

Legal Update

US Proposes New Rule to Address “Currency Undervaluation” as Potential Subsidy

On May 23, 2019, the US Department of Commerce (“Commerce”) announced a proposal to investigate “currency undervaluation” as an actionable government subsidy. This represents a significant reversal of its prior position. In a *Federal Register* notice published on May 28, 2019, Commerce proposes to modify two of its countervailing duty (“CVD”) (aka anti-subsidy) regulations to clarify:

1. How Commerce would determine the existence of a benefit resulting from a subsidy in the form of currency undervaluation; and
2. That companies engaging in international trade can constitute a group of enterprises for purposes of determining whether a subsidy is “specific.”¹

In the Notice, Commerce also seeks comments from the public on a variety of subjects, including (1) the proposed modifications, (2) whether there are other options under existing law to examine potential currency-related subsidies and (3) the expected economic impact of the proposed modifications if they were to become final. All written comments from the public must be received no later than June 27, 2019, to be considered by Commerce.² If

adopted, these modifications would likely lead to increased CVD tariffs (or “margins”) imposed on goods imported from certain countries.

Background

Under US law (and applicable rules of the World Trade Organization (“WTO”)), in order for a subsidy to be “countervailable” (i.e., lead to the imposition of remedial tariffs), it must satisfy three legal requirements: (1) constitute a financial contribution by a public authority, (2) provide a benefit and (3) be specific within the meaning of the US CVD statute.³ Since 2006, Commerce has refused to initiate an investigation on “currency undervaluation” allegations in several CVD proceedings involving Chinese imports.⁴ In those cases, Commerce took the position that the petitioners failed to properly allege, and support with reasonably available evidence, that Chinese government practices with respect to currency valuation satisfy the “specificity” requirement. In those prior cases, Commerce found that China maintains a unified exchange rate regime that applies to *all* enterprises and individuals in the economy and that there was insufficient evidence that benefits from allegedly undervalued RMB are

specific to either exporters or certain select industries or companies.⁵ Moreover, regarding the “benefit” requirement, Commerce’s settled practice has been to compare the subsidy recipient’s current situation with that which would have prevailed without the government assistance. Thus, in the case of “currency undervaluation,” the benefit calculation would “require[] an identification of what the currency’s value should be, absent the alleged undervaluation.”⁶ To determine a foreign currency’s normal, market-based value would no doubt be a highly complex and contentious process. As detailed below, the Notice sets forth Commerce’s proposed solution to some of these salient issues that deterred investigations in the past.

Proposed Legal Framework to Analyze “Currency Undervaluation” Allegations

To address the key obstacles to investigating “currency undervaluation” allegations as actionable subsidies, Commerce now proposes to modify its CVD regulations in two respects:

1. The first proposed amendment would clarify that enterprises that primarily buy or sell goods internationally can constitute a group of enterprises for purposes of determining specificity; and
2. The second proposed amendment would explain how Commerce intends to determine the benefit issue when investigating or reviewing a potential subsidy in the form of currency undervaluation under a unified exchange rate system.⁷

With the proposed modifications, Commerce also lays out the following legal framework under which it may find that undervalued currency provides a countervailable subsidy even under a unified foreign exchange regime:

1. **Financial Contribution** – Commerce proposes to take the position that the receipt of domestic currency from a governmental authority (or an entity entrusted or directed by an authority) in exchange for US dollars could constitute the financial contribution under section 771(5)(D) of the Tariff Act of 1930, as amended;
2. **Benefit** – Commerce proposes an *interagency* process to address the “benefit” requirement of a countervailable subsidy as follows:
 - a) **Prima facie evidence for petition** – Where possible, petitioners making “currency undervaluation” allegations are expected to submit objective, third-party, publicly available estimates of the nominal US dollar rate consistent with the “real effective exchange rate” (“REER”) needed to achieve external balance (i.e., the equilibrium REER). To the extent that a country’s equilibrium REER exceeds its REER in the relevant time period, a benefit may exist;
 - b) **Post-initiation**
 1. The US Department of the Treasury (“Treasury”) would timely provide Commerce with an evaluation and conclusion as to *whether and to what extent the government action* on the exchange rate has resulted in undervaluation of the currency and, if Treasury deems appropriate, an evaluation of the benefit arising from such undervaluation;
 2. Treasury would use a consistent framework to assess currency undervaluation resulting from government action on the exchange rate, recognizing country-specific factors; and
 3. Commerce would place Treasury’s evaluation on the record of the particular CVD proceeding and

defer to Treasury's evaluation as to undervaluation in making Commerce's determination as to countervailability, unless Commerce has good reason to disagree with that evaluation, based on the record as a whole, in which case Commerce will provide Treasury an opportunity to review and rebut the contrary reasoning; and

