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Introduction

When China joined the WTO, there was a certain expectation that a large new market would be opened and that China would, over time, change and become more of a fair trade actor. Regrettably, the path that China has chosen has challenged the very foundation of the WTO and the world trading system. They have chosen to adopt a mercantilist system that has proven to be very difficult for the WTO to gets its arms around, much less to counter. I believe that the future of the WTO, and even the world trading system, is currently at issue as we examine how the WTO will deal with China.

The United States Should Push For Reform To The WTO Dispute Settlement Process

Prior to discussing whether efforts to offset Chinese subsidization are helped or hampered by our membership in the WTO, it is important to note that the functioning of the WTO's dispute settlement system has been, to put it mildly, much less than ideal. In discharging their functions, panels have to observe the standard of review set forth in Article 11 of the WTO's Dispute Settlement Understanding ("DSU").[1] Notably, panels reviewing anti-dumping determinations are subject to a different standard of review, on account of the complexities involved in anti-dumping proceedings. In particular, Article 17.6 of the Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994 (the "AD Agreement") provides:

> In examining [a "matter"]:
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> (i) in its assessment of the facts of the matter, the panel shall determine whether the authorities' establishment of the facts was proper and whether their evaluation of those facts was unbiased and objective. If the establishment of the facts was proper and the evaluation was unbiased and objective, even though the panel might have reached a different conclusion, the evaluation shall not be overturned;

[1] Article 11 of the DSU provides: "The function of panels is to assist the DSB in discharging its responsibilities under this Understanding and the covered agreements. Accordingly, a panel should make an objective assessment of the matter before it, including an objective assessment of the facts of the case and the applicability of and conformity with the relevant covered agreements, and make such other findings as will assist the DSB in making the recommendations or in giving the rulings provided for in the covered agreements". In addition, Article 3.2 of the DSU notes that the WTO dispute settlement system should "clarify the existing provisions of the [covered] agreements in accordance with customary rules of interpretation of public international law".

> (ii) the panel shall interpret the relevant provisions of the Agreement in accordance with customary rules of interpretation of public international law. Where the panel finds that a relevant provision of the Agreement admits of more than one permissible interpretation, the panel shall find the authorities' measure to be in conformity with the Agreement if it rests upon one of those permissible interpretations.

Thus, the special standard of review under Article 17.6 of the AD Agreement has two components. First, in examining the WTO consistency of the legal interpretations adopted by an investigating authority, panels have to interpret the provisions of the AD Agreement in accordance with the customary rules of interpretation of public international law;[2] however, in the event that a provision in the AD Agreement admits more than one "permissible interpretation", a panel should uphold a measure if based on any one of those permissible interpretations. Second, in examining the WTO consistency of a factual determination by an investigating authority, panels can overturn such determination only if the establishment of the facts involved was not accurate or if the evaluation of those facts was biased and not objective. Thus, the standard of review set forth in Article 17.6 of the AD Agreement instructs panels not to engage in *de novo* review and gives them the legal authority to overturn legal interpretations and factual findings by investigating authorities under very limited circumstances.

Given that the AD Agreement has a multiplicity of provisions whose language is somewhat broad or vague precisely to accommodate conflicting positions that could not be completely reconciled at the negotiations stage, one would expect the number of anti-dumping determinations that panels have viewed as relying on constructions of provisions in the AD Agreement that fall within the ambit of "permissible interpretations" to be rather large. Surprisingly, the record shows exactly the reverse. In particular, out of the 80 anti-dumping disputes that have been litigated at the WTO from 1995 to 2009,[3] to my knowledge only on two occasions have panels or the Appellate Body (the "AB") specifically found that a legal interpretation by an investigating authority falls within the category of "permissible interpretations".[4]

Thus, to any impartial observer, it would appear that panels have exhibited a remarkable tendency to overreach.

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[2] A requirement which mirrors the general obligation set forth in Article 3.2 of the DSU.

[3] Kara Leitner and Simon Lester, "WTO Dispute Settlement 1995-2009: A Statistical Analysis", *Journal of International Economic Law*, Vol. 13, No. 1, March 2010, page 210.

