

June 2005

U.S.-CHINA TRADE

Commerce Faces Practical and Legal Challenges in Applying Countervailing Duties



G A O

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Highlights of [GAO-05-474](#), a report to congressional committees

Why GAO Did This Study

Some U.S. companies allege that unfair subsidies are a factor in Chinese success in U.S. markets. U.S. producers injured by subsidized imports may normally seek countervailing duties (CVD) to offset subsidies, but the United States does not apply CVDs against countries, including China, that the Department of Commerce classifies as “nonmarket economies” (NME). In this report, GAO (1) explains why the United States does not apply CVDs to China, (2) describes alternatives for changing this policy, (3) explores challenges that would arise in applying CVDs, and (4) examines the implications for duty rates on Chinese products.

What GAO Recommends

GAO recommends that Commerce clarify its ability to measure Chinese subsidies and the methodologies it might use in doing so. If (1) Commerce changes China’s NME status or (2) Congress decides to authorize application of CVDs to China as an NME, Congress may wish to authorize Commerce to (1) implement China’s WTO commitment on third-country information in CVD cases and (2) make corrections to avoid double counting.

Agency officials thought some of GAO’s suggested actions unnecessary. GAO maintains they are prudent in light of Commerce’s lack of explicit authority in this area and to prepare for potential CVD cases.

www.gao.gov/cgi-bin/getrpt?GAO-05-474.

To view the full product, including the scope and methodology, click on the link above. For more information, contact Loren Yager at (202) 512-4347 or yagerl@gao.gov.

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What GAO Found

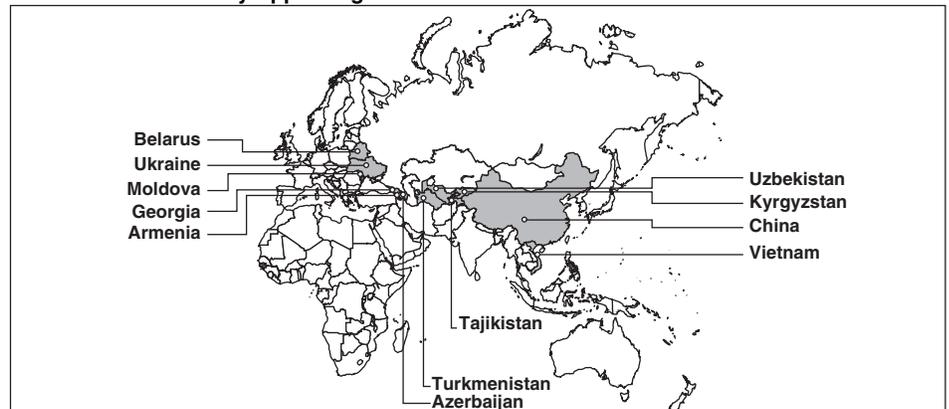
The current Commerce policy of not applying CVDs to NME countries (including China) rests on two principles advanced in 1984 and confirmed by a federal appeals court. These are that Commerce (1) lacks explicit authority to do so, and (2) cannot arrive at meaningful conclusions regarding subsidies in such countries due to government intervention in the economy.

Commerce could reclassify China as a market economy or individual Chinese industries as “market oriented” and apply CVDs against China as a market economy. Commerce has criteria for such determinations, but said that China is unlikely to satisfy them in the near term. It could also reverse its 1984 position and apply CVDs without any change in China’s NME status. However, absent a congressional grant of authority, such a decision could be challenged in court, with uncertain results. World Trade Organization (WTO) rules do not explicitly preclude either alternative.

Commerce would face challenges, regardless of the alternative adopted. Chinese subsidies remain difficult to identify and measure. Employing third-country information or “facts available” may help, but would not eliminate these difficulties. Commerce lacks clear authority to fully implement China’s WTO commitment on use of third-country information in CVD cases.

It is unclear whether, on a net basis, applying CVDs would provide greater protection than U.S. producers already obtain from antidumping duties. CVDs alone tend to be lower than antidumping duties. If Commerce grants China market economy status, both CVDs and antidumping duties could be applied simultaneously, but required methodological changes could well reduce antidumping duties. It is not clear whether CVDs would compensate for these reductions. Regardless of China’s status, some duties might need to be reduced to avoid double counting of subsidies. Commerce lacks clear authority to make such corrections when domestic subsidies are involved.

CVDs Are Not Currently Applied against NME Countries



Sources: Department of Commerce and MapArt.

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Abbreviations

CVD	countervailing duty
ITC	International Trade Commission
NME	nonmarket economy
USTR	Office of the United States Trade Representative
WTO	World Trade Organization

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United States Government Accountability Office
Washington, D.C. 20548

June 17, 2005

The Honorable Richard C. Shelby
Chairman
The Honorable Barbara A. Mikulski
Ranking Minority Member
Subcommittee on Commerce, Justice, and Science
Committee on Appropriations
United States Senate

The Honorable Frank R. Wolf
Chairman
The Honorable Alan B. Mollohan
Ranking Minority Member
Subcommittee on Science, the Departments of State,
Justice, and Commerce, and Related Agencies
Committee on Appropriations
House of Representatives

Imports from China have grown rapidly over the last decade, from a total value of about \$42 billion in 1995 to over \$196 billion in 2004.¹ While the prices of these Chinese goods are often lower than U.S. prices and therefore benefit consumers, this growth has presented a major challenge for U.S. producers that compete with Chinese products in the U.S. market.

Some U.S. companies adversely affected by this growth have alleged that unfair Chinese government subsidies have been an important factor in Chinese companies' success in the U.S. market. U.S. officials have expressed concern about Chinese subsidies in bilateral and multilateral meetings. However, while U.S. producers injured by subsidized imports may normally seek imposition of countervailing duties (CVD) to offset the competitive advantages that these subsidies confer, U.S. CVD laws are not currently applied against countries—including China—that the United States classifies as “nonmarket economy” (NME) countries. Various parties, including U.S. industry representatives, some trade attorneys, and the U.S.-China Economic and Security Review Commission, have advocated taking steps to make CVDs available against Chinese products. Congress is currently considering legislation that would explicitly

¹Both values are expressed in constant 2004 dollars.

authorize CVD actions against NME countries.² Nonetheless, the implications of such steps have not been fully explored.

In light of increased concern about China's trade practices, the conference report on fiscal year 2004 appropriations legislation requested that GAO monitor the efforts of U.S. government agencies responsible for ensuring free and fair trade with that country.³ In subsequent discussions with staff from the House Appropriations Committee's Subcommittee on Science, the Departments of State, Justice, and Commerce, and Related Agencies, we agreed to provide a number of reports on relief mechanisms available to U.S. producers that are adversely affected by unfair or surging imports, and on the manner in which the mechanisms have been applied to China.⁴ In this report, we

- explain why the United States does not currently apply CVDs to imports from China,
- describe alternative courses of action available to the Department of Commerce that would lead to application of CVDs to Chinese-origin imports,
- explore the challenges that Commerce would face in applying these alternatives, and
- examine the potential impact that applying these alternatives would have on the rates of duty applied to Chinese products.

To address our objectives, we reviewed applicable U.S. laws and regulations and World Trade Organization (WTO) agreements, including relevant portions of the agreement through which China acceded to WTO membership in 2001. We conducted a literature search and reviewed relevant scholarly and legal analyses, Department of Commerce determinations, and decisions by U.S. courts and the WTO Dispute

²See, for example, H.R. 1216, S. 593. Similar bills were introduced in both houses of Congress in 2004, but did not gain approval. See H.R. 3716, S. 2212.

³H.R. Rep. No. 108-401, at 574 (2003), accompanying the Consolidated Appropriations Act, 2004, Pub. L. No. 108-199, 118 Stat. 3, 65.

⁴We have already published a report on textile safeguards. See GAO, *U.S.-China Trade: Textile Safeguard Procedures Should be Improved*, [GAO-05-296](#) (Washington D.C.: Apr. 4, 2005). Forthcoming reports will focus on other safeguard measures and antidumping duties.

Settlement Body. We consulted with trade and legal policy experts from the U.S. government, private sector trade associations, consulting and law firms, and academic institutions, as well as representatives of the WTO, the government of China, and other governments. Finally, we assembled and analyzed statistical information on numbers of CVD orders applied by the United States over the last decade and duty rates applied in these cases. For comparison, we assembled equivalent information for antidumping duties applied on similar products over the same period. We conducted our work from January 2004 through April 2005 in accordance with generally accepted government auditing standards. Appendix I contains a more detailed description of our scope and methodology.

Results in Brief

U.S. producers that believe themselves injured by subsidized Chinese imports have not been able to obtain relief through CVD actions because China is considered a nonmarket economy country (NME) under U.S. law and practice. In two 1984 cases, the Department of Commerce declined to make CVD determinations for NME countries on the grounds that it lacked explicit legal authority to impose CVDs on NME countries and that, as a practical matter, it could not arrive at economically meaningful conclusions regarding subsidies in such countries—and therefore could not rationally apply the CVD laws. Commerce based the latter finding on its conclusion that, in such countries, government intervention in the economy is so pervasive that meaningful comparisons between subsidized and market-determined prices are not possible. A federal appeals court subsequently upheld Commerce’s determinations.

Commerce could take either of two paths to applying U.S. CVD laws to China. First, Commerce could, when appropriate, make administrative determinations that reclassify China as a market economy or individual Chinese industries as “market oriented” in character. This would permit Commerce to take CVD action against China on a country or industry basis. Commerce has criteria in place for making both types of determinations. However, Commerce officials stated that it may be difficult for China to meet these criteria in the near term. Second, Commerce could reverse its 1984 position and process CVD actions against China without changing that country’s NME status. However, absent a clear congressional grant of authority, such a decision by Commerce could be challenged in court, with uncertain results. WTO rules, including China’s WTO accession agreement, do not explicitly preclude either of these alternatives. Moreover, the agreement contains provisions that permit application of third-country

information in CVD actions against China and that may facilitate such actions against state-owned enterprises.

Commerce would face substantial challenges in determining appropriate CVD levels against Chinese products. Chinese subsidies remain difficult to identify and quantify—largely because of the structure of the Chinese economy and a lack of transparency in the country’s subsidy regime. Commerce has no directly relevant experience and little guidance in place to indicate how it would proceed. It may be able to overcome these difficulties—at least partially—by using third-country information to create benchmarks for measuring subsidy benefits or by employing “facts available” to complete cases in which foreign parties cannot or will not provide needed information. However, these approaches would not fully resolve the methodological challenges that would face Commerce. Moreover, under current U.S. law, Commerce lacks explicit authority to fully implement China’s commitment regarding use of third-country information in CVD cases.

Making CVDs available against China would give U.S. producers access to import relief measures that explicitly target unfair government subsidies. However, it is unclear whether applying CVDs would result in levels of protection for U.S. producers that are higher than those already applied in the form of antidumping duties. While the magnitude of any CVDs that might be applied to China has yet to be determined, CVDs alone tend to be lower than antidumping duties. Both types of duties could be applied simultaneously. However, for two reasons, simultaneous application could well result in reduced antidumping duties on Chinese products, and it is unclear whether application of CVDs would compensate for these reductions. First, designating China as a market economy would require Commerce to abandon its NME methodology for calculating antidumping duties on Chinese products. If made, such a change is widely expected to lead to lower antidumping duty rates. Second, regardless of whether China is designated a market economy, simultaneous application of CVDs and antidumping duties could, at least in some cases, require corrections to avoid “double counting”—that is, imposing two sets of duties to compensate for the same unfair trade practice. Commerce is required to reduce duties to avoid double counting when export subsidies are involved. However, the full implications of double counting are unclear because Commerce does not have clear legal authority to make adjustments for domestic subsidies.

In order to provide Congress and the Department of Commerce with better information, we recommend that the Secretary of Commerce analyze and report to Congress on

- Commerce's ability to identify and measure subsidy benefits at the present time, based on Commerce's knowledge of significant Chinese subsidy programs; and
- broadly applicable methodologies that Commerce might employ to complete CVD actions against Chinese products, if called upon, including how it might respond to potential double counting of domestic subsidy benefits.

In the event that Commerce changes China's NME status or Congress decides to adopt proposed legislation that would explicitly authorize Commerce to apply U.S. CVD laws to NME countries, including China, Congress may wish to consider adopting legislation to provide Commerce clear authority to (1) implement China's WTO commitment regarding use of third-country information in such cases, and (2) make corrections to avoid double counting domestic subsidy benefits when applying both CVDs and antidumping duties to the same products from NME countries, taking into account Commerce's analyses on this topic.

