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U.S.-CHINA TRADE

Challenges and Choices to Apply Countervailing Duties to China

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Highlights of [GAO-06-608T](#), testimony to the U.S.-China Economic and Security Review Commission

Why GAO Did This Study

Some U.S. companies allege that unfair subsidies are a factor in China's success in U.S. markets. U.S. producers injured by subsidized imports may normally seek countervailing duties (CVD), but the United States does not apply CVDs against countries, including China, that the Department of Commerce classifies as "non-market economies" (NME). In this testimony, which is based on a June 2005 report (GAO-05-474), GAO (1) describes the options for applying CVDs to China, (2) the challenges that would arise, and (3) examines the likely results of applying CVDs on Chinese products.

What GAO Recommends

In its 2005 report, GAO recommended that Commerce report on its ability to measure Chinese subsidies and the methodologies it might use to do so. Also, GAO suggested that Congress may wish to clarify Commerce's authority in several respects if CVDs are to be applied to China.

Agency officials thought GAO's recommendations were 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-06-608T.

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.

U.S.-CHINA TRADE

Challenges and Choices to Apply Countervailing Duties to China

What GAO Found

There are two alternative paths for applying CVDs to China. First, Commerce could determine that China is no longer a nonmarket economy and apply CVDs against China as a market economy. Commerce has criteria for such determinations but stated that China is unlikely to satisfy them in the near term. Second, it could reverse its 1984 position, which was confirmed by a federal appeals court, and apply CVDs without changing China's NME status. However, absent a clear congressional grant of authority, such a decision could be challenged in court, with uncertain results. The House of Representatives passed legislation that would grant this authority in July 2005, and companion legislation was introduced in the Senate. 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 the use of third-country information in CVD cases.

Making CVDs available against China would give U.S. producers an explicit import relief measure that targets unfair government subsidies. However, on a net basis, applying CVDs might not 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, required methodological changes would reduce antidumping duties for some companies. 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.

Two Paths to Apply Countervailing Duties to China

Market Economy Path	Both	NME Path
<ul style="list-style-type: none"> ○ China must meet criteria for market economy status ○ Antidumping duties for some Chinese companies would be reduced 	<ul style="list-style-type: none"> ○ Chinese subsidies difficult to identify and measure ○ Countervailing duties tend to be lower than antidumping duties ○ Commerce lacks explicit authority to use third-country information 	<ul style="list-style-type: none"> ○ Commerce's authority could be challenged with uncertain results ○ Potential double counting of domestic subsidies, without clear Commerce authority to make adjustments

Source: GAO

Mr. Chairman and Members of the Commission:

I am pleased to be here today to contribute to the discussion related to China's Industrial Subsidies and the Impact on U.S. and World Markets. We appreciate the Commission's role and are pleased to be able to contribute to your efforts.

Imports of goods from China have grown rapidly over the last decade, rising to more than \$242 billion in 2005 and making China the second largest foreign supplier of the U.S. market after Canada. 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 the success of Chinese companies 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 (CVDs) to offset the price advantages that these subsidies confer, U.S. CVD laws are not currently applicable against countries—including China—that the Department of Commerce classifies as non-market economy (NME) countries. Various parties—including U.S. industry representatives, some trade attorneys, and this commission—have advocated taking steps to make CVDs available against Chinese products.

Today I will focus my remarks on three issues, after providing some background on CVD and antidumping duties under WTO and U.S. law. First, I will describe the policy options currently available for applying CVDs against China. Second, I will discuss the challenges of doing so. Finally, I will summarize the likely results of applying CVDs to Chinese imports.

A number of the studies we have performed for the Congress address important aspects of U.S.-China trade relations.¹ We have stated in prior testimony before this Commission that U.S. government efforts to ensure that China complies with its WTO commitments will require a sustained approach.² My statement today is drawn mainly from our June 2005 report

¹See Appendix 1 for a list of related GAO products.

²See [GAO-05-295T](#).

U.S.-China Trade: Commerce Faces Practical and Legal Challenges in Applying Countervailing Duties (GAO-05-474). The scope and methodology for our work, which was conducted from January 2004 to June 2005 in accordance with generally accepted government auditing standards, is detailed in an appendix to that report.

