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June 25, 2007

**By Hand and Via E-Mail**

The Honorable Carlos Gutierrez  
U.S. Secretary of Commerce  
U.S. Department of Commerce  
14<sup>th</sup> Street & Constitution Ave., NW  
Washington, DC 20230

**Re: Request for Comments on Market Oriented Enterprises in Dumping  
Proceedings Involving China**

Dear Secretary Gutierrez:

These comments are submitted on behalf of the law firm of Stewart and Stewart in response to the Department's request for comments on its proposal to grant market-oriented enterprise ("MOE") treatment to individual respondents in antidumping proceedings involving China.<sup>1</sup> For the reasons detailed below, we believe that the Department should not implement a methodology that would allow individual respondents in dumping cases involving China to be granted MOE status.

First, the designation of an MOE enterprise within a nonmarket economy ("NME") country would be inconsistent with the Department's long-standing and consistent reading of the antidumping statute, under which the Department has invariably considered actual prices and costs from NMEs to provide an inappropriate basis for the calculation of normal value.

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<sup>1</sup> *Antidumping Methodologies in Proceedings Involving Certain Non-Market Economies: Market-Oriented Enterprise*, 72 Fed. Reg. 29,302 (Dep't Comm., May 25, 2007) (hereinafter "*Request for MOE Comments*").



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Second, it is both unreasonable and impractical for the Department to designate individual firms as market-oriented when – according to the Department’s own recent assessment of China’s NME status – government interventions in the Chinese economy are so deep and pervasive that they fundamentally distort prices and costs throughout the nation’s economy. Third, even if the Department were to attempt to analyze the market-orientation of an individual firm within China, any reasonable analysis must entail an examination of the entire industry and the economy in which that firm operates, as well as the market-orientation of the firm’s suppliers and customers and the market nature of the firm’s actual costs and prices. Finally, the Department’s recent decision to apply countervailing duty (“CVD”) law to China provides no basis for creating an MOE test in dumping proceedings.

For all of these reasons, we respectfully request that the Department not implement its proposal to grant individual respondents MOE status in dumping cases involving China. If the Department nonetheless decides to proceed with its proposal, we believe it is essential that the Department ensure that the alleged market-orientation of a firm be evaluated within the context of the industry and the market in which that respondent operates.

**I. Designation of Market-Oriented Enterprises Deviates from Commerce’s Well-Established NME Practice Under the Statute**

The Department’s proposal to grant MOE treatment to individual respondents in antidumping proceedings involving China would create an unwarranted and unworkable deviation from the Department’s well-established NME practice. In its many years of applying antidumping law to NMEs, the Department has never found that the method for calculating normal value in market economy cases should be applied to NMEs to allow the use of actual nonmarket economy costs and prices in its dumping calculation. When the

Department finds that available information does not permit the normal value of the subject merchandise to be determined in accordance with 19. U.S.C. § 1677b(a), the antidumping statute provides two methods by which the Department may determine the normal value of subject merchandise exported from an NME country: 1) on the basis of the value of the factors of production using prices or costs for these factors from one or more market economies at a comparable level of economic development; or 2) if available information is inadequate to permit the use of surrogate factor values, on the basis of the price at which merchandise comparable to the subject merchandise and produced in a market economy country at a comparable level of development is sold in third countries.<sup>2</sup>

In every antidumping proceeding involving an NME, the Department has invariably relied on one of these two methods. In applying the statute, the Department does not examine whether or not available information permits the calculation of normal value based on actual prices and costs on a case-by-case basis. To the contrary, the consistent practice of the Department every time that an NME is involved in an antidumping proceeding has been to automatically rely on one of the two normal value methods provided for NMEs, without undertaking any specific analysis regarding the availability of information that would permit reliance on actual costs and prices. In taking this approach, the Department has noted that the statute “directs ... {the Department} to base normal value (NV) on the NME producer’s factors of production, valued in a comparable market economy”<sup>3</sup> or that the statute “directs

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<sup>2</sup> 19 U.S.C. § 1677b(c).

<sup>3</sup> *Notice of Preliminary Determination of Sales at Less Than Fair Value, Postponement of Final Determination, and Affirmative Preliminary Determination of Critical Circumstances: Certain Color Television Receivers From the People’s Republic of China*, 68 Fed. Reg. 66,800, 66,803 (Dep’t Comm., Nov. 28, 2003). *See also Notice of Preliminary Determination of Sales at Less Than Fair Value and Postponement of Final Determination: Polyvinyl Alcohol From the People’s Republic of China*, 68 Fed. Reg. 13,674, 13,676 (Dep’t Comm., Mar. 20, 2003); *Notice of Preliminary Determination of Sales at Less Than Fair Value: Refined Brown Aluminum Oxide (Otherwise known as Refined Brown Artificial Corundum or Brown Fused Alumina) from the*

... {the Department} to base normal value, in most circumstances, on the NME producer's factors of production valued in a surrogate market-economy country."<sup>4</sup>

Through this long-standing and consistent practice, the Department has construed the statute to implicitly acknowledge that, while the law provides a theoretical option to rely on actual costs and prices in NME cases, as a practical matter that option is not viable. This reading of the statute is consistent with the provisions that the U.S. has negotiated internationally regarding antidumping proceedings involving NMEs.<sup>5</sup> With regard to China specifically, the U.S. negotiated the right to continue to apply NME methodologies to China for 15 years from the date of China's accession to the WTO.<sup>6</sup>