[4] In *US-Hot Rolled*, the AB found that Commerce's determination of the normal value of related-party sales by making adjustments to the downstream resale price to independent parties was a permissible interpretation of Article 2.1 of the AD Agreement. See, *United States - Anti-Dumping Measures on Certain Hot-Rolled Steel Products from Japan*, Appellate Body Report, WT/DS184/AB/R, adopted August 23 2001, para. 172 ("we find that the reliance by USDOC on downstream sales to calculate normal value rested upon an interpretation of Article 2.1 of the Anti-Dumping Agreement that is, in principle, "permissible" following application of the rules of treaty interpretation in the Vienna Convention") and *United States - Measures Relating to Zeroing and Sunset Reviews*, Panel Report, WT/DS322/R, adopted January 23, 2007, as modified by the Appellate Body Report, para. 7.142 ("we conclude that it is permissible within the meaning of Article 17.6(ii) of the *AD Agreement* to interpret Article VI of the GATT 1994 and relevant provisions of the *AD Agreement* to mean that there is no general requirement to determine dumping and margins of dumping for the product as a whole, which, by itself or in conjunction with a requirement to establish margins of dumping for exporters or foreign producers, entails a general prohibition of zeroing").

Interestingly, in many of the cases where panels have restrained themselves and remained within the bounds of their narrow jurisdiction, it is the AB itself that has engaged in overreach. The history of the WTO litigation on "zeroing" clearly illustrates this point.

As is well known, the AD Agreement is completely silent on the issue of zeroing. Nevertheless, In *EC-Bed Linen* (a case brought against the European Communities), the panel found that zeroing, as practiced in original investigations and in the context of comparing a weighted average normal value against a weighted average export price, was inconsistent with Article 2.4.2 of the AD Agreement. In reaching this conclusion, the panel oddly interpreted the language "all comparable export transactions" in this provision as barring zeroing (under the theory that zeroing is equivalent to making export prices lower than what they actually are and that this alleged manipulation implies calculating the weighted average export price on something other than "all comparable export transactions"). Be that as it may, given that the language "all comparable export transactions" only applies with respect to the weighted average to weighted average methodology for calculating the dumping margin in original reviews, one would have expected the resulting ban on zeroing to be inconsequential for the other two methods foreseen in Article 2.4.2 for calculating the dumping margin in original reviews, and for any method used for calculating the dumping margin in annual reviews, new shipper reviews and sunset reviews (issues which are expressly outside the scope of Article 2.4.2).

The panels in *Softwood Lumber V (21.5 Proceeding)*, *Zeroing (EC)*, *Zeroing (Japan)*, and *Stainless Steel (Mexico)* followed this line of argument precisely. In particular, the panel in *Softwood Lumber V (21.5 Proceeding)* found that zeroing, as practiced by comparing individual normal values against individual export prices in the context of annual reviews, was not inconsistent with Article 2.4.2 of the AD Agreement. In turn, the panels in *Zeroing (EC)*, *Zeroing (Japan)*, and *Stainless Steel (Mexico)* found that zeroing, as practiced through modalities other than a comparison of weighted averages in the context of original investigations, annual reviews, new shipper reviews and sunset reviews, was not inconsistent with Article 2.4.2. The Appellate Body disagreed and overturned these four panels, on the basis of a series of "justifications" that can be best described as a moving target.

The moral of this story is that, even in those cases where panels get things right by sticking to the special standard of review under Article 17.6 of the AD Agreement, the Appellate Body often will find legal obligations where none exist in the treaty text.

The WTO Regime, As It Currently Stands, Is Not Fully Able To Meet The Challenges Posed By Dumping And Subsidies

The challenges posed by dumping and subsidies used by Chinese producers are enormous. These practices are so pervasive that the WTO rules designed to deal with them are rendered close to meaningless. While the existence of the trade remedy laws is better than not having any means to offset these practices, a more systemic approach is essential to address the root causes. The enormous subsidies provided by the Chinese government to favored industries, combined with the massive advantage given to Chinese exporters as a result of currency undervaluation and through the manipulation of the VAT rebate system in China, simply swamp the redress afforded under the current WTO system. At best, industries that have the resources and wherewithal to bring trade actions can benefit from duties that offset the pervasive dumping and subsidies that

we have seen in many industries. But there are many industries in the United States and in other countries that have already been decimated by the wide-spread unfair trade practices of Chinese companies -- and for these industries it is simply too late.