Summary

Commerce could choose one of two paths to apply U.S. CVD laws to China. The current Commerce policy of not applying CVDs to countries with non-market economies (including China) rests on two principles advanced in 1984 and confirmed by a federal appeals court. These were 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. Following the first path, Commerce could, when appropriate, 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 Commerce officials said that China is unlikely to satisfy them in the near term. Following the second path, Commerce could reverse its 1984 position and apply CVDs without any change in China’s NME status. However, the appeals court ruling raises serious doubt about Commerce’s ability to make such a change without a clear grant of authority from Congress and such a decision could be challenged in court, with uncertain results. The House passed legislation that would grant this authority in July 2005, and companion legislation was introduced in the Senate.³ World Trade Organization (WTO) rules do not explicitly preclude either alternative.

If Commerce were to apply CVDs against China, it 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 the 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 challenges at least partially by using third-country information to create benchmarks as part of its methodology 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

³See H.R.3283, S.1421.

resolve the methodological challenges that would face Commerce. Moreover, under current U.S. law, Commerce lacks explicit authority to use of third-country information in CVD cases against China, as provided for in China's WTO commitments.

Making CVDs available against China would give U.S. producers an explicit import relief measure that targets unfair government subsidies. Nonetheless, it is unclear whether, on a net basis, applying CVDs would provide greater protection than U.S. producers already obtain indirectly in the form of antidumping duties calculated using the NME methodology. 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. However, required methodological changes would mean that AD duties would likely decline, especially for Chinese companies not assigned individual rates. Individual company rates would likely diverge, with those that do cooperate with Commerce receiving rates that are substantially lower than those that do not cooperate. 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 is required to reduce duties to avoid double counting when export subsidies are involved. However, Commerce lacks clear authority to make such corrections when domestic subsidies are involved.

As a result, in our 2005 report we made recommendations for Commerce to analyze and report to Congress on its ability to measure Chinese subsidies and what methodologies it might use to do so. We also asked Congress to consider clarifying Commerce's authority to use third-country information in CVD cases and to make corrections to avoid double counting of domestic subsidies.

Background

As explained below, WTO rules provide disciplines on subsidies and countervailing measures used by China, the United States, and other WTO members. China accepted additional commitments in this area when it joined the WTO in 2001. U.S. procedures for countervailing duty actions reflect WTO rules. Such CVD actions are usually applied in tandem with antidumping duties.

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,⁴ 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 suffered. These duties are intended to offset the price advantages that the subsidy confers on the imported product and, more broadly, to encourage governments that maintain subsidies to eliminate them. The subsidies agreement requires that the investigating authorities quantify the value of the subsidies provided and limit the level of duty imposed to that value.

To facilitate identification of subsidies and the 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.”⁵

China Made Additional WTO Commitments

China made additional commitments regarding industrial subsidies as part of its agreement to join the WTO. China agreed, upon WTO accession, to terminate all subsidies on exports, as well as the subsidies conditioned upon the use of either domestic goods or export performance. China listed 24 subsidy programs in the accession agreement and agreed to eliminate 3 programs upon accession. The 24 programs include direct subsidies given by central and local governments to money-losing state-owned enterprises and many other types of indirect subsidy programs. Indirect subsidies include loan priorities, preferential tariffs, tax breaks given to firms encouraged by the government because of their location, export

⁴Export subsidies (those contingent on export performance) and local content subsidies (those contingent on use of domestic over imported goods) are explicitly prohibited.

⁵WTO Agreement on Subsidies and Countervailing Measures, art. 25.3.

performance (amount of exports), and use of local resources for the products they make.

Among the three programs that China agreed to eliminate, two were related to subsidies to the automobile sector, and the other was the central government's program to give budgetary subsidies to money-losing state-owned enterprises. China also committed to treating other subsidies given to state-owned enterprises as subsidies to private enterprises and subjecting them to WTO disciplines. Furthermore, China agreed not to invoke certain articles in the Agreement on Subsidies and Countervailing Measures that make determination of "actionable" subsidies more difficult to establish against developing countries. Given China's present level of economic development and reform, some WTO members were concerned about the potential for China to maintain or raise industrial subsidies, especially to state-owned enterprises. Some members also raised concerns that China's reporting on subsidies in the WTO negotiations was incomplete. In response, China agreed to work toward full notification and acknowledged that subsidies are sometimes difficult to identify.