Commerce's well-established practice is further supported by the fact that the statute's very definition of a nonmarket economy appears to logically preclude reliance on actual prices and costs for normal value purposes:

The term "nonmarket economy country" means any foreign country that the administering authority determines does not operate on market principles of cost or pricing structures, so that sales of merchandise in such country do not reflect the fair value of the merchandise.<sup>7</sup>

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*People's Republic of China*, 68 Fed. Reg. 23,966, 23,968 (Dep't Comm., May 6, 2003); *Notice of Preliminary Determination of Sales at Less Than Fair Value and Postponement of Final Determination: Certain Malleable Iron Pipe Fittings From the People's Republic of China*, 68 Fed. Reg. 33,911, 33,913 (Dep't Comm., June 6, 2003).

<sup>4</sup> *Preliminary Determination of Sales at Less Than Fair Value and Partial Affirmative Determination of Critical Circumstances: Certain Polyester Staple Fiber from the People's Republic of China*, 71 Fed. Reg. 77,373, 77,375 (Dep't Comm., Dec. 26, 2006). See also *Preliminary Determination of Sales at Less Than Fair Value and Postponement of Final Determination: Certain Activated Carbon From the People's Republic of China*, 71 FR 59,721, 59,724 (Dep't Comm., Oct. 11, 2006); *Preliminary Determination of Sales at Less Than Fair Value: Certain Artist Canvas from the People's Republic of China*, 70 Fed. Reg. 67,412, 67,415 (Dep't Comm., Nov. 7, 2005).

<sup>5</sup> See Ad Note 2 to GATT Art. VI:1; WTO Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994 Art. 2.7.

<sup>6</sup> World Trade Organization, Protocol of Accession of the People's Republic of China, WT/L/432 (Nov. 23, 2001) at Art. 15(a) and (d).

<sup>7</sup> 19 U.S.C. § 1677(18)(A).

It would appear to be counterintuitive for the Department to find that actual prices and costs can be used to determine normal value for merchandise from a country that does not operate on market principles of cost or pricing structures. The statute goes on to list the factors that the Department must take into account when designating NMEs, including currency convertibility, the determination of wage rates by free bargaining, openness to foreign investment, government ownership or control of the means of production, and government control over resource allocation and price and output decisions.<sup>8</sup> Each of these factors describes broad, structural aspects of the country's national economy as a whole, not factors that could apply to only certain individual sectors or firms within an economy.

Given that the variety of broad distortions inherently present in the economies of countries that qualify as NMEs under 19 U.S.C. § 1677(18), the Department's consistent practice of not determining normal value on the basis of actual prices or costs in an NME country ensures that dumping calculations in NME cases are accurate, predictable, and fair. The Department's own regulations state that the Department will "normally" calculate normal value for NMEs using the NME methodologies identified by statute rather than the standard normal value methodologies applicable to market economies under 19 U.S.C. 1677b(a).<sup>9</sup> While the Department will use actual costs for an input where an NME producer purchases that input from a market economy supplier and pays for the input in a market economy currency, this practice is not really an exception to the Department's NME methodology of relying on market economy values.<sup>10</sup> To the contrary, this practice simply implements the statute's direction to rely on the best available information regarding market

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<sup>8</sup> 19 U.S.C. § 1677(18)(B).

<sup>9</sup> 19 C.F.R. § 351.408(a).

<sup>10</sup> 19 C.F.R. § 351.408(c)(1).

economy factor values by relying on actual market economy prices for specific input purchases rather than relying on publicly available information regarding market economy surrogate factor values.<sup>11</sup>

Furthermore, it should be noted that the Department's "separate rates" practice for individual respondents in antidumping proceedings involving China has no bearing on the current proposal to grant MOE status to individual respondents. The *de facto* and *de jure* independence criteria in the separate rates analysis relate only to the export side of a firm's operations, and they are not relevant to whether normal values reflect market forces.<sup>12</sup> The separate rates for individual companies are still calculated according to the NME methodology and surrogate values are used to calculate normal values.<sup>13</sup> By contrast, granting a respondent MOE status would result in relying on costs incurred and prices paid in the NME, valued in the NME's currency, instead of using surrogate values.

Currently, the only formal exception to the Department's standard approach to NME normal value calculations is the market-oriented industry ("MOI") standard. Under the test, the Department can grant an NME industry market-economy status if the industry meets the following criteria:

- (1) that there be virtually no government involvement in production or prices for the industry;
- (2) that the industry be marked by private or collective ownership that behaves in a manner consistent with market considerations; and

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<sup>11</sup> See *Lasko Metal Prods. Inc. v. United States*, 43 F.3d 1442, 1446 (Fed. Cir. 1994).

<sup>12</sup> See, e.g., *Preliminary Determination of Sales at Less than Fair Value, Certain Malleable Iron Pipe Fittings from the PRC*, 68 Fed. Reg. 33,911, 33,913 – 33,915 (Dep't Comm., June 6, 2003).