- c) **Benefit calculation** – The amount of benefit related to “currency undervaluation” may be calculated (a) as the difference between the amount of local currency that an enterprise actually received for converted US dollars and the amount that it would have received based on the nominal dollar exchange rate determined by Commerce through the above-mentioned process (i.e., the amount of extra local currency received when converting US dollars due to the undervaluation) and (b) using any other ways considered appropriate in the particular CVD proceeding; and
- 3. **Specificity** – Commerce proposes to employ a two-step process to decide whether benefits from the undervalued currency may be found specific to enterprises that primarily buy or sell goods internationally:
 - a) **Step 1** – *Determine the total amount of US dollars converted into the subject country's local currency:* The market supply of foreign currency (i.e., the amount of foreign currency supplied by broad categories of entities or activities in the subject country) could provide a reasonable proxy for the amount of US dollars converted into the undervalued domestic currency of the country under investigation; and
 - b) **Step 2** – *Determine the portion of this total amount that is composed of*

foreign exchange supplied by enterprises that primarily buy or sell goods internationally. This step may start with gross foreign currency supplied by exporters and then deduct the foreign exchange needed by these exporters to purchase any imported inputs used in the production of exported goods, which would result in a figure for net foreign exchange supplied by the enterprises in the exporting and importing sector of that country. If enterprises in a country that primarily buy or sell goods internationally collectively constitute a *predominant user* or account for a *disproportionate share* of net foreign exchange supply, Commerce could find a currency undervaluation subsidy to be specific to that group of enterprises.⁸

Advice for Interested Parties

The new rule proposed by Commerce regarding “currency undervaluation,” if adopted, would have wide-ranging effects on future CVD proceedings. As the *Federal Register* notice states, “[i]n FY 2018, countervailing duties were deposited on various products imported from 19 countries. For 12 of these 19 countries, at least one of the two sources (IMF or Peterson Institute for International Economics) deemed the domestic currency undervalued during 2017.”⁹ In addition, Commerce has generally indicated a broad interest in considering public comments on any related issues, suggesting possible revisions before it finalizes the new approach. Commerce’s broad interest is necessitated by the contentious nature of the “specificity” issue that derailed investigations in prior cases, other complex legal issues such as what type of government action may be properly considered a market-distorting subsidy practice (as opposed to a legitimate

regulatory act), and the inherently difficult task of attempting to quantify the extent of undervaluation of a currency. Parties potentially affected by the proposed modifications should consider seeking timely advice from legal counsel and preparing comments for submission by the June 27 deadline.

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Endnotes

- ¹ Modification of Regulations Regarding Benefit and Specificity in Countervailing Duty Proceedings, 84 Fed. Reg. 24,406 (Mar. 28, 2019) (the “Notice”).
- ² *Id.*
- ³ 19 U.S. Code § 1677(5) & (5A).
- ⁴ See, e.g., *Coated Free Sheet Paper From China, Indonesia, and Korea*, 71 Fed. Reg. 68,546 (Initiation Notice); *Utility Scale Wind Towers From China (C-570-982)*, Initiation Checklist (Jan. 18, 2012).
- ⁵ *Id.*
- ⁶ *The Notice* at 24,408.
- ⁷ *Id.* at 24,407–24,408. The proposed rule would provide that in cases involving a unified exchange rate system, Commerce 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 making this determination, Commerce will request the US Department of the Treasury to provide its evaluation and conclusion as to (1) whether the currency of a country is undervalued as a result of government action on the exchange rate and (2) the extent of any such undervaluation.
- ⁸ See, generally, *the Notice*.
- ⁹ *The Notice* at n. 13.

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