U.S. Procedures Reflect WTO Rules

Under U.S. law,⁶ 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.⁷ The U.S. International Trade Commission (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 the size of the CVD to impose. To make these determinations, Commerce solicits information from exporting country governments and from individual producers and exporters of the subject merchandise and applies

⁶19 U.S.C. §1671 and following.

⁷U.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).

this information to establish appropriate duty rates for each known exporter or producer.⁸

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 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.⁹ From 1995 through 2004, U.S. domestic industries petitioned the Department of Commerce and the ITC for 72 CVD investigations against 43 different products from 25 countries. Thirty-six of these investigations (50 percent) resulted in application of CVDs. 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.

Dumping occurs when a foreign company sells merchandise in a given export market (for example, the United States) at prices 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.

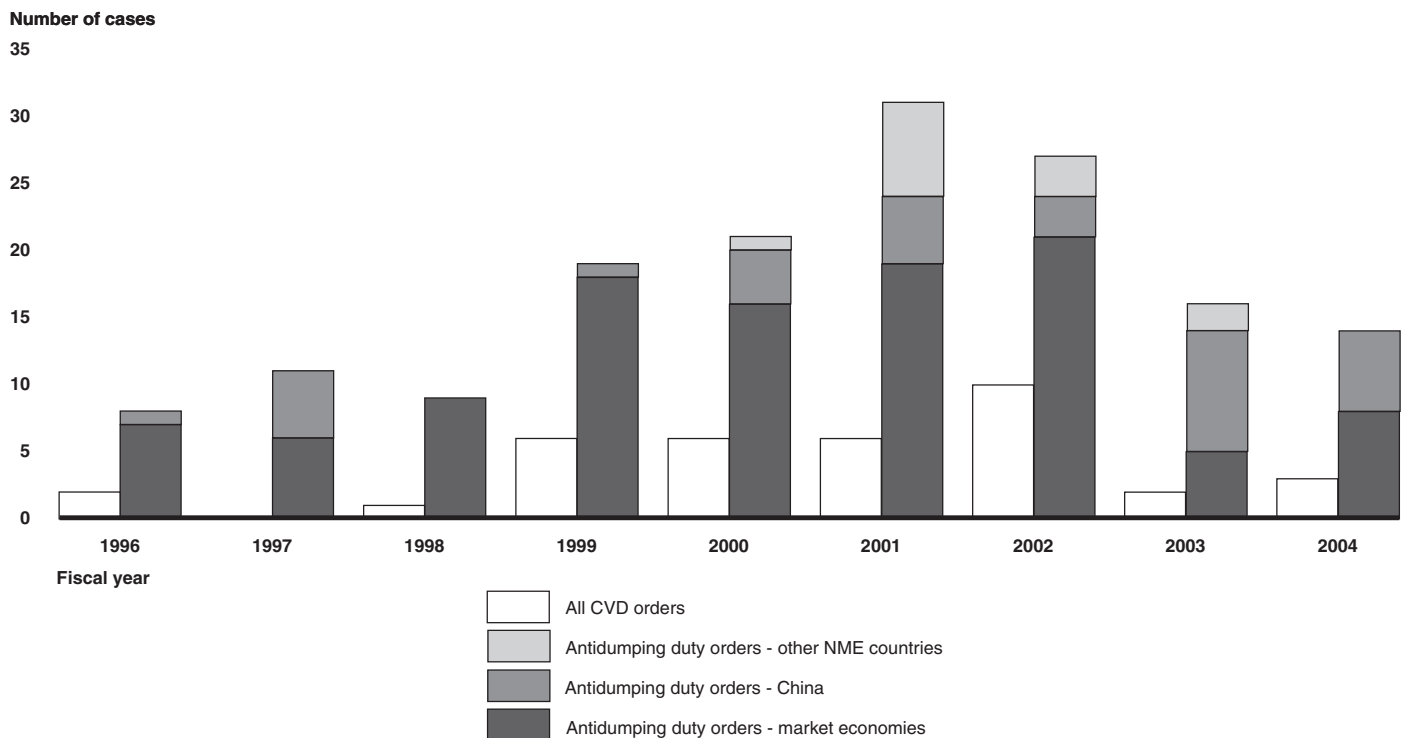
⁸Individual company rates can vary a great deal, depending upon the facts in each case. In one recent case, for example, the Commerce Department applied a CVD of about 17 percent to one Indian exporter of carbazole violet pigment, but a rate of about 34 percent to another Indian exporter of this product. 69 Fed. Reg. 77995 (Dec. 29, 2004).