<sup>13</sup> See, e.g., *Preliminary Determination of Sales at Less Than Fair Value, Affirmative Critical Circumstances, In Part, and Postponement of Final Determination: Certain Lined Paper Products from the People's Republic of China*, 71 Fed. Reg. 19,695, 19,701 (separate rates granted to many respondents), 19,703 (normal value based on FOP methodology) (Dep't Comm., Apr. 17, 2006).

(3) that producers be found to pay market-determined prices for all major inputs, and for all but an insignificant proportion of minor inputs.<sup>14</sup>

This test has not been codified in the Department's regulations, due to the Department's concerns that "the test did not succeed in 'identifying situations where it would be appropriate to use domestic prices or costs in an NME as the basis for normal value.'"<sup>15</sup> In addition, the Department has noted that the MOI test, "must begin with a strong presumption that such situations {of market-oriented industries} do not occur because nonmarket economies are riddled with distortions."<sup>16</sup> In practice, no industry in China has succeeded in meeting the MOI test in the fifteen years since the test was created.<sup>17</sup> In sum, despite numerous reforms in China since the development of the MOI test, the basic structural distortions that continue to require treating China as an NME country are so pervasive and deep-seated that no industry has been able to demonstrate sufficient insulation from these nonmarket forces to merit treatment as an MOI.<sup>18</sup>

While the MOI test may in practice have little relevance for industries in China given the government's continued interference in the nation's economy, the U.S. committed to maintain an opportunity for Chinese producers to demonstrate that market economy

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<sup>14</sup> *Request for MOE Comments* at 29,302 – 29,303. See, e.g., *Preliminary Determination of Sales at Less Than Fair Value: Sulfanilic Acid From the People's Republic of China*, 57 Fed. Reg. 9,409, 9,411 (Dep't Comm., Mar. 18, 1992); *Notice of Final Determination of Sales at Less Than Fair Value and Negative Final Determination of Critical Circumstances: Certain Color Television Receivers From the People's Republic of China*, 69 Fed. Reg. 20,594, 20,595 (Dep't Comm., Apr. 16, 2004).

<sup>15</sup> *Antidumping Duties; Countervailing Duties; Final Rule*, 62 Fed. Reg. 27,295, 27,364 (Dep't Comm., May 19, 1997) (citation omitted).

<sup>16</sup> *Amendment to Final Determination of Sales at Less Than Fair Value and Amendment to Antidumping Duty Order: Chrome-Plated Lug Nuts From the People's Republic of China*, 57 Fed. Reg. 15,052, 15,053 (Dep't Comm., Apr. 24, 1992) (hereinafter "Lug Nuts Amended Final").

<sup>17</sup> See *Request for MOE Comments* at 29,303.

<sup>18</sup> For a recent discussion of the factors supporting China's continued designation as a nonmarket economy country, see generally *Antidumping Duty Investigation of Certain Lined Paper Products from the People's Republic of China – China's status as a non-market economy*, Department of Commerce Memorandum (Aug. 30, 2006) (hereinafter "Lined Paper Memo").

conditions prevail in their industry in China's protocol of accession to the WTO.<sup>19</sup> Thus, even though the MOI test raises too many concerns for the Department to codify it, and even though no industry in China may in fact be sufficiently protected from nonmarket distortions to meet the test, the U.S. maintains the MOI test. Only an acceding country, of course, makes commitments as part of its WTO Protocol of Accession. Nothing in China's Protocol of Accession indicates that China's acceptance of its trading partners' right to use NME methodologies for 15 years was conditioned upon Chinese exporters being afforded the opportunity to demonstrate that individual companies are market-oriented enterprises.<sup>20</sup> Nothing in U.S. law and no conditions to continued use of NME methodology in China's Protocol of Accession require provision of an opportunity for individual Chinese respondents to seek market-economy treatment.

The Department has invariably determined normal values in NME dumping cases by applying NME methodologies, and the Department has not seen the need under the statute to undertake case-by-case analyses of whether or not normal values in NME cases may be determined according to market economy methods. The Department's well-established practice in these cases reflects a reasonable interpretation of the statute: NME countries are, by definition, countries in which prices and costs do not reflect fair market value; therefore, reliance on actual costs or prices from an NME should be the extremely rare exception – justified by clear and convincing evidence – rather than an option available as a matter of course. Even where the Department has created opportunities for NME respondents to demonstrate the market orientation of their industries, in practice they have never been able

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<sup>19</sup> World Trade Organization, Protocol of Accession of the People's Republic of China, WT/L/432 (Nov. 23, 2001) at Art. 15(a) and (d).

<sup>20</sup> *See Id.*



to do so. Nowhere in this framework is the possibility of granting individual respondents MOE status contemplated. In sum, the very proposition that an individual firm's prices and costs can be analyzed in isolation from the larger economy and industry in which it operates – especially when that economy is an NME riddled with government distortions – is inconsistent with the Department's long-standing practice and the statutory scheme as it has been interpreted and applied by the Department.