The Department of Commerce provided written comments on a draft of this report, which are reprinted in appendix III. Commerce disagreed with one of our recommendations, believing that reporting on methodologies that it would employ to complete CVD actions against China would be speculative and might prejudice the results of future cases. Regarding our matters for congressional consideration, Commerce cited some authority to apply third-country information and asserted that double counting of domestic subsidies may not occur and may be difficult to correct. In response, we clarified and elaborated upon our discussion of the legal issues involved. While agreeing that Commerce should not attempt to specify how it would proceed in specific sets of circumstances, we continue to believe that it would be instructive for Commerce to report broadly on how it might apply CVD law to China. We also maintain that it would be prudent for Congress to enact legislation that would fully authorize Commerce to implement China's WTO commitment on using third-country information in CVD cases and correct for any double counting of domestic subsidies that may occur in the event that CVD law is applied to China as an NME country.

The Department of Commerce also provided technical comments on a draft of this report, as did the Office of the United States Trade Representative (USTR) and the International Trade Commission (ITC). We took these comments into consideration and made revisions throughout the report as appropriate to make it more accurate and clear.

Background

The WTO Agreement on Subsidies and Countervailing Measures establishes general international rules regarding the types of subsidies that exporting countries may and may not maintain and procedures that importing countries may employ to counter injurious subsidy practices. U.S. trade law generally reflects the agreement's provisions. The United States applies CVDs with some regularity—almost always in tandem with the other major mechanism for providing relief from unfairly traded imports: antidumping duties. However, CVDs are requested and applied much less frequently than antidumping duties. Appendix II provides additional background information on WTO subsidy rules and relevant U.S. laws, explains antidumping actions in more detail, and provides more detail about how frequently CVD and antidumping actions are sought and duties actually imposed.

Legal and Practical Obstacles Have Prevented Application of CVDs to China

The U.S. government does not apply its CVD laws against China because the Department of Commerce classifies China as an NME country and has adopted a policy against taking CVD actions against countries so designated. This policy rests upon two principles, first advanced in two 1984 Department of Commerce decisions and subsequently upheld by the U.S. Court of Appeals for the Federal Circuit. These principles are (1) from a legal standpoint, Commerce does not have explicit authority to apply CVDs against NME countries; and (2) as a practical matter, Commerce cannot arrive at economically meaningful conclusions regarding subsidies in such countries.

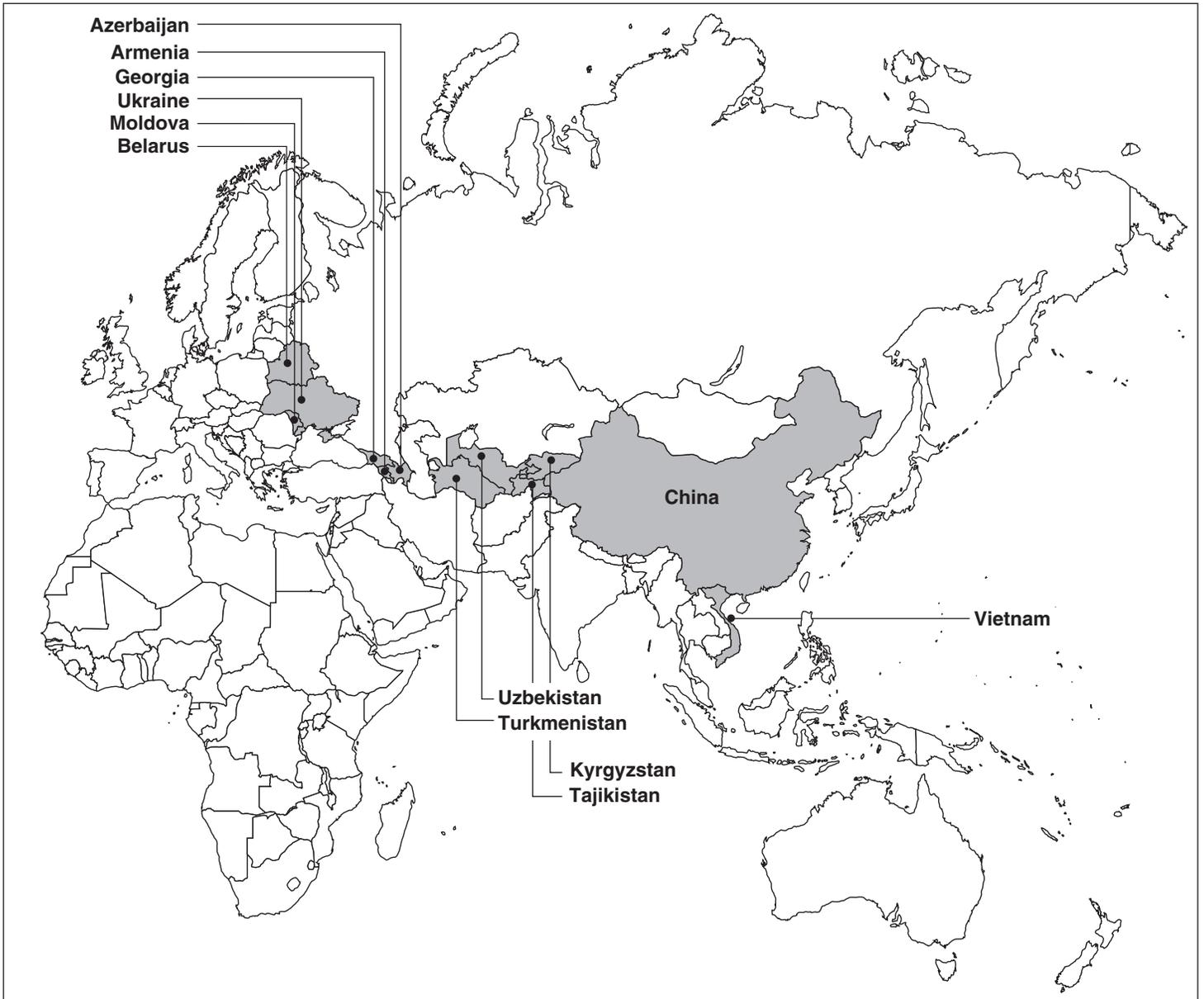
The Department of Commerce Classifies China as an NME Country

The Department of Commerce classifies China, as well as Vietnam and a number of former Soviet republics, as NME countries. Under U.S. trade law, Commerce may classify any country that does not operate on market principles “so that sales of merchandise in such country do not reflect the fair value of the merchandise” as an NME country.⁵ Commerce has classified China as an NME country since 1981.⁶ Figure 4 shows the countries that Commerce currently classifies as NMEs.

⁵19 U.S.C. §1677(18).

⁶*Final Determination at Less Than Fair Value: Natural Menthol from the People’s Republic of China*, 46 Fed. Reg. 24614, May 1, 1981.

Figure 1: Current NME Countries



Sources: Department of Commerce and MapArt.

Note: Commerce has made market/nonmarket economy determinations only when called upon. Commerce has never been called upon to rule on the market/nonmarket status of some countries that one might expect to find in a list of current or former nonmarket economies.

Commerce Determined That It Lacks Authority to Apply Countervailing Duty Law to NME Countries

U.S. trade law does not contain any explicit prohibition against applying CVDs to NME countries. Nonetheless, the Department of Commerce determined in 1984 that it did not have explicit legal authority to apply CVDs to such countries. Commerce set forth its conclusions on this matter in rulings denying CVD protection against carbon steel wire rods from Poland and Czechoslovakia (which were then considered NME countries).⁷ Commerce observed that, even though Congress had addressed unfair trade remedies in both the Trade Act of 1974⁸ and the Trade Agreements Act of 1979⁹ and revised U.S. countervailing duty law on both occasions, it had not given any indication that CVD law should be applied against these countries. Instead, Congress provided two other remedies—antidumping duties and safeguard measures—to address unfair trade practices by NME countries. The U.S. Court of Appeals for the Federal Circuit upheld Commerce’s decision in *Georgetown Steel Corp. v. United States*.¹⁰

Commerce Unable to Measure Subsidy Benefits in NME Countries

In its 1984 determinations, the Department of Commerce concluded that it cannot measure subsidy benefits in NME countries. In explaining this conclusion, Commerce observed that, in market economy countries, markets generate prices that can be used to measure the impact of government subsidies. However, in NME countries, government intervention in the economy is so pervasive that one cannot make meaningful comparisons between market-determined prices and those that have been distorted by government intervention. Commerce summarized the methodological problems it faced in these cases as follows:

⁷49 Fed. Reg. 19370, 19374 (May 7, 1984).

⁸Pub. L. No. 93-618, 88 Stat. 1978.

⁹Pub. L. No. 96-39, 93 Stat. 144.

¹⁰801 F.2d 1308 (Fed. Cir. 1986). In upholding the Department of Commerce’s position, the Court of Appeals overruled an earlier ruling in the same case by the Court of International Trade, which had reversed the department. See *Continental Steel v. United States*, 614 F. Supp. 548, 550 (C.I.T. 1985).

“We believe a subsidy (or bounty or grant) is definitionally any action that distorts or subverts the market process and results in a misallocation of resources. . . . In NMEs resources are not allocated by a market. With varying degrees of control, allocation is achieved by central planning. Without a market, it is obviously meaningless to look for misallocation of resources caused by subsidies. There is no market process to distort or subvert. . . . It is this fundamental distinction—that in an NME system the government does not interfere in the market process but supplants it—that has led us to conclude that subsidies have no meaning outside the context of a market economy.”¹¹

In upholding Commerce’s position in this matter, the Court of Appeals found in *Georgetown Steel* that in nonmarket economies the governments control their trading entities by determining where, when, and what they will sell, and upon what terms. When no market exists, subsidies cannot be found to distort market decisions.

Department of Commerce Could Act to Allow Application of CVD Law to China

Commerce could take either of two paths to applying U.S. CVD law to China. First, Commerce could use its administrative authority to change China’s NME status in whole or in part. This would allow Commerce to apply U.S. CVD law to China on a country or industry basis. However, Commerce officials observed that it may be difficult for China to meet these criteria in the near term. Alternatively, Commerce could reverse its 1984 position and decide that CVD law could be applied to China while it remains classified as an NME country. However, absent a clear grant of authority from Congress, such a reversal could be challenged in court. The results of such a challenge are uncertain. WTO rules, including relevant provisions of China’s WTO accession agreement, do not explicitly preclude the United States from pursuing either alternative. Moreover, China’s WTO accession commitments (1) permit use of third-country information in CVD cases and (2) could facilitate Commerce adjudication of CVD actions against state-owned enterprises in that country.

Commerce Could Change China’s NME Status in Whole or in Part

The Department of Commerce has administrative authority to reclassify NME countries as market economy countries, or individual NME country industries as “market oriented” in character, provided that the country as a whole or the industries in question meet certain criteria.

¹¹49 Fed. Reg. 19370, 19374 (May 7, 1984).

Commerce Could Reclassify
China as a Market Economy
Country

Department of Commerce officials explained that countries classified as NMEs may ask that their status be reviewed either within the context of an ongoing import relief case or as an independent matter. Commerce has responded to a number of requests for such reviews, granting some countries (such as Russia and Estonia) market economy status while classifying others (such as Vietnam) as nonmarket economies.¹² Table 1 shows former NME countries that Commerce has determined merit reclassification as market economy countries.

Table 1: Former NME Countries Reclassified as Market Economy Countries

Country	Year of Commerce decision
Romania	2003
Lithuania	2003
Estonia	2003
Russia	2002
Kazakhstan	2002
Latvia	2001
Hungary	2000
Czech Republic	2000
Slovakia	1999
Poland	1993

Source: Department of Commerce.

In making decisions on such matters, U.S. trade law specifies that Commerce shall take into account the following factors:

- the extent to which the country's currency is convertible into the currency of other countries,
- the extent to which wage rates are determined by free bargaining between labor and management,

¹²For details on these decisions see, for Russia, a Commerce Department memorandum available at <http://ia.ita.doc.gov/download/russia-nme-status/russia-nme-decision-final.htm>; for Estonia, 68 Fed. Reg. 10445 (Mar. 5, 2003); and for Vietnam, 68 Fed. Reg. 4986 (Jan. 31, 2003).

-
- the extent to which joint ventures or other investments by foreign firms are permitted,
 - the extent of government ownership over the means of production,
 - the extent of government control over the allocation of resources and enterprises' price and output decisions, and
 - other factors that Commerce considers appropriate.¹³

In April 2004, the United States and China established a Structural Issues Working Group under the auspices of the U.S.-China Joint Commission on Commerce and Trade.¹⁴ Among other things, this group is examining issues relevant to China's desire to be classified as a market economy country under the criteria set forth in U.S. antidumping law.¹⁵ U.S. officials involved with the group have observed that substantial additional reform will have to take place (e.g., in improving respect for labor rights and reducing or abandoning controls on currency convertibility) before China can expect to be declared a market economy country under the criteria listed above.

The Chinese government regards recognition as a market economy among its trading partners as a desirable diplomatic goal. While acknowledging that this change in status may result in the United States (and other countries) applying countervailing duties, Chinese officials we spoke with emphasized the political value of their country being officially declared a "market economy." Other trade experts pointed out that Chinese officials may also be seeking this change because they believe it would generally

¹³19 U.S.C. §1677(18).

