Submitted Electronically to Attention of:

Department of Commerce
Attn: Jeffrey I. Kessler
Assistant Secretary for Enforcement and Compliance
Rm 1870, Department of Commerce
1401 Constitution Avenue, NW
Washington DC 20230

Submission of the Government of Brazil on Modification of Regulations Regarding Benefit and Specificity in Countervailing Duty Proceedings.

The Government of Brazil presents its compliments to the Government of the US and thanks for the opportunity to present its comments regarding the proposed rule on the modification of regulations regarding countervailing duty proceedings, in order to include currency undervaluation within the scope of actionable subsidies.

Brazil believes that currency undervaluation should not be considered a form of actionable subsidy, under the WTO Agreement on Subsidies and Countervailing Measures (SCM Agreement). It is difficult to define currency undervaluation as a financial contribution, in the first place. It would be even more difficult to argue that it confers a benefit. In any case, it does not fulfill the requirements of the SCM agreement regarding the concept of specificity.

1. **Currency undervaluation as a financial contribution**

When it comes to the characterization of financial contribution, Brazil has reservations about the approach suggested by the Department of Commerce in the 'Proposed Modifications' section of the document published in the Federal Register :

> There are a variety of possible currency-related fact patterns that might satisfy the legal criteria for countervailability, and it is not Commerce's intention to identify or address them all here. That said, one analytical approach is to view currency undervaluation under a unified currency regime as a domestic currency premium. For instance, this occurs when exporting enterprises exchange U.S. dollars for their domestic currency at a state bank or other entity that Commerce determines on the record of the proceeding to be an authority (or a private entity entrusted or directed by an authority) and, in doing so, receive more domestic currency in exchange for each U.S. dollar converted than they would otherwise earn in the absence of the currency undervaluation. **The 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**.

Apparently the Department of Commerce considers that the main hurdles posed by the current legislation in order to determine the existence of a benefit resulting from a subsidy in the form of currency undervaluation come from the characterization of specificity and the calculation of the amount of benefit. As a result, it has not explored in detail the reasoning behind the interpretation of a currency exchange operation as a direct transfer of funds as established under section 771(5)(D) of the Act.

Brazil believes that the Department of Commerce may have overlooked the difficulty to frame such operations under the definition of financial contribution pointed in the subparagraphs of Article 1.1(a)(1).

Article 1.1(a)(1) sets forth a list of the types of transactions that constitute financial contributions under the SCM Agreement. Such a list is exhaustive, as observed in the Appelate Body report US – Large Civil Aircraft (2nd complaint) :

> "613. … Article 1.1(a)(1) defines and identifies the government conduct that constitutes a financial contribution for purposes of the *SCM Agreement*. **Subparagraphs (i)-(iv) exhaust the types of government conduct deemed to constitute a financial contribution. This is because the introductory chapeau to the subparagraphs states that 'there is a financial contribution by a government …, i.e. *where*:'. Some of the categories of conduct—for instance those specified in subparagraphs (i) and (ii)—are described in general terms with illustrative examples that provide an indication of the common features that characterize the conduct referred to more generally.** Article 1.1(a)(1), however, does not explicitly spell out the intended relationship between the constituent subparagraphs. Finally, the subparagraphs focus primarily on the action taken by the government or a public body."
>
> 614. Subparagraph (i) of Article 1.1(a)(1) identifies, as one type of financial contribution, a government practice involving "a direct transfer of funds". It indicates action involving the conveyance of funds from the government to the recipient. The Appellate Body has endorsed a meaning of "funds" that includes not only money, but also financial resources and other financial claims more generally. The direct transfer of funds in subparagraph (i) therefore captures conduct on the part of the government by which money, financial resources, and/or financial claims are made available to a recipient.
>
> 615. Article 1.1(a)(1)(i) lists in brackets examples of direct transfers of funds ("e.g. grants, loans, and equity infusion"). As the Appellate Body has confirmed, the fact that the words "grants, loans, and equity infusion" are preceded by the abbreviation "e.g.", indicates that they are cited as examples of transactions falling within the scope of Article 1.1(a)(1)(i). **These examples, which are illustrative, do not exhaust the class of conduct captured by subparagraph (i). The inclusion of specific examples nevertheless provides an indication of the types of transactions intended to be covered by the more general reference to "direct transfer of funds".Indeed, in Japan – DRAMs (Korea), the Appellate Body found that transactions that are similar to those expressly listed in subparagraph (i)—in that case, debt forgiveness, the extension of a loan maturity, and debt-to-equity swaps—are also covered by that provision**.

Furthermore, the negotiating history of Article 1 demonstrates that not all government measures that confer benefits would be considered subsidies, as observed by the Panel in US – Export Restraints:

> "8.38. … [B]y introducing the notion of financial contribution, **the drafters foreclosed the possibility of the treatment of any government action that resulted in a benefit as a subsidy. Indeed, this is arguably the principal significance of the concept of financial contribution**, which can be characterised as one of the "gateways" to the SCM Agreement, along with the concepts of benefit and specificity. **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**.
>
> 8.65. The negotiating history of Article 1 confirms our interpretation of the term 'financial contribution'. This negotiating history demonstrates, in the first place, that **the requirement of a financial contribution from the outset was intended by its proponents precisely to ensure that not all government measures that conferred benefits could be deemed to be subsidies**. This point was extensively discussed during the negotiations, with many participants consistently maintaining that only government actions constituting financial contributions should be subject to the multilateral rules on subsidies and countervailing measures.
>
> 8.73. … **[T]he negotiating history confirms that the introduction of the two-part definition of subsidy, consisting of 'financial contribution' and 'benefit', was intended specifically to prevent the countervailing of benefits from any sort of (formal, enforceable) government measures, by restricting to a finite list the kinds of government measures that would, if they conferred benefits, constitute subsidies. The negotiating history confirms that items (i)-(iii) of that list limit these kinds of measures to the transfer of economic resources from a government to a private entity**. Under subparagraphs (i)-(iii), the government acting on its own behalf is effecting that transfer by directly providing something of value – either money, goods, or services – to a private entity. Subparagraph (iv) ensures that the same kinds of government transfers of economic resources, when undertaken through explicit delegation of those functions to a private entity, do not thereby escape disciplines."