## **II. The Market-Orientation of Individual Enterprises Cannot Be Adequately Analyzed in Isolation from the Economy and Industry in Which the Enterprises Operate**

The Department's notice requests comments regarding "the conditions and factors that would guide the Department's assessment of the market-orientation of individual respondents, as opposed to industries."<sup>21</sup> However, in both theory and practice, it is virtually impossible to isolate an individual firm from the industry – and indeed the economy – in which it operates. There are several levels at which a firm's decisions regarding costs and prices are affected by the larger industry and economic environment in which the firm operates. First, fundamental market distortions that permeate an economy will taint the prices for basic factors of production such as land, labor and credit such that no individual firm – no matter how rational or profit-maximizing – is able to escape the influence of those distortions. Second, any individual firm must make decisions regarding the prices it will pay its suppliers for inputs and the prices it will charge customers for its products in the context of competition with other firms in its own industry. Thus, to the extent that an individual firm's industrial competitors do not operate on commercial terms, it will necessarily distort the terms upon which any individual firm within that industry makes its decisions regarding

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<sup>21</sup> *Request for MOE Comments* at 29,303.

costs and prices. Third, an individual firm is dependent upon other sectors of the economy for its supplier base and its customer base – to the extent that those upstream and downstream industries fail to operate on commercial terms, it will necessarily distort the cost and price signals that even a rational, profit-seeking firm receives regarding its inputs and its products. It would be highly impractical for the Department to seek to account for each of these factors in efforts to identify individual market-oriented firms in China and isolate those firms' prices and costs that are market-driven.

A. Fundamental Distortions to Markets for Basic Factors of Production Impact All Firms in China

In its investigation on imports of lined paper from China in 2006, the Department conducted an extensive analysis of China's economy to assess whether designation as an NME country was still warranted.<sup>22</sup> As a result of this analysis, the Department concluded that, despite significant progress in China over the past 25 years, "market forces in China are not yet sufficiently developed to permit the use of prices and costs in that country for the purposes of the Department's dumping analysis."<sup>23</sup> The memo did not separate out certain industries, regions, or segments of China's economy in its assessment. Instead, the memo considered the statutory factors laid out by Congress in 19 U.S.C. § 1677(18)(A) on a national basis to develop a comprehensive picture of the Chinese economy as a whole.

The Department found that significant distortions persist with regard to each of the statutory factors:<sup>24</sup>

- The Department found that China "maintains significant restrictions on both the interbank foreign exchange (FOREX) market and on capital account

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<sup>22</sup> See *Lined Paper Memo*.

<sup>23</sup> *Id.* at 4.

<sup>24</sup> *Id.* at 2 – 3.

transactions,” and thus that, “China’s reforms to date cannot ensure that the *reminbi* is market-based.”

- With respect to wage rates, the Department concluded: “There are a number of important institutional and administrative constraints, including the lack of independent unions, prohibition on the right to strike, as well as significant restrictions on labor mobility, which limit the extent to which market forces influence the formation of wages.”
- Despite recent openings to foreign investment in China, the Department found: “China still manages foreign investment to significant degree,” by favoring certain regions and industries over others.
- Regarding government ownership or control of the means of production, the Department concluded that state-owned industries enjoy significant land-use rights received free of charge and that state control continues to be favored in a number of core industries.
- On the important issue of resource allocation, prices, and output, the Department found that the government of China is “deeply entrenched in resource allocation,” particularly in the government-dominated and controlled financial sector. In addition, the Department found that the government of China maintains price controls or price guidance for a number of key basic resources, including natural gas, gasoline, diesel, electricity, and telecommunications.<sup>25</sup>
- Finally, in considering other appropriate factors the Department noted “major challenges in overcoming institutional weaknesses regarding rule of law, property rights and bankruptcy.”

While the Department chose not to apply these economy-wide factors in its MOI inquiry in the original final determination on chrome-plated lug nuts from China,<sup>26</sup> in the amended final determination in that case many of these factors did indeed come into play in the Department’s decision that the industry at issue was not market-oriented.<sup>27</sup> Indeed, the Department noted that its initial analysis “was too narrow,” and the Department stated that it

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<sup>25</sup> *Id.* at 49 – 50.

<sup>26</sup> *Final Determination of Sales at Less Than Fair Value: Chrome-Plated Lug Nuts From the People’s Republic of China*, 56 Fed. Reg. 46,153, 46,154 – 46,155 (Dep’t Comm., Sept. 10, 1991) (hereinafter “*Lug Nuts Final*”).

<sup>27</sup> *Lug Nuts Amended Final*.

was necessary to determine whether “market forces” were at work in determining input prices “in general within the PRC.”<sup>28</sup> The same principle holds true today. Government interventions that distort markets for land, capital, labor, and basic resources and utilities affect all firms within China. A single enterprise, no matter how vigorously it seeks to operate on market principles, cannot pay a market price for land when private ownership of land is prohibited. An individual firm cannot engage in truly free bargaining with its employees over wages when those employees are legally barred from forming an independent trade union or exercising the right to strike. A single enterprise cannot ensure that the cost of its credit is based on market fundamentals when the financial market is almost entirely state-dominated and fails to operate on the basis of commercial considerations. An individual company cannot pay market prices for gas and electricity when the prices for those resources are firmly controlled by the state.