¹⁴The commission was established in 1983 to serve as a forum for high-level dialogue on bilateral trade issues.

¹⁵According to Commerce, the working group has held two meetings (in July 2004 and May 2005).

result in lower antidumping duties being assessed against Chinese products.¹⁶

China has actively sought change in its status among its trading partners. A number of them, including Singapore and Malaysia, have declared China to be a market economy. However, in June 2004, the European Union officially declined a Chinese request for designation as a market economy. In making this decision, the EU acknowledged that China had made progress, but concluded that much remained to be done in reducing state interference in the economy, improving corporate governance and the rule of law, and bringing the banking sector under market rules.¹⁷ Department of Commerce officials informed us that Chinese representatives have not yet officially requested that Commerce review their country's NME status under U.S. law.

Commerce Could Classify Individual Chinese Industries as Market Oriented

The Department of Commerce could also designate individual Chinese industries as "market oriented" and thus as eligible for application of CVDs. In a 1992 CVD decision involving imported oscillating and ceiling fans from China, Commerce determined that, short of finding that an entire country merits designation as a market economy, Commerce can find specific industries within such countries to be "market oriented" in character.¹⁸ Commerce stated that certain criteria, developed earlier in the context of an antidumping case (also against China),¹⁹ would have to be met for an

¹⁶Application of Commerce's NME ("surrogate" or third-country-based) methodology for calculating antidumping duties is widely believed to lead to application of duties that are significantly higher than those resulting from application of the department's standard methodology for market economy countries. We were unable to identify any analyses showing conclusively that this is the case. Our forthcoming report on the application of antidumping duties to Chinese products will include information and analyses of this question.

¹⁷European Union, *China—Market Economy Status in Trade Defense Investigations*, memo 04/163 (Brussels, June 28, 2004).

¹⁸*Oscillating and Ceiling Fans from the People's Republic of China*, 57 Fed. Reg. 24018 (Dept. of Commerce, 1992) (final determination) and 57 Fed. Reg. 10011 (Dept. of Commerce, 1992) (preliminary determination). In issuing these decisions, the department was responding to an allegation from the company petitioning for relief that, regardless of the nature of China's economy, the Chinese fan industry operated pursuant to market principles and that U.S. CVD laws should therefore apply.

¹⁹*Sulfanilic Acid from the People's Republic of China*, 57 Fed. Reg. 9409, 9411 (Dept. of Commerce, Mar. 18, 1992).

industry to be found market oriented. The industry in question must be characterized by the following:

- virtually no government involvement in setting prices or amounts to be produced,
- private or collective ownership, and
- market-determined prices being paid for all significant inputs, whether material or nonmaterial, and for all but insignificant proportions of all the inputs accounting for the total value of the product.

Commerce justified application of these criteria to determine whether a CVD investigation should proceed by observing that if the Chinese fan industry met the criteria just described, then Commerce could rely on prices and costs to producers in that industry to provide accurate measures of value. Commerce concluded that, if the prices and costs in a sector of an NME were market determined, then the practical concerns cited by the Court of Appeals in *Georgetown Steel* would not arise and Commerce could apply U.S. CVD law.²⁰

To date, Commerce has not accepted any claim that an NME country industry should be designated as market-oriented in character. Commerce officials observed that, as a practical matter, the criteria for designation as a market-oriented industry may be difficult for producers operating in a nonmarket economy to satisfy. In any event, Commerce has not received a CVD petition involving a market-oriented industry claim since the early 1990s. In a few cases, Chinese companies have responded to antidumping cases, in part, by requesting designation as a market-oriented industry. Commerce has denied these requests—primarily on the grounds that the Chinese companies in question submitted information that was insufficient

²⁰Commerce also observed that Congress had amended U.S. antidumping laws in 1988 to provide the department with the authority to use its market economy methodology to calculate antidumping duties on industries from NME countries when the available information permits. The department stated that “this change was added in recognition of attempts by the traditional NME countries to evolve toward market-oriented economies” and that “Congress clearly contemplated a situation in which a sector of an NME may be sufficiently free of NME distortion so that the actual prices and/or costs incurred in the NME could be used in dumping calculations and render meaningful results.” Commerce also found that, if a market-oriented industry existed, failure to permit application of CVD law would leave affected U.S. industries at a disadvantage. 57 Fed. Reg. 24018 (June 5, 1992).

or provided too late in Commerce's process to allow an informed decision.²¹

Commerce Could Apply CVD Law against NME Countries, but There Are Legal Obstacles to Such Action

Since there is no explicit statutory bar to applying CVDs to NME country products, Commerce could make an administrative determination to apply such duties to China and other NME countries. Some legal experts have taken the position that *Georgetown Steel* merely upheld Commerce's decision that it could not apply CVD law to NME countries, and that Commerce could therefore change its policy so long as the change could be defended as reasonable. Commerce officials told us that it might be possible for parties in a particular case to present new legal positions that would permit it to apply CVDs against an NME country product without a change in current law. They added, however, that in the absence of an actual case, it was hard to say whether or how this would occur.

While Commerce could reverse its 1984 position, the Court of Appeals' *Georgetown Steel* ruling raises serious doubt about Commerce's ability to make such a change without a clear grant of authority from Congress. The Court of Appeals did uphold Commerce, but the court also appeared to make its own findings. The court emphasized that recent trade legislation showed that Congress had intended that any selling by NME countries at unreasonably low prices should be dealt with under the antidumping law, and that there was no indication that Congress had intended or understood that the CVD law would also apply. The court stated, in addition, that "[i]f [antidumping law] is inadequate to protect American industry from such foreign competition (resulting from sales in the United States of merchandise that is priced below its fair value) . . . it is up to Congress to provide any additional remedies it deems appropriate."²² The Uruguay Round Agreements Act,²³ adopted in 1994, made important changes in U.S. CVD law but did not add any language authorizing CVD actions against NME countries. Moreover, the *Statement of Administrative Action* accompanying the Act acknowledged that the *Georgetown Steel* ruling stood for "the reasonable proposition that the CVD law cannot be applied

²¹For example, the Department of Commerce recently denied such requests by Chinese color television and bedroom furniture companies. See 69 Fed. Reg. 20594 (Apr. 16, 2004) and 69 Fed. Reg. 67313 (Nov. 17, 2004).

²²801 F.2d 1308, 1318 (Fed. Cir. 1986).

²³Pub. L. No. 103-465, 108 Stat. 4809, adopted Dec. 8, 1994.

to imports from nonmarket economy countries.”²⁴ Although Members of Congress introduced legislation to make U.S. CVD law explicitly applicable to NME countries in 2004, and again in 2005, these bills did not gain approval. Consequently, a Commerce decision to reverse the position it adopted in 1984 and allow CVD actions against NME countries could very well be challenged in court. The results of such a challenge are uncertain.

WTO Agreements Are Silent on NME Issue in CVD Actions

WTO subsidy and countervailing duty rules do not address the issue of NME status in CVD proceedings. The WTO Agreement on Subsidies and Countervailing Measures does not discuss market/nonmarket economy designations in general and, more specifically, does not address the question of whether members can bring CVD actions against NME countries. The CVD provisions in China’s WTO accession agreement are similarly silent.²⁵ Thus, we believe that these rules (1) do not explicitly restrict the United States from continuing or ceasing to apply NME status to China on either a countrywide or industry-specific basis and (2) do not explicitly preclude bringing CVD actions against countries that are classified as NMEs.

Accession Agreement Permits Use of Third-Country Information to Calculate Countervailing Duties

While WTO rules allow members to apply alternate methodologies—not based strictly on information from within the exporting country—to calculate antidumping duties in certain cases,²⁶ the organization’s rules do not make explicit provision for applying third-country information in CVD cases. However, China’s WTO accession agreement specifically permits application of third-country information in CVD determinations. The agreement states that countries attempting to identify and quantify subsidy

²⁴The statement presented the Clinton administration’s views on the interpretation and application of the agreements resulting from the Uruguay Round of trade negotiations, and was approved by Congress as part of this Act. 108 Stat. 4814, 19 U.S.C. § 3511(a)(2).

²⁵China’s accession agreement does recognize that decisions on NME status in antidumping actions are to be made under the national laws of WTO members. WTO Protocol on the Accession of the People’s Republic of China, art. 15(d).

²⁶General Agreement on Tariffs and Trade Annex I, Ad art. VI, states, “[I]n the case of imports from a country which has a complete or substantially complete monopoly of its trade and where all domestic prices are fixed by the State, special difficulties may exist in determining price comparability [in antidumping analyses] and in such cases importing contracting parties may find it necessary to take into account the possibility that a strict comparison with domestic prices in such a country may not always be appropriate.”

benefits in China may encounter special difficulties because “prevailing terms and conditions in China may not always be available as appropriate benchmarks.” In such situations, the agreement allows other member countries to employ “terms and conditions prevailing outside China” to generate benchmarks that can be used to measure subsidy benefits and establish appropriate CVDs. The agreement does require, however, that before considering application of information from outside China, member countries should first seek to use adjusted information from China itself.²⁷ This provision has no expiration date and does not differentiate between China as a market or a nonmarket economy.²⁸

Accession Agreement May Facilitate Actions against State-Owned Enterprises

China’s WTO accession agreement contains another provision that may facilitate application of CVDs in some cases involving state-owned enterprises.²⁹ WTO members may only apply CVDs when the subsidies in question can be shown to be “specific to an enterprise or industry or group of enterprises or industries.”³⁰ Determining whether a particular subsidy meets this test can be challenging. For example, a government loan program directed specifically at providing below-market financing to enable fishermen to acquire boats and equipment might be considered specific, and thus actionable. On the other hand, a program that provides below-market financing to many types of small businesses, including some fishermen, might not be considered specific, and thus not open to application of CVDs.³¹

China’s accession agreement provides that subsidies benefiting state-owned enterprises will be regarded as specific if, among other things, such enterprises are the “predominant” recipients or receive “disproportionally

²⁷WTO Protocol on the Accession of the People’s Republic of China, art. 15(b).

²⁸China’s accession agreement also affirms other WTO members’ right to apply third-country information in antidumping actions against China. However, the agreement provides that members will cease doing so in the event that they recognize China as a market economy, in whole or in part. The agreement indicates further that its provisions on applying third-country information in antidumping cases will expire in December 2016.

²⁹USTR officials stated that state-owned enterprises are believed to be, by far, the major recipients of subsidies in China.

³⁰WTO Agreement on Subsidies and Countervailing Measures, art. 2.1.

³¹See WTO, *Technical Cooperation Handbook on Notification Requirements*, WT/TC/NOTIF/SCM/1, 9 (Geneva, September 1996), 6-7.

large amounts” of such subsidies.³² This may facilitate application of CVDs in some circumstances because it may make it difficult for China to argue that such subsidies are generally available, and thus not actionable. Instead, members may regard them as specific to state-owned businesses without regard for the sector in which they operate.³³

Challenges Would Remain in CVD Actions against China

While Commerce could proceed with CVD actions against China, it would continue to face substantial practical challenges in identifying Chinese subsidies and determining appropriate CVD levels. Commerce could employ third-country information or “facts available” to complete China CVD actions. However, these approaches would not eliminate the challenges that such actions would present. Moreover, Commerce lacks explicit legal authority to implement China’s WTO commitment allowing other members to employ third-country information in CVD actions against China.

Chinese Subsidies Remain Difficult to Identify and Assess

Several trade experts stated that even in the best of circumstances, it can be quite difficult to identify and quantify subsidy benefits.³⁴ In joining the WTO, China specifically agreed to eliminate all prohibited subsidies upon accession and to provide the organization with information on all of its subsidies as called for in the WTO subsidies agreement. Some trade experts we spoke with believed that sufficient information could be obtained to understand and estimate the benefits derived through Chinese subsidies. However, U.S. government officials and other trade experts said that it remains particularly difficult to obtain substantive information about Chinese subsidies. For example, USTR has observed the following:

“It is difficult to identify and quantify possible export subsidies in China because of the lack of transparency in China’s subsidy regime. Chinese subsidies are often the result of internal administrative measures and are not publicized. U.S. subsidy experts are currently seeking

³²WTO Protocol on the Accession of the People’s Republic of China, art. 10.

³³According to the World Bank, state-owned enterprises now account for less than one-quarter of China’s industrial output. See the World Bank, *China: An Evaluation of World Bank Assistance* (Washington, D.C., 2004).