Perhaps in time China will come to understand that the bedrock principal of the WTO regime is the operation of free markets, where an industry's success is founded on comparative advantage, not based on a government's intervention to promote and guarantee success. This message must come, first and foremost, from the WTO itself, and from the WTO leadership, in particular. Simply looking the other way when China engages in the mercantilist policies that form the core of China's current trade strategy, risks the entire system, and the multilateral consensus upon which it is based. The institutional bias of the dispute settlement system against the use of trade remedy laws has exacerbated the problem, and sends exactly the wrong message to Chinese policymakers.

There have been some examples where the use of the WTO consultation and dispute settlement mechanisms have resulted in positive policy reforms in China. In DS358/ DS359, for example, a number of countries, led by the United States, challenged a host of China's export-contingent tax refunds, reductions, and exemptions. This dispute was ultimately settled, with China offering to withdraw the subsidies involved. Similar challenges in DS387/DS388/DS390, are still pending. WTO members have also successfully challenged China's discriminatory application of its indirect tax regime aimed at providing protection to domestic industries. In DS309, the United States challenged the 17 percent VAT imposed on imported integrated circuits as compared to the 3 percent VAT levied on integrated circuits of domestic origin. As a result of this challenge, China offered to cease the practice. Similarly, in DS339/DS340/DS342, the WTO Appellate Body upheld the panel's finding that China applied on imported auto parts a tax charge that was not applied on auto parts of domestic origin.

But again, these challenges are a drop in the bucket compared to the vast arsenal of market intervention tools that the Chinese government has at its disposal -- including ownership over most key raw materials, land, energy, and capital, and complete control over the exchange rate. Without a more systemic approach to dealing with these disjunctures, national trade remedy laws and the WTO dispute settlement process are like using a pea shooter to bring down a stampeding elephant. Moreover, even with respect to the above cases, the real long term effects of these apparent successes are unclear, as China contemplates or implements alternative strategies that achieve the same results.

The Commission questions whether U.S. efforts to deal with dumping and subsidies used by China are hampered or helped by <u>our</u> WTO membership. Of course, the United States has been at the forefront of market opening efforts, and its stake in the system is too vast to imagine a world where the U.S. simply opts out. But it is the fact that our efforts to deal with Chinese dumping and subsidies may in fact be harmed at this point by WTO oversight, since the appropriate standard of review is rarely applied. Our administrators are not only trying to deal with the WTO rules, which in themselves impose constraints on legitimate efforts to counter unfair trade practices. But in addition, they now must deal with illegitimate constraints imposed by improper WTO decisions which go beyond the mandate of the agreements--such as the

decisions in the zeroing and CDSOA cases. The United States has made the decision to apply even these improper WTO decisions.

Moreover, I believe that global trade policymakers were somewhat overly optimistic in their assumption that China's accession to the WTO would automatically lead to a greater market orientation in China. It may well result in greater market orientation, but only if the United States, and the rest of the free trade world, continue to demand positive market-oriented changes in China. If China's policies are left unchallenged, the fundamental principals of the WTO system are compromised, and the WTO risks becoming a facilitator for China's mercantilist policies rather than being a force for change.

We Can, And Should, Use Our Unfair Trade Laws To Counter China's Underpriced Currency

The WTO Agreement on Subsidies and Countervailing Measures ("SCM Agreement") has a clear and strict definition of a countervailable subsidy: there must be a financial contribution, there must be a benefit, and there must be specificity. This exact definition of a countervailable subsidy is incorporated in United States Unfair Trade laws at § 771(5) & (5A) of the Tariff Act of 1930.[5] China's practice of undervaluing its currency to gain unfair trade advantage meets all the legal criteria necessary for the imposition of countervailing duties: The Chinese government through its currency practices makes a financial contribution that provides a benefit which is specific to exporters and certain other groups of Chinese manufactures. As a result, the United States absolutely can and should use countervailing duties to counter China's harmful currency practices.