Brazil also understands that WTO jurisprudence has narrowed down the interpretation of Article 1.1(a)(2). In US – GOES, the Panel pointed out that measures only having side-effects on prices, such as export restraints, did not constitute price support:

> "7.85. … Reading the term "price support" in this context, it is our view that it does not include all government intervention that may have an effect on prices, such as tariffs and quantitative restrictions. In particular, **it is not clear that Article 1.1(a)(2) was intended to capture all manner of government measures that do not otherwise constitute a financial contribution, but may have an indirect effect on a market, including on prices. The concept of "price support" also acts as a gateway to the SCM Agreement, and it is our view that its focus is on the nature of government action, rather than upon the effects of such action**. Consequently, the concept of " price support" has a more narrow meaning than suggested by the applicants, and includes direct government intervention in the market with the design to fix the price of a good at a particular level, for example, through purchase of surplus production when price is set above equilibrium. "

Therefore, a currency undervaluation scheme could hardly fall within the scope of Article 1.1(a)(2) so as to constitute a form of income or price support in the sense of Article XVI

of GATT 1994, considering that an undervalued currency would only have an indirect effect (a side effect) on the prices received by the exporters.

The narrow interpretation of financial contribution and price support adopted by the abovementioned jurisprudence intended to avoid the effects-based approach to the concept of a subsidy, as noted in US – GOES. However, the US proposal seems to tend towards the reintroduction of such an approach by focusing the analysis on the concepts of benefit and specificity.

In the light of negotiating history and of WTO jurisprudence, Brazil understands that the nature of the government measures matter in order to qualify any government action as a financial contribution. In this sense, it is important to notice that currency undervaluation schemes mentioned in the Department of Commerce proposal are very different from the illustrative examples mentioned in Article 1.1(a)(1)(i) because of their systemic nature. Even if currency undervaluation is proven to exist in a given case and its benefit could be measured in accordance with Article 14 of the SCM Agreement, it seems that the general nature of such actions would constitute a legal barrier in order to qualify such a scheme as subsidy in accordance with WTO provisions.

2. Currency undervaluation and the concept of benefit

Even if it could be proven that undervaluing a currency is a form of financial contribution in accordance with Article 1.1(a)(1) of the SCM Agreement, calculating the benefit it would supposedly confer to enterprises is a matter subject to strong controversy.

Brazil is concerned with the validity of the method of calculation of the supposed benefit on which eventual countervailing duties would be based. There is no consensus in the international community, including in the context of the IMF, on how to measure the level of undervaluation of a given currency.

To impose countervaling measures on the basis of a nebulously calculated amount of benefit risks burdening countries subject to the measure in excess of the real amount of the subsidy, which would be contrary to Article VI.3 of GATT/94.

3. Currency undervaluation and specificity

The US proposal claims that currency undervaluation may be a form of specific subsidy, because it may confer benefits for exporting or importing companies.

Brazil does not consider that industries that are engaged in foreign trade should be deemed a specific sector of the economy. In our view, engaging in foreign trade activities is an objective that virtually all firms from all sectors may pursue in an open and market-driven economy.

In this vein, exporting or importing companies cannot fit in Article 2 of the SCM Agreement's concept of "certain enterprises". Brazil understands from this Article that the concept of certain enterprises relates to the production of specific types of goods. Let us assume that the currency of a diversified economy is undervalued. Companies that export agricultural goods will exchange money under the same exchange rates used by companies that export manufactured goods, which will also occur with companies that sell high-tech goods abroad. It is not reasonable to consider that these different firms could be regarded as a specific sector of the economy. Furthermore, it is worth remembering that Article 2.1(c) of the SCM Agreement establishes that, when determining the "de facto" specificity of a subsidy, "account shall be taken of the extent of the diversification of economic activities within the jurisdiction of the granting authority (…)".

The US claims that the fact that exporting or importing companies may benefit more from currency undervaluation than other economic players could evidence that high exchange rates are a form of specific subsidies. Exchange rates, however, are horizontal factors in an economy, used as price references by all players.

Even if an analysis of a given economy leads to the conclusion that companies that trade internationally benefit more from exchanging currency at high exchange rate levels than other actors, it is not proof of specificity. The SCM Agreement provides that for a subsidy to be portrayed as *de facto* specific, the use of the program must be analyzed, not the benefits arising from it. Regardless of which sectors could allegedly benefit from currency undervaluation, the use of exchange rates is horizontal, hence, not specific.

Furthermore, the very assumption that exchanging money at undervalued currency levels confers benefits specifically to importing or exporting companies seems questionable. Exchange rates influence a plethora of other macroeconomic elements that may benefit or not a series of players, in a number of different ways.

Brazil believes, therefore, that considering currency undervaluation to be a specific subsidy is not in line with the definition of specificity provided for in the SCM Agreement.