³⁴WTO officials observed that even the United States—a country wherein government actions that influence the economy are comparatively well documented—has had difficulty identifying and quantifying subsidy information that it is required to report to the WTO.

more information about several Chinese programs and policies that may confer export subsidies. Their efforts have been frustrated in part because China has failed to make any of its required subsidy notifications since becoming a member of the WTO.”³⁵

Commerce officials told us that even though there has been substantial reform in China, underlying features of the Chinese economy continue to make it difficult to identify appropriate benchmarks for measuring subsidies. For example, according to USTR, most Chinese subsidies are believed to be provided through that country’s financial system. However, some trade experts stated that government control over the banking system in China makes it difficult to identify market-determined rates of interest that could be used as benchmarks to determine whether, or to what extent, particular companies or industries are benefiting from credit subsidies. U.S. government and private sector analysts added that while the Chinese government heavily influences allocation of credit—favoring some industries over others—it is uncertain how to quantify the subsidy benefits conferred through this process. In addition, while some attorneys who have represented Chinese companies disagreed, Commerce officials and attorneys who have represented U.S. firms said that lack of adherence to generally recognized accounting standards and unreliable bookkeeping among Chinese companies can make accurate identification and accurate measurement of subsidy benefits extremely difficult. Some Commerce officials and trade experts also said that unlike most market economies, which are national, China’s economy is fragmented into five or six regions, each with its own pricing. Thus, even if an industry were declared to be

³⁵USTR, *National Trade Estimates Report* (Washington, D.C., March 2004).

market oriented, it would be difficult to evaluate the subsidy benefits accruing to the national industry as a whole.³⁶

Third-Country Information or “Facts Available” May Be Useful, but Would Not Fully Resolve Challenges

Commerce may find employing third-country information or “facts available” helpful in completing China CVD actions. However, these approaches would not fully resolve the challenges that would face Commerce.

Commerce has not attempted to develop methodologies or procedures for determining CVDs against products from nonmarket economies—based either on information from within the country itself or from a third country. Nonetheless, Commerce officials stated that, if required, they would endeavor to apply existing guidance and conduct an investigation that would withstand analytical and legal scrutiny.

While the United States employs “surrogate” or third-country information to calculate antidumping duties on imports from China and other NME countries, CVD cases against China would raise issues that Commerce analysts do not face in antidumping cases and that may not be resolved by use of third-country information. For example, it may be difficult to separate specific (and therefore countervailable) subsidies from those that are generally available (and therefore not countervailable).³⁷ In addition, identifying reasonable benchmarks (such as market-determined capital costs) in third countries will only provide Commerce with a starting point

³⁶While Commerce has never reached an affirmative final determination in a CVD case against China—or any other NME country—Canada did complete three CVD cases against China during the last year. In two of these cases, Canadian officials were able to obtain sufficient information from the Chinese government and exporting companies to complete their analyses. Canada Border Services Agency, *Statement of Reasons: Outdoor Barbeques Originating in or Exported from the People’s Republic of China*, CVD/102 (Ottawa, Dec. 3, 2004), and *Statement of Reasons: Certain Laminate Flooring Originating in or Exported from the People’s Republic of China*, CVD/104 (Ottawa, June 1, 2005). In the remaining case the agency was unable to obtain sufficient information from the Chinese government and completed its analyses by employing “the best information available.” Canada Border Services Agency, *Statement of Reasons: Certain Carbon Steel and Stainless Steel Fasteners Originating in or Exported from the People’s Republic of China*, CVD/103 (Ottawa, Dec. 24, 2004). Unlike the United States, Canada does not differentiate between market and nonmarket economy countries in countervailing duty actions. Canadian officials did not employ third-country information in any of these cases. As far as we are aware, these are the only CVD actions completed against China to date by any WTO member.

³⁷As already observed, article 10 of China’s WTO accession protocol facilitates such determinations when state-owned industries are involved.

for calculating CVD rates that should be applied to Chinese products. After establishing such benchmarks, Commerce would then face significant challenges in quantifying, for example, the capital or utility costs that are actually being paid by Chinese companies under investigation, so that analysts can determine the difference between unsubsidized and subsidized costs.

Commerce also has the authority to employ facts available to overcome difficulties in calculating subsidy benefits and corresponding CVD rates. Commerce normally obtains information from U.S. companies seeking relief and also from foreign companies and government agencies alleged to be benefiting from or providing subsidies. However, U.S. law grants Commerce authority to make determinations based on facts otherwise available when foreign sources cannot or will not provide needed information.³⁸ Commerce might be able to complete some China CVD cases by applying this approach. However, Commerce officials pointed out that their authority to employ facts available is subject to certain limitations.³⁹ The extent to which Commerce would employ this approach in China CVD cases is uncertain.

Commerce Does Not Have Explicit Authority to Implement China's WTO Commitment Regarding Third-Country Information in CVD Cases

Existing U.S. laws do not provide Commerce with clear authority to fully implement China's WTO commitment allowing members to use third-country information to identify and measure Chinese subsidy benefits. In joining the WTO, China made commitments regarding four import relief measures that other members may apply against imports from China. As already noted, even before China joined the WTO, U.S. trade law specifically allowed for implementation of the first of these commitments—application of third-country information in antidumping cases. Congress has passed legislation—commonly referred to as section 421—implementing the second (involving application of safeguard measures).⁴⁰ While Congress did not adopt legislation to implement China's

³⁸19 U.S.C. §1677e(a).

³⁹For example, 19 U.S.C. §1677e(b) prevents the department from applying information that is clearly adverse to the interests of an exporter unless it determines that the exporter has failed to cooperate with the investigation to the best of its abilities.

⁴⁰Section 421 of the Trade Act of 1974, as amended, Pub. L 106-286, 114 Stat. 882, 19 U.S.C. § 2451. This section implements article 16 of China's WTO protocol of accession, which authorizes other WTO members to apply product-specific safeguards on Chinese imports that are deemed to be causing or threatening to cause market disruption.

third import-relief commitment (regarding textile safeguards), the U.S. interagency group responsible for processing textile safeguard cases⁴¹ believes that existing legislation provides it with authority to implement such measures.⁴²

In contrast, U.S. trade law was not amended to explicitly authorize Commerce to implement China's fourth commitment, regarding application of third-country information in CVD cases, and does not otherwise clearly state that Commerce may apply third-country information in such cases against foreign countries in general. Commerce regulations do provide for application of third-country information to CVD cases—but only in some circumstances.⁴³ The most explicit provision covers only subsidies that impact goods and services used in producing the allegedly subsidized imports.⁴⁴

This lack of clarity raises a question about whether Commerce could currently apply this commitment, even if it were to decide to reclassify

⁴¹This interagency group, which is headed by the Commerce Department, is the Committee for the Implementation of Textile Agreements.

⁴²See 7 U.S.C. 1854 and Exec. Order 11651, 37 Fed. Reg. 4699 (Mar. 3, 1972), as amended. Nevertheless, the interagency group's authority to process China textile safeguard cases has been challenged in court by the U.S. Association of Importers of Textiles and Apparel, partially on the ground that Congress did not enact legislation implementing China's commitment. *U.S. Ass'n of Importers of Textiles and Apparel v. United States*, Ct. No. 00598 (C.I.T. Dec. 1, 2004). GAO takes no legal position on this issue.

⁴³For example, according to Commerce, 19 C.F.R. § 351.505 authorizes use of international lending rates to measure subsidy benefits from certain loans. However, this provision only applies to loans and does not specifically authorize use of third-country information.

⁴⁴When no useable market-determined prices are available in the exporting country, 19 C.F.R. § 351.511 authorizes the use of world market prices to determine subsidy benefits for goods and services employed in producing the exports in question. However, this provision does not extend to subsidy benefits conveyed through other means, such as equity investments. In its ruling on the United States application of CVDs against Canadian softwood lumber, the WTO Appellate Body found that information from outside the subsidizing country could be used to measure subsidy benefits in very limited circumstances. However, it did not make any specific findings on the U.S. regulations. WTO, *United States—Final Countervailing Duty Determinations with Respect to Certain Softwood Lumber from Canada*, WT/DS257/AB/R, paras. 77-103 (Geneva, January 2004). Several North American Free Trade Agreement panels have also ruled on the softwood lumber CVD case and questioned application of the methodology set forth in the U.S. regulation. North American Free Trade Agreement Secretariat, *United States—Final Affirmative Countervailing Duty Determination: Certain Softwood Lumber Products from Canada*, File USA-CDA-2002-1904-03 (Aug. 13, 2003, and June 7, 2004).

China as a market economy or specific Chinese industries as market oriented in character. Department of Commerce officials said they had not yet decided whether Commerce could fully apply the commitment in the absence of authorizing legislation.

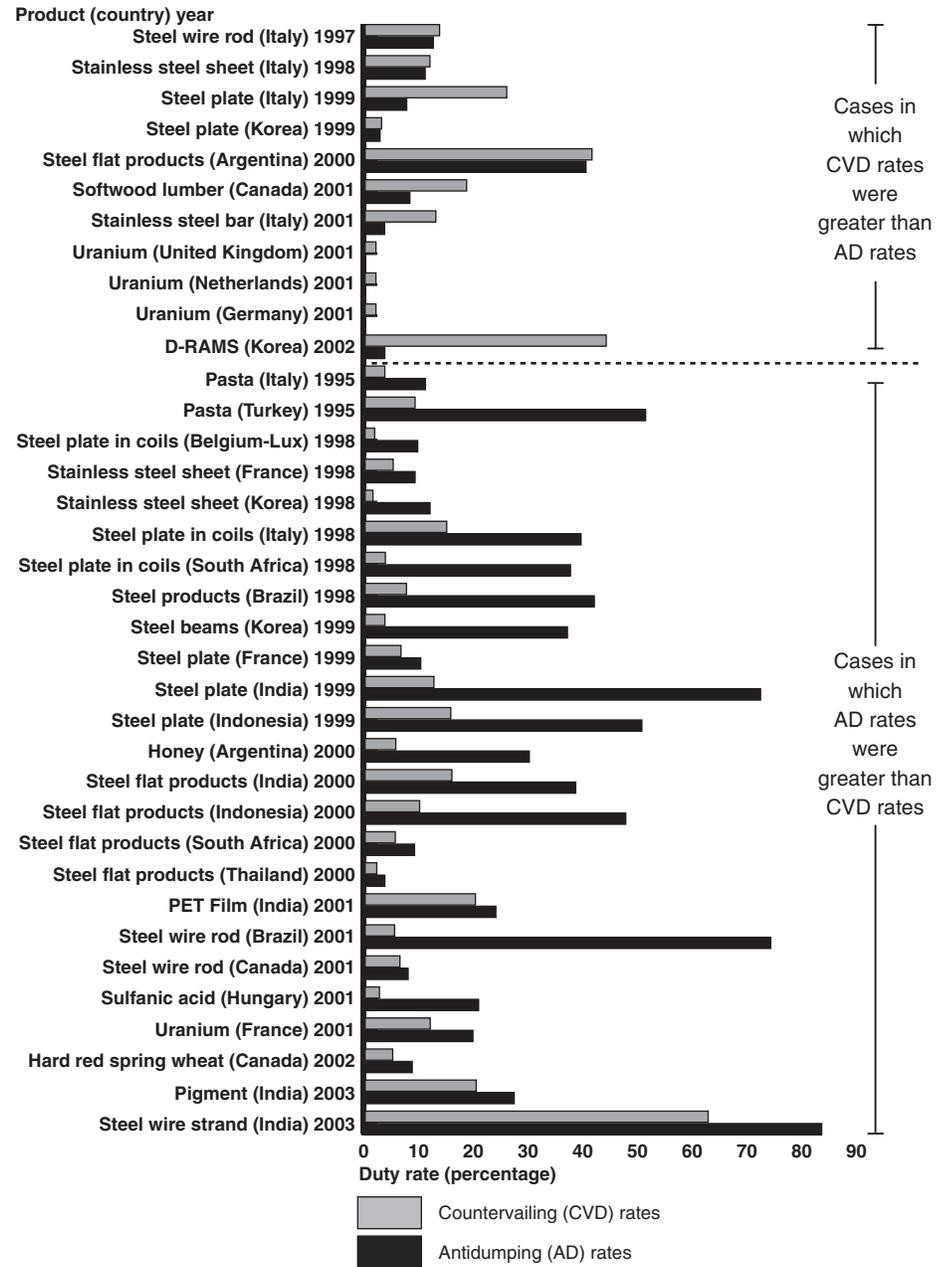
Uncertain Whether Applying CVDs Would Result in Increased Protection

Making CVD procedures available to U.S. producers that believe they are injured as a result of unfairly subsidized Chinese imports would provide a mechanism for taking actions that specifically target Chinese government subsidies. However, it is unclear whether, on a net basis, applying CVDs to China would result in overall levels of protection for U.S. products that are higher than those already applied through antidumping duties. CVDs could be applied alone or in tandem with antidumping duties. CVDs alone generally tend to be lower than antidumping duties. For two reasons, simultaneous application of both types of duties could well result in reduced antidumping duties, and it is unclear whether application of CVDs would compensate for such reductions. First, designating China as a market economy would require a change in the methodology used to calculate companion antidumping duties that is widely expected to lead to lower duty rates. Second, regardless of whether China is designated as a market economy, some companion antidumping duties might need to be reduced to avoid double counting subsidy benefits. Each of these considerations introduces an element of uncertainty about the magnitude of the total level of protection that would be applied to Chinese products; each may result in combined rates that are lower than might be expected.

