



FAIR CURRENCY COALITION

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FACT OF THE WEEK (December 1, 2009)

HOW ENFORCED UNDERVALUATION OF A COUNTRY'S CURRENCY UNLAWFULLY SERVES AS AN EXPORT SUBSIDY (PART II)

Export-contingent subsidies have been prohibited as inherently distortive of international trade since 1947, when the fundamental rules that now govern international trade were adopted by the United States and other major trading powers through the signing of the General Agreement on Tariffs and Trade (GATT). The Fact of the Week dated October 13, 2009,¹ described how enforced protracted undervaluation of a country's currency (1) involves a governmental financial contribution, (2) benefits the recipient, and (3) is export-contingent. Those are the three tests that must be satisfied for an export subsidy to be prohibited under U.S. and international law. And when subsidized imports injure or threaten to injure a country's domestic industry, the relevant international agreements and U.S. law then permit the imposition of countervailing duties to neutralize the unfair advantage that results from the injurious subsidy.

Despite the clear logic of treating enforced undervaluation of a currency as a countervailable export subsidy, the U.S. Department of Commerce, the lead federal agency charged with administering the countervailing duty (CVD) law, has refused to investigate the matter. In a series of cases brought by U.S. producers and workers over the last couple of years, Commerce simply has said that the petitioning U.S. domestic industry has not "sufficiently alleged the elements necessary" for a countervailable subsidy (that is, a governmental financial contribution, a benefit to the recipient, and export-contingency).

In two recently commenced subsidy proceedings against imports into the United States of coated paper and steel fasteners from China, however, Commerce has finally expressed a reason as to why it refuses to investigate this issue. According to Commerce, the benefit of realizing more undervalued renminbi ("RMB") when a Chinese exporter exchanges U.S. dollars than if the renminbi were realistically valued is not export-contingent, thus failing the third test. In Commerce's words, ". . . receipt of the excess RMB is independent of the type of transaction or commercial activity for which the dollars are converted or of the particular company or individuals converting the dollars."

Commerce's train of thought actually reinforces the conclusion that enforced undervaluation of an exporting country's currency *is* a prohibited export subsidy. First, by focusing exclusively on

¹ See: <http://www.faircurrency.org/Factoftheweek/10%2013%2009%20FCC%20Fact%20of%20the%20Week.pdf>

the factor of export-contingency, Commerce appears implicitly to have accepted that the excess renminbi provided by the Chinese government in exchange for U.S. dollars is a governmental financial contribution and does provide a benefit to the Chinese exporter to the extent of the excess renminbi. Together, under the Agreement on Subsidies and Countervailing Measures of the World Trade Organization (“the SCM Agreement”), this contribution and this benefit constitute a subsidy.

Further, this subsidy is export-contingent. Under the SCM Agreement, subsidies contingent upon export performance, in law or in fact, “whether solely or as one of several other conditions,” are prohibited and countervailable. Only if a manufacturer in China exports goods and is paid in U.S. dollars does that manufacturer receive the subsidy of the excess RMB when the dollars obtained are exchanged for RMB. In contrast, if the manufacturer in China sells goods in China, the transaction will be denominated purely in RMB, such that there will be no dollar-RMB exchange and no additional RMB generated by that domestic sale in China.

Moreover, the fact that other commercial activities by other individuals and companies may be conducted in dollars does not negate the export-contingency of this subsidy. The key is that exportation is one of several conditions by which the subsidy can be obtained, and this basic point has been recognized and upheld in dispute settlements at the World Trade Organization. Indeed, exportation is the means by which the great preponderance of this subsidy is bestowed by the Chinese government.

Consider this simple hypothetical example:

- Wang exports a widget for \$1,000. When he cashes in those dollars, he receives 6,800 renminbi in exchange.
- If the fair market value of the \$1,000 is only 4,500 RMB, Wang gains a windfall of 2,300 RMB.
- Any subsequent buyer of those dollars, however, can resell the \$1,000 for 6,800 RMB, realizing no gain on the transaction.
- Thus, the only financial contribution and the only benefit are reaped by the exporter that first earned the dollars. The currency undervaluation conveys a subsidy that *is* contingent on export.

Commerce’s rationale for not investigating enforced undervaluation of another country’s currency consequently does not withstand scrutiny. Fundamental misalignment of a currency is a subsidy that is export-contingent and should be countervailed.

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