Since these key inputs – land, labor, capital, and basic resources – are inputs that every producer must rely upon to manufacture any good, government distortions to markets for these basic inputs permeate the entire Chinese economy, every sector of that economy, and every firm operating within that economy. Thus, it is not only a single firm’s own costs of production, but also the costs of production of its competitors, its suppliers, and its customers, that will be fundamentally compromised by these economy-wide distortions to basic factor markets. Therefore, it is not sufficient to try to isolate these basic factors of production and exclude actual costs for these factors from a constructed value calculation while relying on actual costs for other inputs. Since all domestically-sourced inputs are also produced in this same nonmarket economy environment, the cost of those inputs also reflects

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<sup>28</sup> *Id.* at 15,053.

the fundamental underlying distortions to markets for land, labor, capital, and basic resources. Seeking to isolate and adequately account for the distortions to prices for these basic factors in a dumping proceeding would be highly impractical, if not impossible.

B. Individual Firms Are Influenced by Industry Conditions

Basic economic theory holds that a single firm within a competitive industry cannot maintain prices significantly higher than, or costs significantly lower than, its competitors for long without losing part of its customer base or its supplier base to its competitors. Thus, the cost and price behavior of actors within an industry affects the competitive conditions within which all other firms in that industry operate. To the extent that such competitive cost and price signals are compromised by nonmarket distortions within a segment of that industry, other segments of that industry will also be compromised and unable to operate on a truly commercial basis.

In its MOI practice, the Department has recognized that the nonmarket conditions that affect one segment of an industry necessarily impact other segments of that industry. As a result, the Department has found that an MOI allegation must cover all, or virtually all, of an industry to succeed.<sup>29</sup> Specifically, the Department has rejected arguments that it would be sufficient to find just one segment of an industry to be market-oriented, since that segment could still be affected by government distortions that are present in the rest of the industry.

We ... disagree that it is sufficient to find a segment of a particular industry, such as the steel wire rod manufacturers in a particular province, to be free of government control, as price and quantity decisions made by the state for the PRC steel industry could affect the local steel wire rod industry.<sup>30</sup>

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<sup>29</sup> See, e.g., *Notice of Preliminary Determination of Sales at Less Than Fair Value and Postponement of Final Determination: Synthetic Indigo From the People's Republic of China*, 64 Fed. Reg. 69,723, 69,725 (Dep't Comm., Dec. 14, 1999).

<sup>30</sup> See, e.g., *Lug Nuts Final* at 58,516.

The Department has concluded that an examination of an individual firm's transactions – without assessing whether market conditions apply in the industry as a whole – provides an inadequate basis upon which to find that the firm's prices and costs can be used to determine normal value.<sup>31</sup>

Thus, in both theory and practice, it would be extremely difficult if not impossible for an individual producer to operate on a market basis if it is part of an industry that is not itself market-oriented. Each firm must compete with other firms in its industry to set costs that are sufficient to procure adequate inputs from suppliers and to set prices that are competitive enough to retain and gain customers. To the extent that some actors within an industry are able to set their own costs and prices based on non-commercial factors, this will alter the competitive environment in which all other firms in that industry operate and necessarily impair those firms' ability to operate on a market basis. For all of these reasons, it would be extremely difficult for the Department to identify individual market-oriented enterprises without first determining that those enterprises are part of a market-oriented industry.

C. Individual Firms Rely on Suppliers and Customers Outside of Their Industry

In addition to depending on market signals from other firms within their industry, individual firms also rely on signals from their suppliers and their customers to set competitive, market-based prices and costs. The Department has recognized that functioning markets for inputs must be in place before a firm's input costs can be found to reflect market principles. This recognition is reflected in the fact that the third leg of the MOI test focuses on input markets. An MOI cannot be found to exist unless “producers ... pay market-

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<sup>31</sup> *Lug Nuts Amended Final* at 15,053.

determined prices for all major inputs, and for all but an insignificant proportion of minor inputs.”<sup>32</sup>

The Department has explained that, to satisfy this test, an industry must be found to exist in a virtual “bubble of capitalism” within a nonmarket economy, where the industry is effectively sealed off from nonmarket influences.<sup>33</sup> In applying this test, the Department noted:

... {W}e question whether it is possible to have a “bubble of capitalism” in an otherwise nonmarket economy .... Therefore, we have imposed what may be viewed as a strict test for determining whether a “bubble of capitalism” exists in an otherwise nonmarket economy – the price or cost of all inputs into the production of the product must be market-driven. This test clearly will be met only in exceptional circumstances, which accords with our view that bubbles of capitalism are exceptional events.<sup>34</sup>

In its amended final determination in the same case, the Department went on to clarify that it is not sufficient for individual transactions between a producer and its supplier to be market-driven – instead, it is necessary to examine whether commercial forces are functioning in the overall market for the input in question.

The absence of explicit government involvement in these transactions {purchases of steel and chemical inputs} is not sufficient to warrant the conclusion that the prices for these inputs are market-driven .... it is necessary to look beyond direct state involvement in the specific transactions between the manufacturer under investigation and its suppliers to ascertain whether market forces are actually at work in determining input prices.<sup>35</sup>

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<sup>32</sup> See, e.g., *Preliminary Determination of Sales at Less Than Fair Value: Sulfanilic Acid From the People’s Republic of China*, 57 Fed. Reg. 9,409, 9,411 (Dep’t Comm., Mar. 18, 1992); *Notice of Final Determination of Sales at Less Than Fair Value and Negative Final Determination of Critical Circumstances: Certain Color Television Receivers From the People’s Republic of China*, 69 Fed. Reg. 20,594, 20,595 (Dep’t Comm., Apr. 16, 2004).