CVD Rates Vary, but Tend to Be Lower Than Antidumping Duties

U.S. CVDs tend to be lower than companion antidumping duties. This may, in part, explain why U.S. producers seek CVDs less often than antidumping duties. Figure 2 compares CVDs and antidumping duties imposed on the same products over the last decade. As the figure shows, CVDs imposed on these products varied from less than 2 percent to more than 60 percent. However, CVDs were lower than companion antidumping duties in nearly 70 percent of the 36 cases where the United States imposed CVDs. The average CVD rate imposed in these cases was about 13 percent, while the average antidumping duty rate imposed was about 26 percent.

Figure 2: U.S. Countervailing Duties and Companion Antidumping Duties, 1995-2004



Source: GAO analysis of Department of Commerce data.

Notes: This figure compares “all others” duty rates from each new CVD action concluded during the indicated period to the “all others” antidumping duty rates applied to the same products. “All others” rates are weighted averages of the individual rates assigned to the exporting companies investigated in each case. The data is displayed according to the year in which petitioners filed for CVD action. Comparisons employing the highest rates issued in each case (that is, the highest rates applied to any individual company) or the median values of the rates applied to individual companies provide similar results. While Commerce can, and does, change rates over time to reflect changing circumstances, the figure does not take such changes into account.

In the three cases involving uranium from the United Kingdom, Germany, and the Netherlands, Commerce concluded that no antidumping duty should be applied. For more information, see 66 Fed. Reg. 65886 (Dec. 21, 2001).

Commerce ordered antidumping duties on Korean D-RAMS in 1993. However, Commerce subsequently revoked its order, and collection of these duties ended in 1999—prior to initiation of a CVD action on these products. For more information, see 65 Fed. Reg. 59391 (Oct. 5, 2000).

Under the WTO subsidies agreement and U.S. law, CVD rates are limited to the levels required to offset the amount of the subsidies.⁴⁵ For example, a company may be receiving government credit subsidies that reduce its capital costs by 20 percent. This advantage may make a real difference in the company’s ability to compete in the international market. However, Commerce stated that CVD rates are calculated by dividing the total value of subsidy benefits by the total value of an exporting company’s sales. Since the subsidy just mentioned affects only one portion of the company’s balance sheet (capital costs) the countervailing duty applied to offset this benefit may be much lower than 20 percent. In some instances, past government intervention and support may have been critical to an exporting industry’s start-up or survival. However, loans and nonrecurring benefits, such as equity infusions or grants, are generally amortized over a period of years. After several years have passed, the current value of these subsidies may have declined to a comparatively insignificant level. U.S. companies, therefore, may experience substantial difficulty in competing

⁴⁵See article 19 of the WTO Agreement on Subsidies and Countervailing Measures, and 19 U.S.C. §1671(a).

with Chinese companies that owe their existence to favorable government actions in the past, but find that legitimately applied CVDs are minimal.⁴⁶

Change in Methodology May Lower Antidumping Duties

Administrative actions reclassifying China as a market economy (in whole or in part) would require Commerce to cease applying its NME methodology for calculating antidumping duties on affected Chinese products. This is significant because, as noted earlier, CVD actions usually have a companion antidumping action. U.S. law allows Commerce to employ its third-country-based methodology to calculate antidumping duties only when the merchandise in question is being produced in countries that it classifies as NMEs. Therefore, once Commerce reclassified China as a market economy it could no longer apply this methodology. Similarly, Commerce could no longer apply this methodology to individual Chinese industries after it found them to be market-oriented in character. After either finding, Commerce would apply its market economy approach to calculate antidumping duties. Commerce has never attempted to calculate antidumping duties on Chinese products based on prices charged within China. Whether these antidumping duties would be higher, lower, or approximately the same as those derived through Commerce's NME approach remains uncertain.⁴⁷ However, if—as trade experts commonly expect—they prove to be significantly lower than antidumping duty rates derived through Commerce's NME methodology, then even in combination with companion CVDs, the total level of protection applied may not be as high as that currently applied against Chinese products.

⁴⁶The likelihood that significant CVDs could be imposed to counter past government support in China and other NME countries is further reduced by a 2002 WTO dispute settlement decision that established a rebuttable presumption that prior subsidies usually will not be considered to have provided countervailable subsidy benefits for new, private owners of former state-owned enterprises—provided that the enterprise was turned over to private ownership in an arm's length, fair market transaction. WTO, *United States—Countervailing Measures Concerning Certain Products from the European Communities*, WT/DS212/AB/R (Geneva, December 2002). Furthermore, in a countervailing duty case involving exports from Hungary, Commerce found that subsidies provided by a country before its status is changed from nonmarket to market economy are not subject to U.S. countervailing duty law. *Sulfanilic Acid from Hungary*, 67 Fed. Reg. 60223 (Dept. of Commerce, 2002) (Issues and Decision Memorandum for the Final Determination at 14-15).

⁴⁷GAO is currently engaged in an analysis of how antidumping duty rates derived through Commerce's nonmarket economy methodology compare with duty rates derived through the department's standard methodology. The results of this analysis will be included in our forthcoming report on application of antidumping duties to China.

Adjustments to Avoid Double Counting Might Lower Companion Antidumping Duties

If called upon to apply CVDs against Chinese products, Commerce would have to adjust companion antidumping duty rates downward in some cases in order to avoid “double counting”—imposing two sets of duties to compensate for the same unfair trade practice. However, the extent of these adjustments—and their net impact on combined duty rates to be applied—remains uncertain.

Adjustments Required to Avoid Double Counting of Export Subsidies

Both WTO rules and U.S. laws require adjustments in combined duty rates to avoid double counting of export subsidies. WTO rules specify that no product can be subjected to both antidumping and countervailing duties “to compensate for the same situation of dumping or export subsidization.”⁴⁸ U.S. law echoes this provision, in effect, by requiring adjustments in antidumping duties in the event that CVDs are applied simultaneously to counter export subsidies on the same products.⁴⁹

The rationale behind these provisions is that since antidumping duties are calculated by comparing domestic prices with export prices, such duties already offset the price advantage that export subsidies confer over the prices charged in the exporter’s domestic market. When imposing both countervailing and antidumping duties, Commerce adjusts antidumping duty rates downward by any amount that is attributable to export subsidies. Commerce would be obliged to make such adjustments when applying both types of duties to China, regardless of whether China remains an NME country under U.S. law.

The extent to which Commerce would have to reduce antidumping duty rates in order to avoid double counting Chinese export subsidies is unknown. As already noted, China agreed to cease providing export subsidies upon joining the WTO. Some trade experts allege that China has nonetheless continued to provide such subsidies. However, no industry group has petitioned for application of countervailing duties against Chinese subsidies, and U.S. officials have not attempted to quantify the benefits provided by Chinese subsidy programs in general, or export subsidies in particular.

⁴⁸WTO General Agreement on Tariffs and Trade, art. VI.5.

⁴⁹19 U.S.C. §1677a(c)(1)(C).

Implications of Double Counting Domestic Subsidies Are Unclear

Another potential source of double counting could emerge if Commerce were to apply CVDs to China while it retains its NME status. In such circumstances, Commerce would continue to use third-country information to calculate antidumping duties. While, in principle, double counting of actionable domestic subsidies generally does not occur when analysts employ information from exporting countries themselves to determine duty rates, it may occur when analysts use third-country information. However, current trade law does not make any specific provision for adjusting antidumping duties in such situations, and the implications of such situations arising are therefore unclear.

When an antidumping duty is calculated using the third-country-based methodology that Commerce applies to NME countries, the normal value of the product (the basis for calculating an antidumping duty) is based not on Chinese prices (which might be artificially low as a result of domestic subsidies) but on information from a country where prices are determined by free markets. Thus, when the normal value is compared with the export price, the difference will, at least in theory, reflect the price advantages that the exporting company has obtained from both export and domestic subsidies.⁵⁰

Economists, trade law practitioners, and Commerce officials we consulted disagreed on whether, in practice, antidumping duties derived through the third-country-based methodology effectively offset *all* of the subsidy benefits enjoyed by Chinese exporters.⁵¹ However, they generally agreed that, in theory, antidumping duties derived in this way do offset much of the value of both export and domestic subsidies. As a result, it appears that some double counting of actionable domestic subsidies could occur if Commerce used third-country information to calculate antidumping duties on the same products against which it also applied CVDs.

⁵⁰In contrast, when a market economy methodology is used, both the normal value and the export price will, in principle, reflect the benefits that the producer has derived from domestic subsidies. Therefore, comparing the normal value with the export price will not result in an antidumping duty rate that captures the benefits provided by these subsidies; these benefits will be captured only in a CVD investigation. Thus, domestic subsidy benefits generally would not be double counted.

⁵¹For example, some of those with whom we spoke pointed out that Commerce's analyses may not result in antidumping duties that fully offset Chinese subsidies because the third-market values employed by the department may, themselves, be distorted by subsidies provided by other governments.

Because the United States has never attempted to apply both countervailing and antidumping duties against an NME country, the implications of taking such an action are unknown. The relevant WTO agreements are silent with regard to making adjustments to avoid double counting actionable domestic subsidies, and U.S. law does not provide Commerce with any specific authority to avoid double counting in such situations. Therefore, Commerce officials observed that they would have no choice but to apply both duties without making any adjustments.⁵² While at least two U.S. courts have suggested that double counting to compensate for the same unfair trade practice is generally considered improper,⁵³ they have not ruled on the specific question of whether double counting of actionable domestic subsidies, in particular, is improper. Commerce officials told us that, theoretical arguments aside, interested parties finding fault with Commerce’s decision making would have to prove that there was actual double counting.

Conclusions

Despite increasing concern about Chinese government subsidies and their adverse impacts on U.S. producers, U.S. producers may not currently avail themselves of the U.S. government’s primary tool for countering unfair subsidies—CVDs. While the methodology that Commerce currently employs to calculate antidumping duties on Chinese products already results in duty rates that offset subsidy benefits to some degree, Commerce

⁵²Commerce officials identified one case involving alleged double counting of domestic subsidies. The case involved application of antidumping and countervailing duties against low enriched uranium from France—a market economy country. In this case, Commerce concluded that the information on the record did not provide a sufficient basis for determining whether double counting had taken place. Some parties to the case objected to Commerce’s conclusion, but they did not provide any new information that would have helped Commerce in re-examining it; they also did not challenge Commerce’s reasoning before the courts. The determination itself may be accessed online <http://ia.ita.doc.gov/frn/0112frn/01-31509.txt>. A decision memorandum providing additional information is also available at <http://ia.ita.doc.gov/frn/summary/france/01-31509-1.txt>.

⁵³For example, in a CVD case involving tax subsidies, the Court of Appeals for the Federal Circuit found that Commerce had erred in counting both a rebate of a tax and a tax deduction in calculating the amount of a subsidy. Similarly, in an antidumping case against Chinese companies, the court found that Commerce had double counted a substantial component of total freight expenses such that the results fell “outside the limits of permissible approximation.” Finally, in an antidumping case, the Court of International Trade instructed Commerce to reconsider its method of calculating exporter profit margins, in part to avoid double counting. *Kajaria Iron Castings PVT. LTD v. United States*, 156 F. 3d 1163, 1173-74 (Fed. Cir. 1998); *Sigma Corp. v. United States*, 117 F. 3d 1401, 1407 (Fed. Cir. 1997); and *Geum Pong Corp. v. United States*, 193 F. Supp. 2d. 1363, 1370 (C.I.T. 2002).

could act to make CVDs available against China as well. It could do this either by changing China's NME status, or by changing its current policy and determining that it may apply CVD law against China regardless of its NME status. However, Commerce appears unlikely to employ the first alternative in the near future, and the *Georgetown Steel* ruling raises an obstacle to employing the second, without clear authority from Congress.

While Congress is considering legislation that would authorize Commerce to apply CVDs to China as an NME country, substantial practical questions about how such cases would proceed remain unanswered, and the results that they would produce remain uncertain. The absence of such information makes it difficult for interested Members of Congress, prospective participants in CVD cases, and Commerce itself to gain any perspectives on the implications of taking such actions. Commerce has had no experience in attempting to complete CVD investigations on Chinese products and has no specific guidance in place for how to proceed. In particular, Commerce lacks guidance or experience in applying third-country information to calculate CVD rates—an approach that is explicitly permitted under the terms of China's accession to the WTO and that Commerce may very well find necessary to employ given lack of transparency regarding China's subsidy practices. The CVD rates that would result from these investigations are uncertain, as are the net effects of applying both CVDs and antidumping duties to Chinese products.