Furthermore, we believe that the United States' imposition of countervailing duties not only will withstand WTO scrutiny, but indeed the authority to apply countervailing duty law to remedy unfair currency practices rests squarely within the WTO Agreements. We need only look at the General Agreement on Tariffs and Trade ("GATT"), its negotiating history, and the SCM Agreement to see that countervailing duties are an appropriate and necessary remedy to deal with China's currency undervaluation.

Three points illustrate that the WTO system clearly allows the application of the CVD law to currency practices.

First, while drafting the GATT, the Preparatory Committee of the United Nations Conference on Trade and Employment ("Preparatory Committee"), which included delegates from China, discussed situations where a country's devaluation of its currency creates a subsidy to its exporters. As the Australian delegation to the Preparatory Committee stated:

> We see great dangers, both in regard to a country's exports and to a country's imports from multiple currency practices….As regards imports

[5] 19 U.S.C § 1677(5) & (5A).

> into our own country, we feel that multiple currency practices may, in certain circumstances, constitute an export subsidy.[6]

This concern that currency practices could generate a subsidy to a country's exports is memorialized as GATT Ad Art. VI, ¶ 2 & 3, note 2, which states that "multiple currency practices can in certain circumstances constitute a subsidy to exports which may be met by countervailing duties under paragraph 3 {GATT Article VI} or can constitute a form of dumping by means of a partial depreciation of a country's currency which may be met by action under paragraph 2 {GATT Article VI}."

Second, GATT Article XV: 4, states that "Contracting parties shall not, by exchange action, frustrate the intent of the provisions of this Agreement, nor, by trade action, the intent of the provisions of the Articles of Agreement of the International Monetary Fund." Clearly, by causing its currency to remain undervalued, thereby promoting its exports at the expense of its trading partners (and hindering imports into China), the Chinese undermine GATT's intent.

Third, the SCM Agreement's Illustrative List of Export Subsidies, item (b) is "Currency retention schemes or any similar practices which involve a bonus on exports." Our economic analysis indicates that Chinese manufacturers who exchange dollars for RMB receive 40 percent more RMB than they would if RMB were at an equilibrium rate of exchange. This is unequivocally a bonus on exports.

These three points together illustrate that the GATT/WTO system provides that countervailing duties can and should be applied to remedy currency practices that give rise to subsidies. U.S. law is consistent with its obligations under these agreements.

Furthermore, under U.S. law, the investigation of a country's currency practices as a countervailable subsidy is not an issue of first impression. Instead, there is a fifty-year history during which the United States has investigated alleged currency subsidies by Mexico, Uruguay, and Germany.[7] The United States should treat China no differently than other countries. Although the ultimate imposition of a countervailing duty can only be decided in the course of an investigation, these prior investigations demonstrate that the countervailing duty law provides an appropriate remedy for currency subsidies.

Moreover, what is at issue right now in cases before the U. S. Department of Commerce is only the question of initiation of a case. In the petitions currently before the Department of Commerce, we have demonstrated all the elements necessary for initiation of a countervailing duty investigation. In fact, these petitions not only meet the legal standard for initiation, we believe they far exceed the standard for initiation both under the WTO and under U.S. law.

The initiation standard for an investigation under the Tariff Act is quite clear: "A countervailing duty proceeding *shall* be initiated whenever an interested party…files a petition with the

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[6] *See* U.N. Economic and Social Council, 2d Session of the Preparatory Committee of the United Nations Conference on Trade and Employment, *Verbatim Report of the Thirty-Second Meeting of Commission A*, E/PC/T/A/PV/32 (July 23, 1947).

[7] *See Final Negative Countervailing Duty Determination; Pork Rind Pellets From Mexico*, 48 Fed. Reg. 39,105 (Aug. 29, 1983)(the investigation of Mexico's currency practices is the most recent investigation of currency practices under U.S. law).

administrating authority…which alleges the elements necessary for the imposition of the duty…and which is accompanied by information reasonable available to the petitioner supporting those allegations."[8]

The legislative history of the U.S. Unfair Trade laws is also clear and solidly supports that we have exceeded the standard for initiating an investigation of China's currency practices. The legislative history of the Trade Agreements Act of 1979 states that:

> "{T}he Committee expects that the Authority will act upon most petitions, rejecting only those which are clearly frivolous, not reasonably supported by the facts alleged or which omit important facts which are reasonably available to the petitioner. The Committee views the rigor of the requirements of this threshold test as roughly analogous to the rigor of the requirements necessary to make out a cause of action for purposes of civil litigation."[9]

Three points from this history, and section 702(b)(1) of the Tariff Act, indicate to us that our petitions on Chinese currency practices meet the standard for initiation of an investigation: (1) the petitions are not frivolous: they are substantial, well-researched, and supported by expert economic data analysis; (2) the petitions are based on reasonably available factual information; and (3) the petitions allege the elements necessary for the imposition of the duty imposed by section 701(a).

The "elements necessary" for the imposition of a countervailing duty are: (1) financial contribution, (2) benefit, and (3) specificity.

a. Financial Contribution:

The first element that the law requires for the imposition of a countervailing duty is that a government, or a public body, provides a "financial contribution." The form of the financial contribution can vary but in this case, the Chinese government directly transfers funds to its manufacturers. When Chinese manufacturers earn foreign exchange through exports, they are required to exchange most earnings for RMB at government-mandated exchange rates and at government-owned banks or government-authorized exchange facilities.

b. Benefit:

The second element that the law requires for the imposition of a countervailing duty is that the subsidy provides a benefit to the recipient. The current economic research indicates that the Chinese government understates the value of the RMB vis-à-vis the dollar by 40 percent. As a result, when a Chinese manufacturer exchanges dollars, they

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[8] *See* § 702(b)(1) of the Tariff Act of 1930, 19 U.S.C § 1671a(b)(1).
[9] *See* H.R. Rep. No. 317, 96th Cong., 1st Sess. 51 (1979). *See also Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 556 (U.S. 2007)(interpreting Fed. R. Civ. P. 8 on requirements necessary to state a claim for relief in Federal civil litigation and holding); *see also Ashcroft v. Iqbal*, 129 S. Ct. 1937, 1953 (U.S. 2009)(applying Twombly's interpretation of Rule 8 to all federal civil actions).

receive much more RMB than they would absent the Chinese government's direct intervention in the currency market.

c. Specificity:

The third element that the law requires for the imposition of a countervailing duty is that the subsidy be "specific." The basic premise of this legal provision is to prevent application of countervailing duties to subsidy practices that governments use for the greater benefit of society as a whole. For instance, the law normally would not apply countervailing duties for subsidies granted to infrastructure like highways, parks, or hospitals because these benefit the greater good.

However, if a subsidy is limited to certain groups, then it is "specific" and can be remedied with countervailing duties. Our analysis indicates that the Chinese government's currency practices promote exportation—particularly by select groups of enterprises or industries—at the expense of domestic consumption and the overall health of its domestic economy. We submitted a thorough economic study from an outside economist to support this claim.

i. Exports:

If a subsidy is contingent upon export, then it is deemed a "specific" subsidy and countervailing duties can be applied. Both the WTO Appellate Body and the U.S. Court of International Trade ("CIT") have provided analysis of what subsidies meet the definition of an "export subsidy."

For the WTO, an export subsidy can be found if the subsidy generates sales of products and, as one point, considers export potential.[10] For the CIT, an export subsidy must simply be linked to exportation.[11] Our analysis shows that the Chinese government's currency practices undoubtedly meet both legal standards: currency undervaluation generates export sales and is linked to exportation.

Our economic study demonstrates that as of this January, 70 percent of China's foreign exchange earnings from Current Account transactions and from long-term Capital and Financial account transactions were from the export of goods.

ii. Foreign-Invested Enterprises ("FIEs"):

In China, FIEs receive numerous types of subsidies. One basis for determining that a subsidy is "specific" is to analyze whether certain groups of enterprises, like FIEs, (1) are the predominant users of a subsidy or (2) receive a disproportionate amount of subsidy.

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[10] *See* Panel Report, *Canada – Measures Affecting the Export of Civilian Aircraft*, WT/DS70/R, adopted 20 August 1999 at para. 9.341, as upheld by Appellate Body Report WT/DS70/AB/R, DSR 1999:IV, 1443.