<sup>33</sup> *Lug Nuts Final* at 46,154.

<sup>34</sup> *Id.* at 46,154.

<sup>35</sup> *Lug Nuts Amended Final* at 15,053.

The same analysis that applies to input markets should also apply to a firm's customer base. An individual firm will reach negotiated prices with its customers based not only on the producing firm's costs and profit goals, but also based on the purchasing firms' needs and priorities. If a downstream industry is influenced by government interference, it may be unable to negotiate prices for its inputs on a commercial basis. To the extent that downstream industries' and customers' purchasing decisions are influenced by nonmarket distortions, these distortions flow through to the pricing and output decisions of upstream suppliers.

The steel industry, for example, relies on a broad array of downstream industries to send market signals regarding the commercial price for various steel products. Effective market functioning in the automotive industry, appliance industry, construction industry, and many others is required to ensure that steel prices are based on commercial considerations that are free from serious nonmarket distortions. If the automotive industry does not operate on a commercial basis, it may lack the required market incentives to negotiate a price for steel that reflects supply and demand and other market fundamentals. This, in turn, distorts the price signals for the steel industry, regardless of how vigorously the steel industry (or individual firms within that industry) may seek to function in a market-oriented manner.

Given the important influence that the market-orientation of upstream and downstream industries can have on producers, it is essential that any analysis of the degree to which an individual producer is market-oriented fully take into account the degree to which market signals to that producer regarding prices and costs may be distorted by the nonmarket orientation of its suppliers and its customers.



### **III. If a Market-Oriented Enterprise Test Is Created, It Must Account for the Industry and Market Environment Within Which the Enterprise Operates**

As explained in Section II.B, above, it is extremely difficult, if not impossible, for a firm to operate based on market principles if it is situated within an industry where competitors do not operate on the basis of those same principles. Accordingly, we do not believe that Commerce should create an MOE test. If the Department nonetheless creates a test, it should be done, consistent with the above discussion, as an additional test for companies in an industry where the “bubble of capitalism” has been found to exist. Stated differently, to be designated as a market-oriented enterprise, an enterprise should have to demonstrate:

- 1) The firm is part of a market-oriented industry as currently defined by Commerce; and
- 2) The company itself also conforms to market principles.

First, a company should have to show it is part of a MOI before it can qualify for market-economy treatment. The Department should continue to apply the MOI factors it currently employs. If the industry as a whole is distorted by government interference and control to the extent that it does not behave in a manner consistent with market principles, the mere fact that a particular company within that industry might somehow be free of government control or influence does not negate the nonmarket influence that the rest of the industry will have on the competitive conditions the enterprise faces. Second, a firm should have to demonstrate that the company itself meets industry standards and operates consistent with market considerations – that it is not somehow a nonmarket aberration within an MOI.

In addition, as reviewed in Section II.C, above, the ability of an individual enterprise to operate according to market principles depends heavily upon whether functioning markets

for that firm's inputs exist. Under its current MOI practice, the Department must determine that the producers in that industry pay market-determined prices for all major inputs and "for all but an insignificant proportion" of minor inputs.<sup>36</sup> Once this test is satisfied, the Department should only rely on those input costs that the company can demonstrate are actually determined by market forces. Currently, the Department uses actual prices paid for inputs in an NME if: 1) they are obtained from a market source; and 2) they are paid for in a market economy currency.<sup>37</sup> The Department should not weaken its current standards. Firms should be required to demonstrate that each input for which it seeks to use actual costs was obtained from a market economy supplier or a supplier that is itself a market-oriented enterprise within a market-oriented industry, that the price paid for the input was market-driven, and that the currency in which the price for the input was paid is a market economy currency or a freely convertible currency.

In applying this test, the Department should adopt a strong presumption that prices for key inputs such as land, labor, capital, and basic resources are not market-determined in any nonmarket economy and in China in particular. The very fact that a country qualifies as a nonmarket economy under the statutory factors outlined at 19 U.S.C. § 1677(18)(A) means that prices for basic factors of production in that economy are fundamentally distorted by government intervention. In China's case, the Department's own extensive analysis concluded that market forces do not yet operate at sufficient levels in markets for land, labor,

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<sup>36</sup> See, e.g., *Preliminary Determination of Sales at Less Than Fair Value: Sulfanilic Acid From the People's Republic of China*, 57 Fed. Reg. 9,409, 9,411 (Dep't Comm., Mar. 18, 1992); *Notice of Final Determination of Sales at Less Than Fair Value and Negative Final Determination of Critical Circumstances: Certain Color Television Receivers From the People's Republic of China*, 69 Fed. Reg. 20,594, 20,595 (Dep't Comm., Apr. 16, 2004).

<sup>37</sup> 19 C.F.R. § 351.408(c)(1).

capital, and basic resources.<sup>38</sup> As discussed in Section II.A, above, these distortions permeate factor costs for firms throughout the nation's economy such that it would be extremely difficult, if not impossible, for the Department to isolate these distorted costs from other input costs. Since land, labor, capital, and basic resources are "major inputs," it is difficult to conceive of a situation in which a Chinese firm could demonstrate that it pays market-determined prices for all major inputs.