Furthermore, Commerce lacks clear authority under U.S. law to either fully implement China's WTO commitment regarding the use of third-country information in CVD cases or adjust antidumping duty rates to avoid double counting of Chinese domestic subsidy benefits. Given this lack of clarity, it is reasonable to expect that parties objecting to Commerce's decisions on these issues would challenge relevant aspects of CVD decisions against China, complicating and delaying application of such duties to products from that country. Until these issues are clarified, policymakers will not be fully informed about the implications of applying U.S. CVD laws to China, and Commerce will not be prepared to implement such a change in policy.

Recommendations for Executive Action

In order to provide Congress and the Department of Commerce with better information about the implications of taking actions that would result in application of U.S. CVD laws to China, we recommend that the Secretary of Commerce analyze and report to Congress on

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- Commerce’s ability to identify and measure subsidy benefits at the present time, based on its knowledge of significant Chinese subsidy programs; and
 - broadly applicable methodologies that Commerce might employ to complete CVD actions against Chinese products, if called upon, including how it might respond to potential double counting of domestic subsidy benefits when applying both countervailing and antidumping duties to the same products.

Matters for Congressional Consideration

In the event that (1) Commerce changes China’s NME status or (2) Congress decides to adopt proposed legislation that would authorize Commerce to apply U.S. CVD laws to NME countries, including China, Congress may wish to consider adopting legislation to provide Commerce clear authority to

- fully implement China’s WTO commitment regarding use of third-country information in CVD cases, and
- make corrections to avoid double counting domestic subsidy benefits when applying both CVDs and antidumping duties to the same products from NME countries, in situations where Commerce finds that double counting has in fact occurred, taking into account Commerce’s analyses of this issue prepared in response to our recommendation above.⁵⁴

Agency Comments and Our Evaluation

The Department of Commerce provided written comments on a draft of this report. These comments are reprinted in appendix III. Commerce provided a different characterization of our finding that it did not have clear legal authority to apply CVD law to China, taking the position that there is no explicit statutory bar to taking such an action, and stating that Commerce would carefully consider any CVD petition. We modified our report to clarify that Commerce could decide, in response to a petition, that circumstances warrant and permit a change in its policy. However, given that Commerce determined in 1984 that it did not have explicit legal

⁵⁴We limit this matter for congressional consideration to situations involving NME countries because we believe it unlikely that double counting problems involving domestic subsidies will arise in companion antidumping and countervailing duty actions against market economy countries.

authority to take such an action, and this was subsequently upheld and affirmed by a federal appeals court, and later confirmed by a 1994 statement of administrative action, we continue to believe that there would be legal obstacles to Commerce changing its policy.

With regard to our recommendations, Commerce did not comment on our recommendation that it analyze and report on its ability to identify and measure subsidy benefits in China. Commerce believed our recommended report on the methodologies the department would employ if called upon to apply CVDs to China would be too speculative, and therefore not meaningful or appropriate before an actual case was filed, and that such a report could prejudice the outcome of future actions. We agree that specific decisions on how best to complete individual CVD actions against China would depend upon the facts in particular cases. We did not intend that Commerce provide detailed discussions of how it would respond to particular sets of circumstances. Rather, this report would provide Commerce, Members of Congress, and potential parties to CVD cases with some general-level guidance about how such actions might proceed. For example, such a report could address Commerce's use of benchmark information from within or outside China to measure subsidy benefits and application of China's WTO commitment regarding CVD actions involving state-owned enterprises. Providing broad commentary on such points would be consistent with Commerce making general guidance on its antidumping practices publicly available.⁵⁵

Regarding our matters for congressional consideration, Commerce cited some legal authority for using external benchmarks in CVD cases. We evaluated this information and added a discussion in our report. We were not convinced that the cited authority would clearly provide for full implementation of the special methodology in China's WTO accession agreement. An explicit grant of authority by Congress would remove doubt and lessen the chances for legal disputes, and therefore we continue to believe our suggestion is prudent. Commerce also said our suggestion that Congress provide Commerce with authority to correct any double counting of domestic subsidies in companion CVD and antidumping actions was not warranted or appropriate because Commerce had not yet encountered this

⁵⁵U.S. trade law provides general rules for completing antidumping actions against NME countries. 19 U.S.C. § 1667b(c). However, Commerce has also provided additional guidance. See Department of Commerce, *Import Administration Dumping Manual*, chapter 8, (Washington, D.C., 1997). This document is available on the Internet at <http://ia.ita.doc.gov/admanual/index.html>.

situation, such corrections might be too difficult, and it would put China in a special category distinct from all other countries. We maintain that our analysis shows that there is substantial potential for double counting of domestic subsidies if Commerce applies CVDs to China while continuing to use its current NME methodology to determine antidumping duties. We believe that, in such a situation, Commerce should be provided authority to proactively address potential double counting, rather than waiting for it to occur and create methodological and legal problems. Finally, we intended that our suggestion on double counting apply to all NME countries, and have clarified our language on this point.

The Department of Commerce also provided technical comments, as did USTR and ITC. We took these comments into consideration and made revisions throughout the report as appropriate to make it more accurate and clear.

We are sending copies of this report to the Secretary of Commerce and the United States Trade Representative, appropriate congressional committees, and other interested parties. We will also make copies available to others upon request. In addition, the report will be available at no charge on GAO's Web site at <http://www.gao.gov>.

If you or any of your staff have any questions about this report, please contact me at (202) 512-4347 or yagerl@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made major contributions to this report are listed in appendix IV.



Loren Yager
Director, International Affairs and Trade

Objectives, Scope, and Methodology

In May 2003, the House Appropriations Committee's Subcommittee on Commerce, Justice, and State, the Judiciary, and Related Agencies held hearings regarding U.S. government efforts to support American businesses adversely affected by imports from China. In light of concerns expressed at this hearing, the conference report on fiscal year 2004 appropriations legislation requested that GAO monitor the efforts of U.S. government agencies responsible for ensuring free and fair trade with China.¹ In subsequent discussions with your staff, we agreed to respond by providing a number of reports on relief mechanisms available to U.S. producers adversely affected by unfair or surging imports, and the manner in which they have been applied to China.² In this report, we (1) explain why the United States does not currently apply CVDs to imports from China, (2) describe available alternatives for applying CVDs to Chinese-origin imports, (3) explore the challenges that the Department of Commerce would face in applying these alternatives, and (4) examine the potential impact that applying these alternatives would have on the rates of duty applied to Chinese products.

To address our objectives, we reviewed applicable U.S. laws and regulations and World Trade Organization (WTO) agreements, including the Agreement on Subsidies and Countervailing Measures, and China's WTO accession agreement. We conducted a literature search and reviewed relevant scholarly and legal analyses, Department of Commerce determinations, and decisions by U.S. courts and the WTO Dispute Settlement Body. We consulted with trade and legal policy experts from the U.S. government, private sector trade associations, consulting firms, and academic institutions; law firms with broad experience in trade actions against China; as well as representatives of the WTO, the government of China, and other governments concerned about Chinese trade practices, including the European Union, Canada, New Zealand, and Mexico.

In addition, to address our fourth objective, we obtained information on U.S. countervailing and antidumping duty actions from 1995 through 2004 from the Department of Commerce and the U.S. International Trade Commission. We used this data to construct our own database on

¹H.R. Rep. No. 108-401, at 574 (2003), accompanying the Consolidated Appropriations Act, 2004, Pub. L. No. 108-199, 118 Stat. 3, 65.

²We have already published a report on textile safeguards. See GAO, *U.S.-China Trade: Textile Safeguard Procedures Should be Improved*, GAO-05-296 (Washington, D.C.: Apr. 4, 2005). Forthcoming reports will focus on other safeguard measures and antidumping duties.

countervailing duty determinations and antidumping duties applied on similar products over the same period. We included all countervailing duty cases over this time period, as well as all antidumping cases in which a petition was filed by U.S. industry for an antidumping investigation against a similar product from the same country (e.g., honey from Argentina). Of the 72 countervailing duty cases from 1995 through 2004, we found only 3 in which a similar antidumping petition was not also filed. Our database includes information on the outcome of the investigations (e.g., whether an order was issued), the status of the orders as of the end of 2004, the duty rates imposed in each case that resulted in a CVD order and the antidumping duty rates imposed on similar products. For each countervailing or antidumping duty order, the Department of Commerce may issue several different duty rates. These may include separate duty rates for large individual companies (suppliers), as well as weighted average “all others” rates for smaller suppliers. We collected all of these rates and compared the lowest and highest separate rates, the average of all separate duty rates, and the “all others” rates. As we report above, we found that the averages or median rates for countervailing duties orders are smaller than similar antidumping rates, whether comparing the lowest rates, the highest rates, the average rates, or the “all others” rates. However, as shown in figure 2, in some individual cases countervailing duty rates were higher than antidumping rates. Also, future investigations may yield different results depending on the types of products, countries, and activities investigated. Having verified these data with the original *Federal Register* notices, which provide the official U.S. government notification of investigations and orders, we find the data to be sufficiently reliable for analyzing the number, status, and duties (if imposed) on U.S. countervailing duty cases from 1995 through 2004, as well as U.S. antidumping cases on similar products.

In addition, to provide information on the growth of U.S. imports from China, we examined official U.S. import data from the Department of Commerce, Bureau of the Census, which we adjusted for inflation using the end-use import price index published by Commerce’s Bureau of Economic Analysis. While U.S. data on imports from China have some acknowledged limitations, we found them to be sufficiently reliable for the purpose of establishing that there has been rapid growth in these imports in recent years.

We performed our work from January 2004 through June 2005 in accordance with generally accepted government auditing standards.

CVDs and Antidumping Duties under WTO Rules and U.S. Law

WTO Agreement Provides General Rules

The WTO Agreement on Subsidies and Countervailing Measures defines a subsidy as a financial contribution by a government or any public body within a WTO member that confers a benefit. While the agreement imposes an outright ban on some types of subsidies,¹ most types are not completely prohibited but are classified as actionable under certain conditions. Actionable subsidies are those that are specific—i.e., benefit a specific enterprise, industry, or group of enterprises or industries—and cause adverse effects to the interests of another WTO member, such as injury to their domestic industries.

According to the WTO, members may impose CVDs when they (1) identify subsidized imports, (2) determine that a domestic industry is suffering injury, and (3) establish a causal link between the subsidized imports and the injury being suffered. These duties are intended to offset the price advantages that the subsidy confers on the imported product and, more broadly, encourage governments that maintain subsidies to eliminate them. The subsidies agreement requires that the investigating authorities quantify the value of the subsidies being provided and limits the level of duty imposed to that value.

To facilitate identification of subsidies and evaluation of their trade effects, the agreement requires WTO members to provide the organization with annual notifications on all of the specific subsidies they maintain and to provide additional information on any of these programs when requested. The agreement specifies that member states should provide sufficient information “to enable other Members to evaluate the trade effects and to understand the operation of notified subsidy programs.”²

¹Export subsidies (those contingent on export performance) and local content subsidies (those contingent on use of domestic over imported goods) are explicitly prohibited. Members may challenge prohibited subsidies through the WTO’s dispute settlement process and may impose countermeasures if the member being challenged declines to eliminate the subsidies. In contrast to CVD actions, members bringing such complaints do not have to show that their domestic industries have suffered adverse effects as a result of these subsidies.

²WTO Agreement on Subsidies and Countervailing Measures, art. 25.3.

