. 2378, 111th Cong. (2010), the House committee report noted: "{I}n two pending countervailing duty investigations the Department of Commerce decided not to investigate allegations that the undervaluation of the currency of the People's Republic of China (the renminbi, or 'RMB') confers a countervailing subsidy." H.R. Rep. No. 111-646, at 7 (2010).

[12] *See* 161 Cong. Rec. 6570-71 (2015) (text of Senate Amendment 1224).

[13] *See* Title VII Trade Facilitation and Trade Enforcement Act of 2015, Pub. L. No. 114-125, Title VII (2016). *See also* H.R. Rep. No. 114-376, at 75-79 (2015) (conference committee report); 161 Cong. Rec. H9296-97 (daily ed. Dec. 11, 2015) (adoption of conference committee recommendations).

[14] *See, e.g.*, Trade Preferences Extension Act of 2015, Pub. L. No. 114-27, 129 Stat. 362, 383-87 (2015); Trade Facilitation and Trade Enforcement Act of 2015, Pub. L. No. 114-125, 130 Stat. 122, 156-61 (2016).

This Congressional acquiescence in the Department's longstanding practice precludes Commerce from unilaterally altering its approach. As the Supreme Court has observed, "Congress is presumed to be aware of an administrative or judicial interpretation of a statute and to adopt that interpretation when it re-enacts a statute without change."[15] And, in the words of the Federal Circuit, "Once Congress has ratified a statutory interpretation through reenactment, agencies no longer have discretion to change this interpretation."[16] Consequently, "if Commerce believes that the law should be changed, the appropriate approach is to seek legislative change."[17]

Please do not hesitate to contact us if you have any questions.

Respectfully submitted,

/s/ Jeffrey M. Winton

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Amrietha Nellan
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[15] *See Lorillard v. Pons*, 434 U.S. 575, 580 (1978). *See also, e.g.*, *Forest Grove Sch. Dist. v. T.A.*, 129 S. Ct. 2484, 2491-92 (2009); *Faragher v. City of Boca Raton*, 524 U.S. 775, 792 (1998).

[16] *See GPX Int'l Tire Corp. v. United States*, 666 F.3d 732, 740 (Fed. Cir. 2011)

[17] *Id.* at 745.