The Department should ensure that its presumption that prices for these major inputs in China are not market-determined can only be overcome in exceptional circumstances by clear and convincing evidence put forward by an interested party. To demonstrate that the price paid for an input is market-driven, the Department should require enterprises to demonstrate the following with regard to each input:

- Central, provincial, and local authorities were not involved in setting or providing guidance for the price of that input;
- In the case of land prices, leases are at or above the prices paid by other companies in the locality;
- Wage rates are at or above the rates paid in comparable market economies where free bargaining between management and labor is assured;
- Interest rates paid on loans are at or above the commercial benchmarks for comparable loans determined by the Department in its countervailing duty proceedings involving China; and
- Prices paid for electricity, gas, and other forms of energy are at or above the rates paid in market economies at comparable levels of development.

If a respondent is not able to make such a demonstration with regard to each input for which it seeks to use actual prices or costs, the respondent should be required to explain why it cannot satisfy the specific test in question on the basis of market-based factors. If the

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<sup>38</sup> See *Lined Paper Memo*.

respondent cannot demonstrate that its prices and costs are market-determined as outlined above, and cannot provide sufficient market-based reasons for its inability to meet the tests outlined above, the Department should maintain its presumption that the actual prices for the input in question are not market-driven.

Furthermore, as explained in Section II.C, above, the ability of an individual enterprise to operate according to market principles also depends upon the degree to which downstream consuming industries operate on a commercial basis. The Department should therefore include as an element of its MOE test a requirement that the downstream industries which a producer supplies are themselves market-oriented under the Department's current MOI test. Prices for individual sales should only be included in the investigation to the extent that these prices are market-driven.

If the Chinese economy has indeed changed enough to justify finding that market-oriented enterprises exist, the respondents should be able to meet each of the elements of this test. If they cannot do this, it would simply mean that conditions in China are still not ripe for finding that certain companies are market-oriented. Any test that fails to include each of these elements is likely to result in the use of inappropriate prices and costs that do not reflect commercial considerations and market forces. Such a result would fundamentally compromise the fairness, accuracy, and predictability of the Department's dumping calculations in proceedings involving China.

#### **IV. Application of Countervailing Duty Law to China Provides No Basis for Granting Individual Respondents Market-Economy Status in Antidumping Proceedings**

One reason the Department cites for its proposal to create an MOE test is the Department's recent preliminary decision to apply countervailing duty law to imports from

China.<sup>39</sup> Yet this decision does not provide a sufficient basis for granting individual respondents MOE status in dumping cases involving China. At the outset, it is important to distinguish the reasoning underlying the decision to apply countervailing duty law to China from the concept of granting MOE status to individual firms in China for dumping purposes.

In its preliminary determination to apply CVD law to China in its investigation on coated free sheet paper, the Department analyzed changes in China's economy over the past 25 years and concluded that the movement away from a Soviet-style command-and-control economy permitted the Department to determine whether or not subsidies in China are specific and measure the extent to which these subsidies confer a benefit.<sup>40</sup> Application of CVD law to Soviet-style economies was not possible in the Department's assessment, because alleged subsidies in an economy where the government had pervasive ownership and control over the means of production "essentially involved one arm of the government giving money to another arm."<sup>41</sup> In the coated free sheet paper preliminary determination, the Department noted that "the extent of government control and direction over the country's economy warrants the continued designation of China as an NME" for antidumping purposes.<sup>42</sup> The Department found that, "China's economy, though riddled with distortions attendant to the extensive intervention of the PRC Government, is more flexible" than the Soviet-style economies to which the Department had previously determined it could not apply CVD law.<sup>43</sup>

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<sup>39</sup> *Request for MOE Comments* at 29,303.

<sup>40</sup> *See* Dep't Comm. Memorandum Re Whether the Analytical Elements of the *Georgetown Steel* Opinion are Applicable to China's Present-Day Economy (C-570-907) (March 29, 1997).

<sup>41</sup> *Id.* at 10.

<sup>42</sup> *Id.* at 4.

<sup>43</sup> *Id.* at 5.

While China's move away from a Soviet-style economy permits the Department to identify subsidies that are specific and to measure the benefit of those subsidies, this finding in no way detracts from the Department's conclusion that China remains an NME for dumping purposes and that prices and costs in China are still too distorted by government intervention to provide an appropriate basis for dumping calculations. The same logic applies at the industry and enterprise level. Just as China need not qualify as a market economy country to permit application of CVD law, an industry or enterprise within China need not qualify as "market-oriented" for antidumping purposes in order for the Department to be able to measure the benefit conferred on that industry or firm by specific government subsidies.