U.S. Procedures Reflect WTO Rules

Under U.S. law,³ CVDs may be imposed against subsidized imports from other WTO members when a U.S. industry is materially injured or threatened with injury or the establishment of an industry in the United States is materially retarded.⁴ The ITC and the Department of Commerce share investigative and decision-making responsibility in CVD cases. The ITC determines whether there is material injury or threat thereof to the domestic industry by reason of the subject imports. Commerce determines whether the foreign country is providing a countervailable subsidy, and, if so, the size of the subsidy and (consequently) the size of the CVD that should be imposed. To make these determinations, Commerce solicits information from exporting country governments and from individual producers and exporters of the subject merchandise and applies this information to establish appropriate duty rates for each known exporter or producer.⁵

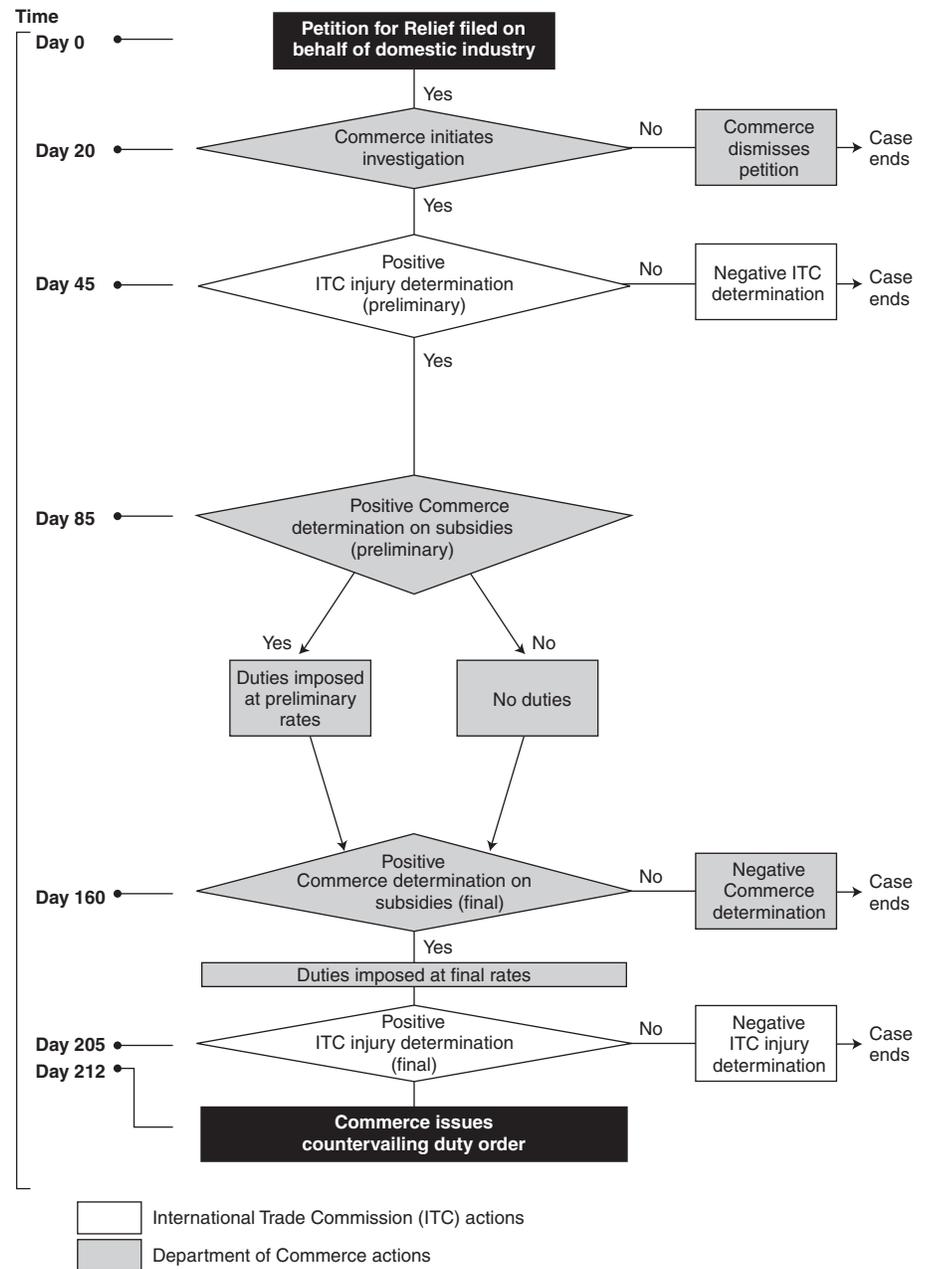
³19 U.S.C. §1671 and following.

⁴U.S. law requires an injury test when the exporting country is a WTO member or meets certain other criteria. 19 U.S.C. §§1671(b) and (c).

⁵Individual company rates can vary a great deal, depending upon the facts in each case. In one recent case, for example, the Commerce Department applied a CVD of about 17 percent to one Indian exporter of carbazole violet pigment, but a rate of about 34 percent to another Indian exporter of this product. 69 Fed. Reg. 77995 (Dec. 29, 2004).

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Figure 3: Outline of the U.S. Process for Making CVD Determinations



Source: Department of Commerce.

Notes: In addition to producers and associations of producers, U.S. law grants unions and other recognized worker groups in affected U.S. industries the right to submit petitions for relief. Petitions are filed with Commerce and ITC simultaneously. Commerce may also self-initiate investigations.

Commerce will dismiss petitions that (1) do not allege the elements necessary for imposition of a duty and contain information “reasonably available to the petitioner” in support of these allegations or that (2) have not been filed by or on behalf of the domestic industry concerned. The information to be submitted must address, among other things, the nature of the subsidies being provided to the foreign producers, the competitive benefits that these subsidies bestow, and injury to the U.S. industry by reason of the subject imports.

Countervailing Duties Usually Applied in Tandem with Antidumping Duties

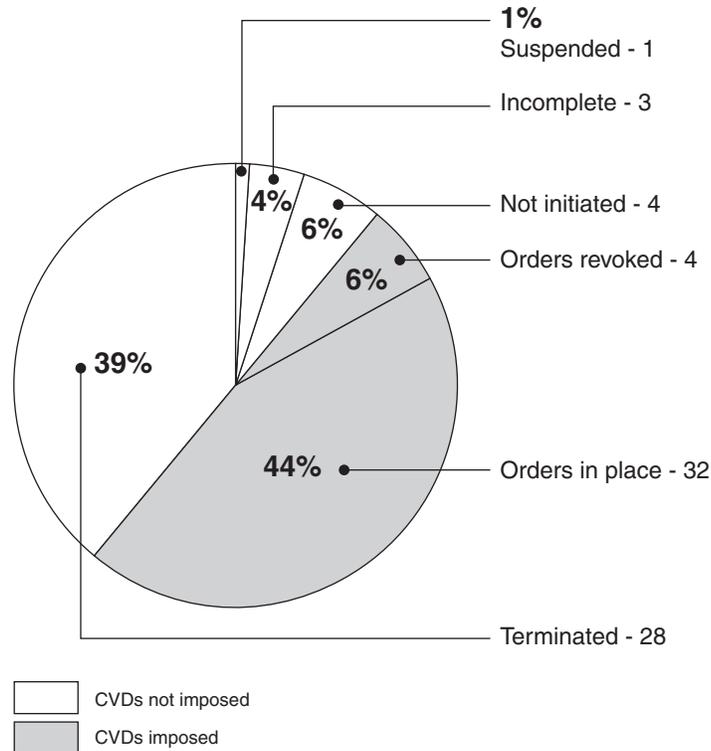
The United States has imposed CVDs with some regularity, on a variety of products from a variety of countries.⁶ From 1995 through 2004, U.S. domestic industries petitioned for 72 CVD investigations against 43 different products from 25 countries.⁷ Thirty-six of these investigations (50 percent) resulted in application of CVDs.⁸ Figure 4 shows the results of these 72 petitions.

⁶The United States has more CVDs in place than any other country. According to the WTO, the United States had 57 CVD measures in place as of June 2004. The next highest reported totals were for the European Community (18) and Canada (10). See WTO, *Report (2004) of the Committee on Subsidies and Countervailing Measures*, G/L/711 (Geneva, Nov. 9, 2004).

⁷The Department of Commerce declined to initiate investigations in 4 of the 72 cases, involving certain crude petroleum oil products from Mexico, Iraq, Saudi Arabia, and Venezuela, because of insufficient U.S. industry support for the petition. 64 Fed. Reg. 44480 (Aug. 16, 1999).

⁸Twenty-three of these 36 cases (64 percent) involved steel products. Other products included pasta, honey, softwood lumber products, low enriched uranium, and semiconductors. India was the country most petitioned against (10 out of the 72 investigations), while Italy faced the most positive determinations. (All six of the investigations against Italy resulted in CVDs.)

Figure 4: Results of 72 CVD Petitions, 1995-2004



Source: Federal Register.

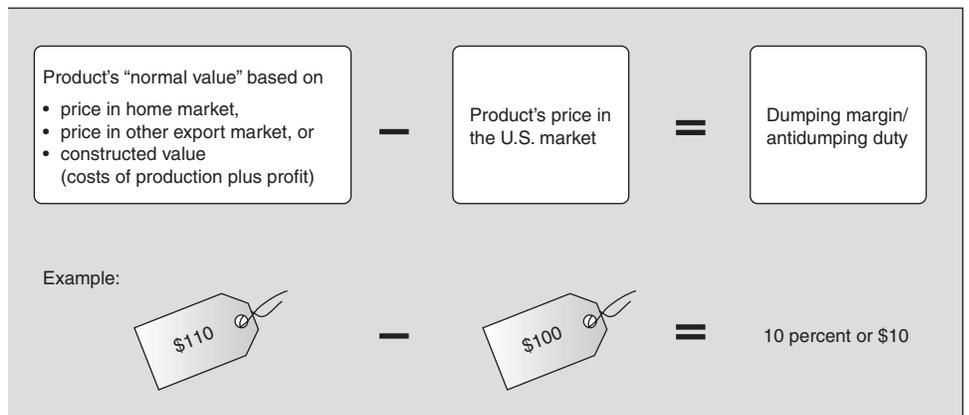
Note: There are currently 57 CVD orders in place. Thirty-two of these (as shown in the figure) resulted from petitions filed from 1995 through 2004. The remainder resulted from petitions filed prior to 1995.

Generally, when petitioners seek imposition of CVDs, they also seek imposition of antidumping duties on the same product from the same country. In 69 of the 72 CVD cases, petitioners also requested a companion antidumping investigation.⁹

⁹The three cases in which petitioners requested CVDs but not antidumping duties involved laminated and hardwood flooring from Canada (1996), carbon and certain alloy steel wire rod from Turkey (2001), and D-RAMS (a type of semiconductor) from Korea (2002). The Department of Commerce did order assessment of antidumping duties against Korean D-RAMS beginning in 1993. However, this order was revoked approximately two years prior to initiation of a CVD action against these products.

Dumping occurs when a foreign company sells merchandise in a given export market (for example, the United States) at prices that are lower than the prices charged in the producers' home market or another export market. When this occurs, and when the imports have been found to materially injure, or threaten to materially injure, U.S. producers, WTO rules and U.S. laws permit application of antidumping duties to offset the price advantage enjoyed by the imported product. As in CVD cases, Commerce analysts establish antidumping duties for each known producer or exporter. Figure 5 illustrates how antidumping duties are determined.

Figure 5: How Are Antidumping Duties Determined?



Source: 19. U.S.C. §§ 1673 and following.

Note: As with CVDs, the Department of Commerce and ITC share responsibility for processing antidumping actions. Commerce determines whether and to what extent dumping is taking place, while ITC determines whether a U.S. industry has suffered material injury as a result. Duties may be imposed only if both agencies make positive determinations.

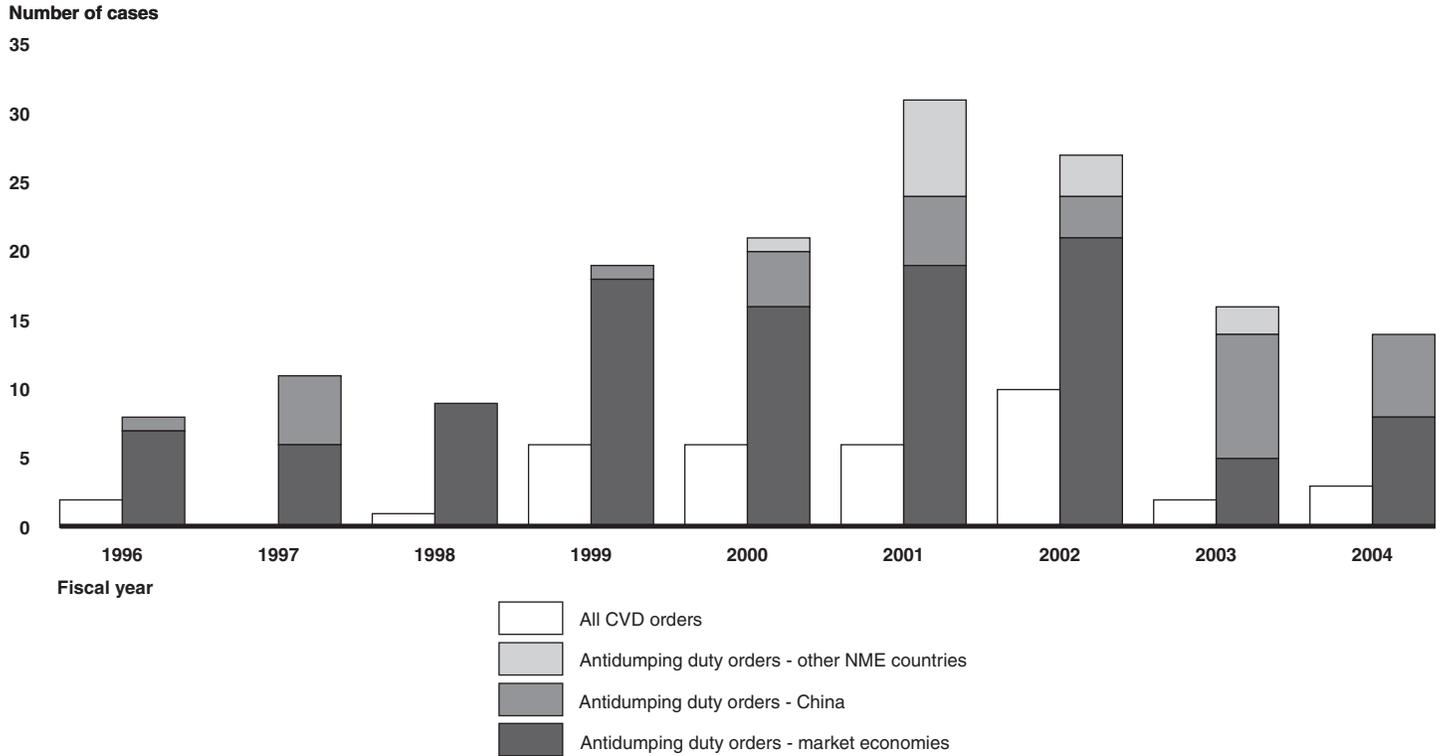
Petitioners requesting antidumping investigations do not always request CVD investigations, and CVDs are, in fact, sought and imposed much less frequently than are antidumping duties. From 1995 through 2004, U.S. industry groups petitioned for nearly five times as many antidumping as countervailing duty investigations (354 compared with 72). Similarly, the United States put in place over four times as many antidumping duty orders (156) as it did CVD orders (36).