[11] *See Can-Am Corp. v. United States*, 11 C.I.T. 424, 430 (Ct. Int'l Trade 1987)(upholding Commerce's interpretation of "contingent upon export").

> In analyzing Chinese currency practices, we found that FIEs alone accounted for over half of Chinese exports. Specifically, FIEs accounted for 56.1% of total exports from China between January and November 2009.[12] Therefore, FIEs are the predominant group of enterprises that receive excess RMB when they exchange their export earnings. Moreover, FIEs receive a disproportionate amount of currency subsidies. Our economic analysis indicates that although FIEs as a group likely account for no more than about 20% of GDP, they account for 55% of total Chinese exports.

Although we recognize that the International Monetary Fund ("IMF") has broad jurisdiction over international exchange rate policy, this jurisdiction does not negate the authority of international trade law over injurious subsidy practices. IMF scholars have recognized that a country's currency practices are addressable under the GATT/WTO trade agreements. In his seminal book, *Exchange Rates in International Law and Organization*, Sir Joseph Gold,[13] states that currency practices "have consequences under treaties other than the {IMF's} Articles. The most obvious treaty is GATT."[14]

Moreover, U.S. courts have also found that the IMF's treatment of a currency practice is irrelevant to whether that practice creates a countervailable subsidy. If a country's currency practices create a countervailable subsidy, then the Tariff Act requires that countervailing duties be imposed.[15]

Therefore, currency undervaluation as a subsidy is a WTO issue and cognizable under the WTO and the CVD law. There is no exception to the WTO because it is a currency issue. This would be like saying that the subsidies laws do not apply to agriculture or fisheries because there are separate laws or a separate department for agriculture or aquaculture issues. That is never a way the subsidies disciplines and laws have been circumscribed. I have already discussed the clear textual points from GATT Ad Art. VI, note 2, GATT Art. XV:4, and the SCM Agreement Illustrative List of Export Subsidies.

Conclusion

Two other points are occasionally raised in the context of discussing whether the CVD law should be applied to cover currency undervaluation. The first is that there are ongoing "negotiations" between China and the U. S. on currency and it is posited that these negotiations are the appropriate forum for dealing with this issue. My response to that is, first, that the United

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[12] FIE exports amounted to 55.3%, 57.1%, 58.2% and 58.3% of China's total exports in 2008, 2007, 2006, and 2005 respectively.

[13]Sir Joseph Gold served as a member of the International Monetary Fund from 1946 to 1960, as General Counsel and Director of the Legal Department from 1960 to 1979, and as Senior Consultant to the Fund until shortly before his death in 2000.

[14] *See* Sir Joseph Gold, *Exchange Rates in International Law and Organization* 278 (ABA 1988).

[15] *Energetic Worsted Corp. v. United States*, 51 Cust. Ct. 55, 65 (Cust. Ct. 1963) *rev'd* 53 C.C.P.A. 36 (1966)(Although the U.S. Customs Court upheld the Treasury Department's imposition of a countervailing duty under section 303 of the Tariff Act of 1930, the U.S. Court of Customs and Patent Appeals reversed this decision on the ground that the weighted benchmark used to calculate the subsidy benefit was not supported by substantial evidence).

States CVD law requires that the Commerce Department investigate whether currency undervaluation is a subsidy, and there is no exception to the law simply because negotiations are going on elsewhere. But secondly, the application of the CVD law to China on this issue, by a department of the U. S. government separate from Department of the Treasury which is leading the currency discussions, could in fact be very helpful to the progress of these negotiations. It is almost never a negative to have some kind of a stick in international negotiations, a stick which the CVD law would provide.

The second point is one I make quite regularly, which is reiteration of the reason the CVD law should be applied to currency undervaluation now. My view is that this is not a long term problem which can await some resolution next year or in the next decade or three weeks from never. United States workers are losing their jobs now, and towns across this country are shutting down along with the manufacturing plants in them. If this were the result of normal competitive processes, so be it. Competition is part of our capitalist system. But I find it almost unbelievable that we allow that to occur as a result of unfair trade and are doing nothing to counter that. That is not the way to solve a problem. And that is why the CVD law should be applied to currency undervaluation now.