Though the private sector in China has grown, it does not follow that the firms operating within that private sector experience costs and prices that are effectively insulated from the distortionary influence of government interference in the market. As the Department noted in the coated free sheet paper determination: "Private enterprises and citizens in China, though generally free to pursue entrepreneurial activities, still conduct business within the broader, distorted environment over which the PRC Government has not ceded fundamental control."<sup>44</sup> In addition, in applying CVD law to China the Department has explicitly recognized that persistent government distortions in key sectors of the economy, particularly the financial sector, require reliance on external commercial benchmarks to measure the full extent of the benefit provided to Chinese firms by

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<sup>44</sup> *Id.*

government subsidies.<sup>45</sup> Reliance on such external benchmarks is also provided for in China's Protocol of Accession to the WTO.<sup>46</sup>

Moreover, there is a fundamental difference between the nature of a subsidies analysis in a CVD case and a dumping analysis. A subsidies analysis seeks to identify specific subsidy programs benefiting a producer and to measure the value of the benefit provided under those programs relative to the producer's sales. Thus, in a CVD proceeding, the Department is comparing apples to apples in two senses. First, the Department determines whether a subsidy program is "specific" by examining whether the program benefits only certain sectors of the economy and not others – whether they be particular industries instead of others, exporters instead of those producing for the domestic market, or producers who satisfy domestic content requirements instead of producers who fail to satisfy these requirements. Thus, in its specificity analysis the Department identifies programs that disproportionately benefit one segment of the economy relative to another – the implicit comparison is between some firms in China (who benefit from the subsidy program) and all other firms in China (who do not). Second, when calculating CVD margins, the numerator and the denominator in the Department's equation are both directly comparable – one is the benefit conferred on the firm by Chinese subsidy programs and the other is the Chinese firm's sales. The resulting margin is a percentage based on the comparison of two internally coherent figures. Broader economy-wide distortions in an NME should not compromise the integrity of either analysis. The Department can still identify programs that are specific to some firms within that distorted economy but not other firms in that same economy, and the

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<sup>45</sup> See *Coated Free Sheet Paper From the People's Republic of China: Amended Preliminary Affirmative Countervailing Duty Determination*, 72 Fed. Reg. 17,484, 17,487 – 17,489 (Dep't Comm., Apr. 9, 2007).

<sup>46</sup> World Trade Organization, Protocol of Accession of the People's Republic of China, WT/L/432 (Nov. 23, 2001) at Art. 15(b).

Department can still derive a reliable margin based on the value of the subsidy benefit relative to the producer's sales.

The analysis in the dumping context is, however, altogether different. In a dumping case, the Department is not comparing apples to apples if it compares U.S. prices to the fundamentally distorted prices in a nonmarket economy. Instead, the Department must conduct a fair comparison between the normal value for a good and the export price of that good. To the extent that fundamental distortions in the home country market make actual prices and costs unreliable for the purposes of determining normal value, it can undermine the entire analysis and make the comparison between normal value and export price virtually meaningless. That is why the statute provides for specific methodologies to determine normal value in NME cases and why the Department has consistently and invariably rejected reliance on actual prices and costs in NME cases.

Even where the overall economy is distorted by pervasive government interference, it is still possible to conduct a meaningful analysis of the specificity of government subsidies and the benefit conferred by those subsidies. At the same time, these same distortions prevent reliance on actual costs and prices in a meaningful dumping analysis. Thus, there is no fundamental contradiction between the Department's determination that China's economy has evolved to a point that allows the application of CVD law and the conclusion that actual prices and costs in the Chinese economy as a whole, as well as for individual Chinese firms and industries, do not provide an appropriate basis for dumping calculations.

## **V. Conclusion**

U.S. antidumping and countervailing duty laws were enacted by Congress to serve a remedial purpose. They reflect the understanding that dumping and subsidization distort



trade and harm U.S. industries and their workers. The law is designed to provide the domestic industry and U.S. workers with a tool to remedy these unfair trade practices. Effective enforcement of the law allows the U.S. to compete on fair and open terms that reflect market principles instead of discriminatory practices or government largess.

Over many years, the Department has developed a fair, consistent, and predictable practice for remedying dumping by NMEs under the statute. This practice is based on a reading of the statute that views the fundamental distortions in NME economies as posing a major difficulty to the use of actual prices and costs for normal value calculations. Just last year, the Department conducted an exhaustive analysis and reaffirmed China's status as an NME, based on the fact that prices and costs in China are still heavily influenced by government interference and fail to reflect market fundamentals. At the same time, the Department has recently recognized that changes in China's economy make it more feasible to apply countervailing duty law to the country, since the identification and measurement of specific subsidies is no longer precluded by the existence of a unitary, Soviet-style economy in China. By ensuring that both tools are available to redress unfair trade practices by China, and by ensuring that both tools can be used effectively, the Department has taken an important step towards ensuring that the remedial purpose of the laws Congress enacted can be fulfilled.

The proposal to grant individual respondents in China MOE status would constitute a major step backwards in effective enforcement of U.S. trade remedy laws. The proposal is inconsistent with the long-standing practice established by the Department, and it is inconsistent with the Department's existing analyses of how China's economy functions both in theory and in practice. To conclude that the application of CVD law to China requires

substantial weakening of the dumping rules that apply to China not only lacks a reasonable basis – it violates the fundamental goal of the trade remedy laws. Only when the domestic industry and its workers can use trade remedy laws to effectively redress the variety of harms Congress intended the laws to address – including injury both from foreign government subsidies and from foreign dumping below fair market value – will the full remedial purpose of those laws be fulfilled.

For all of these reasons, we respectfully request that the Department not implement its proposal to grant individual respondents MOE status in dumping cases involving China. If the Department nonetheless decides to proceed with its proposal, we believe it is essential that the Department ensure that the alleged market-orientation of a firm be evaluated within the context of the industry and the market in which that respondent operates, as detailed above.

Respectfully submitted,

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