Figure 6 shows the distribution of these countervailing and antidumping duty orders by year for 1996 through 2004. For antidumping orders, these are further broken down into orders against market economies, China, and

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other nonmarket economies. The number of CVD orders imposed might have been higher, and the contrast with antidumping duty orders less pronounced, if CVDs had been available against nonmarket economies during this period. Nonetheless, figure 6 shows that even among market economy countries, the United States imposes CVDs much less frequently than antidumping duties.

Figure 6: U.S. CVD Orders against All Countries and Antidumping Duty Orders against Market Economies, Other NME Countries, and China, 1996-2004



Notes: The figure shows the countervailing and antidumping duty orders issued each year as a result of petitions submitted from 1995 through 2004. The figure does not provide data for 1995 since all of the investigations based on petitions filed in that year remained incomplete at the end of the year.

According to the WTO, antidumping and countervailing duties affected less than 0.5 percent of U.S. imports in 2001. See WTO, *Trade Policy Review—United States 2004* (Geneva, 2004).

Comments from the Department of Commerce

Note: GAO comments supplementing those in the report text appear at the end of this appendix.



UNITED STATES DEPARTMENT OF COMMERCE
The Under Secretary for International Trade
Washington, D.C. 20230

JUN 1 2005

Mr. Loren Yager
Director
International Affairs and Trade
U.S. Government Accountability Office
Washington, D.C. 20548

Loren
Dear Mr. Yager:

Thank you for the opportunity to comment on the Government Accountability Office (GAO) draft report entitled, "US-China Trade: Commerce Faces Practical and Legal Challenges in Applying Countervailing Duties (GAO-05-074).

Enclosed are the Department's comments on the draft report. In addition, attachment one contains technical edits to the draft report. We hope our comments as well as the suggested edits assist you and your staff in addressing this important issue. If you have any questions or concerns regarding our response, please address them to John Herrmann at 202-482-1780.

Thank you again for requesting the Department's views on the draft report.

Sincerely,

Handwritten signature of Timothy J. Hauser in black ink.

Timothy J. Hauser
Acting

Enclosure



DOC Response to GAO Report on China and CVD

The following responds to a pre-publication draft report entitled “U.S.-CHINA TRADE: Commerce Faces Practical and Legal Challenges in Applying Countervailing Duties” that the Government Accountability Office (GAO) provided to the Department of Commerce for review and comment. The draft report explains why the United States has in the past not applied the U.S. countervailing duty (CVD) law to China, describes options for changing this policy, and examines the challenges and implications of such changes. The draft report makes two recommendations to the Department of Commerce for action to be undertaken in advance of any decision to apply the U.S. CVD law to China. In the event that a decision is made by Congress or Commerce to begin applying the CVD law to China, the report also urges that Congress consider legislation that would ensure an accurate application of the CVD law to China.

See comment 1.

At the outset we would like to comment on one of the premises that informs the draft report. This premise is that Commerce does not now have clear legal authority to apply the CVD law to China, and to do so would require either new CVD legislation or the Department’s “graduation” of China to market economy status for purposes of the U.S. antidumping laws. First, there is no explicit statutory bar against applying the CVD law to NME countries. Similarly, it is inaccurate to state that the Department does not currently accept CVD petitions against China. Rather, given the ruling in *Georgetown Steel*, the Department has not for some time received any CVD petitions against China. The Department would carefully review any CVD petition against China, as it does all CVD petitions, to ensure that all legal and evidentiary requirements have been met, giving due consideration to any difficulties arising from benchmark or data source concerns. Finally, it is not correct to presume that applying the CVD law to China would necessarily lead to China’s graduation to market-economy status under the antidumping law. While such a decision may result in China formally requesting that it be graduated, this is not required under either U.S. law or China’s WTO accession protocol.

See comment 2.

With respect to other issues relating to the draft report, the GAO recommends that:

“In order to provide decision-makers in Congress and the Department of Commerce with better information about the implications of taking actions that would result in application of U.S. CVD laws to China, we recommend that the Secretary of Commerce analyze and report to Congress on

- Commerce’s ability to identify and measure subsidy benefits at the present time, based on its knowledge of significant Chinese subsidy programs; and
- methodologies that Commerce would employ to complete CVD actions against Chinese products, if called upon, including how it would respond to potential counting of domestic subsidy benefits when applying both countervailing and antidumping duties to the same products.”

See comment 3.

With respect to the draft report’s second recommendation, the Department does not believe it would be a meaningful or appropriate exercise to report to Congress the methodologies it would conceivably employ to address PRC government subsidies in potential future CVD proceedings. At best, this would amount to a speculative exercise that would occur in the absence of a full

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factual record and would not be based on any administrative experience, established practice, or expertise in applying CVD to non-market economy countries. Of greater concern, however, is that such a report could pre-judge the outcome of a future case. We believe the most appropriate forum in which to make decisions on the best CVD methodology to apply would be in the context of future cases. Applying the CVD law to China would be a challenging exercise, but the best methodology for doing so would hinge, in part, on the particular facts of any proceeding that may ultimately be brought before the Department. Conducting such an analysis within the context of an actual proceeding would also provide interested parties with a full opportunity to participate and comment on any proposed methodology that might be adopted by the Department. Furthermore, the Department's determination would be subject to judicial review.

See comment 4.

In the event that the Department should begin to apply the CVD law to China, the draft report also recommends that Congress consider granting the Department authority to employ third-country information in CVD cases. The draft report states that Commerce "has never applied third-country information in CVD cases, and moreover, does not have clear legal authority to do so." This statement should be revised to reflect Commerce's practice prior to issuance of the final report. In particular, Commerce has the authority to use external benchmarks under 19 C.F.R. §351.511 of the CVD regulations in certain circumstances for purposes of identifying or measuring a subsidy. (*See, e.g., Notice of Final Affirmative Countervailing Duty Determination and Final Negative Critical Circumstances Determination: Certain Softwood Lumber Products From Canada*, 67 Fed. Reg. 15,545 (Apr. 2, 2002), and accompanying Decision Memorandum; and *Notice of Final Results of Countervailing Duty Administrative Review and Rescission of Certain Company-Specific Reviews: Certain Softwood Lumber Products from Canada*, 69 Fed. Reg. 75,917 (Dec. 20, 2004), and accompanying Decision Memorandum.) Commerce has successfully defended this methodology at the WTO with respect to the first lumber CVD case cited above. Commerce has also used international lending rates, such as LIBOR, to measure the benefit from government-provided foreign-currency denominated loans or where no comparable domestic lending rates are available in accordance with 19 C.F.R. §351.505 of the CVD regulations. (*See, e.g., Final Affirmative Countervailing Duty Determination: Certain Stainless Steel Wire Rod from Italy*, 63 Fed. Reg. 40,474 (July 29, 1998); *Final Affirmative Countervailing Duty Determination: Certain CTL arbon-Quality Steel Plate from Italy*, 64 Fed. Reg. 73,244 (Dec. 29, 1999); and *Final Results of Countervailing Duty Administrative Review: Grain-Oriented Electrical Steel from Italy*, 66 Fed. Reg. 2885 (Jan. 12, 2001).)

See comment 5.

The draft report also recommends that Congress consider legislative action, should Commerce undertake CVD cases against China, to "make corrections to avoid double-counting domestic subsidy benefits when applying both CVDs and antidumping duties to the same products, taking into account Commerce's analyses of these issues." We do not believe that this legislative action is either warranted or would be appropriate. First, given that the Department has not yet undertaken concurrent CVD and antidumping cases against China, there is no reason to assume that such double-counting would even exist. Second, because U.S. law does not currently allow for any adjustments to be made to the export price in an antidumping case for the amount of any countervailing duties collected to offset domestic subsidies (*see*, Section 772 of the Trade Act of 1930, as amended), the proposed change would put China into a special category distinct from all other countries when subject to concurrent antidumping and countervailing duty investigations. Such a change seems wholly inappropriate. Finally, we would like to point out

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that making such adjustments would raise complex methodological issues, the costs of which may far outweigh the purported equity gains of any such adjustment.

The following are GAO's comments on the Department of Commerce's letter dated June 1, 2005.

GAO Comments

1. We agree that U.S. trade law does not explicitly bar CVD actions against NME countries. Also, we acknowledge that the Department of Commerce remains open to considering petitions for CVD action against such countries, and that Commerce could conceivably decide that the facts in a particular case warrant and permit applying CVDs in an NME context. We have revised the text to ensure that these points are clearly stated.

Nonetheless, while not explicitly barring CVD actions against NME countries, U.S. trade law also does not explicitly authorize such actions, and both Commerce and a U.S. Court of Appeals decision have indicated that U.S. CVD law was not intended to be applied to NME countries. This position was also supported by the Statement of Administrative Action accompanying the 1994 Uruguay Round Agreements Act. Accordingly, we conclude that there would be legal obstacles to Commerce reversing its policy and allowing CVD actions against NME countries, including China. It is likely that, absent a clear grant of authority, such a policy change would result in court challenges.

2. We do not presume that applying CVD law to China would require that China be designated a market economy under U.S. antidumping law. We assume that if Commerce applied CVDs to China without changing its status as an NME country, it would continue to apply its NME methodology in antidumping cases against that country.
3. We agree that completing CVD actions against China would be a challenging exercise, and that specific decisions on how best to complete such actions would depend on the facts at hand in particular cases. We do not intend to suggest that Commerce provide detailed analyses of how it would respond in case-specific circumstances.

Nonetheless, a Commerce study evaluating how it might generally proceed in such cases would be helpful to Commerce itself and Members of Congress in considering whether to take actions that would lead to CVD cases against NME countries, as well as to potential parties to such actions concerned about how to proceed in such cases. For example, such a report could address (1) benchmark information

from within or outside China that Commerce would consider in measuring subsidy benefits, (2) methods and approaches that could be employed to respond to potential double counting of domestic subsidy benefits, and (3) how China's WTO commitment regarding subsidies and state-owned enterprises might affect specificity determinations.

We have revised the report text to make these points.

4. We acknowledge that Department of Commerce regulations do provide for applying information from outside a subsidizing country to assist in assessing subsidy benefits—in some circumstances—and that Commerce has applied them in a number of cases. We have revised our report to include information on these provisions.

Nonetheless, current U.S. law does not explicitly authorize Commerce to fully apply China's commitment regarding the use of information from outside China to complete CVD actions. Also, as discussed in more detail in the body of the report, the methodologies set forth in regulatory provisions cited by Commerce do not apply to the full range of subsidies that might arise in a CVD case. Moreover, the methodology in the more specific of these provisions has been questioned in a dispute settlement case under the North American Free Trade Agreement.

5. We agree that any legislation authorizing Commerce to adjust duty rates to avoid double counting in applying countervailing and antidumping duties to products from NME countries should not apply only to China. We have modified the report text to make this clear.

We disagree with Commerce's comment that legislative action on this matter is not warranted or appropriate. We believe that sound economic reasoning suggests that there is substantial potential for domestic subsidies to be double counted in the event that Commerce applies CVDs to NME country products while continuing to use third-country information to calculate antidumping duties on those same products. Therefore, congressional action to provide Commerce with authority to avoid double counting in these instances would be prudent. We agree that making such adjustments could raise complex methodological issues. It is for this reason that we recommend that, in reporting on methodologies for completing CVD actions against China, Commerce include discussion on responding to potential double counting of domestic subsidy benefits. This would allow Commerce to

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evaluate, among other things, the feasibility and cost of making such adjustments and their likely impact.

GAO Contact and Staff Acknowledgments

GAO Contact

Loren Yager, (202) 512-4347

Staff Acknowledgments

In addition to those named above, the following individuals made significant contributions to this report: Adam R. Cowles, R. Gifford Howland, Michael McAtee, Richard Seldin, Ross Tuttelman, and Timothy Wedding.

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