⁹The 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 of the Committee on Subsidies and Countervailing Measures*, G/L/711 (Geneva: Nov. 9, 2004).

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 1 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 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 1 shows that even among market economy countries, the United States imposes CVDs much less frequently than antidumping duties.

Figure 1: U.S. CVD Orders against All Countries and Antidumping Duty Orders against Market Economies, Other NME Countries, and China, 1996- 2004



Source: Federal Register.

Options Available to the Department of Commerce to Apply CVDs Against 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. Commerce (or Congress) could take one of two paths to apply U.S. CVD law to China. First, they could change China's NME status to a market economy status in whole or in part and allow Commerce to apply U.S. CVD law to China on a country or industry basis. Alternatively, they could decide that CVD law could be applied to China while it remains classified as an NME country. WTO rules, including relevant provisions of China's WTO accession agreement, do not explicitly preclude the United States from pursuing either alternative.

The Department of Commerce Does Not Apply CVD Law to China as an NME Country

The policy not to apply CVD law 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 were (1) from a legal perspective, 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 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.¹⁰ Commerce has classified China as an NME country since 1981.¹¹

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.¹² In its 1984 determinations, the Department of Commerce also concluded

¹⁰19 U.S.C. §1677(18).

¹¹Final Determination at Less Than Fair Value: Natural Menthol from the People's Republic of China, 46 Fed. Reg. 24614, May 1, 1981.

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

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.

The U.S. Court of Appeals for the Federal Circuit upheld Commerce's decision in *Georgetown Steel Corp. v. United States*.¹³ In upholding Commerce's position in this matter, the Court of Appeals found that governments with nonmarket economies 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 Apply CVD Law

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. Commerce, for example, recently granted Ukraine market economy status. We detail the criteria for making such determinations, which include currency convertibility, in our report. However, Commerce officials observed that it may be difficult for China to meet these criteria in the near term. Furthermore, they noted that Chinese representatives have not yet officially requested that Commerce review their country's NME status under U.S. law.¹⁴

Alternatively, CVD law could be applied to China while it remains classified as an NME country. Congress could pass legislation now under

¹³801 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's position. See *Continental Steel v. United States*, 614 F. Supp. 548, 550 (C.I.T. 1985).

¹⁴Commerce also has the authority to designate individual NME industries as market oriented in character. Commerce officials noted that on several occasions Chinese industries responding to antidumping duty petitions have requested designation as market-oriented industries. To date, Commerce has denied such requests—primarily on the grounds that the Chinese companies in question submitted information that was insufficient or was provided too late in Commerce's process to allow an informed decision.

consideration to apply countervailing duties to NME countries. Commerce could reverse its 1984 position to do this; however, we believe that absent a clear grant of authority from Congress, such a reversal could be challenged in court. The results of such a challenge would be uncertain. The Court of Appeals upheld Commerce’s position, but the court also appeared to make its own findings. The court emphasized that 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.”¹⁵ The Uruguay Round Agreements Act,¹⁶ 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 to imports from nonmarket economy countries.”¹⁷

Commerce Would Face Challenges in Applying CVDs against China

Although 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.

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

¹⁶Pub. L. No. 103-465, 108 Stat. 4809, adopted Dec. 8, 1994.

¹⁷The 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).

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.¹⁸ In joining the WTO, China specifically agreed 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.

Commerce officials told us that despite 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 the 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 because the Chinese government heavily influences allocation of credit by favoring some industries over others, it is uncertain how to quantify the subsidy benefits conferred through this process. In addition, some attorneys and Commerce officials have said that lack of adherence to generally recognized accounting standards and unreliable bookkeeping among Chinese companies can make accurate identification and measurement of subsidy benefits extremely difficult.

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 Commerce would face. 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. 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

¹⁸WTO officials observed that even the United States—where government actions influencing the economy are comparatively well documented—has had difficulty identifying and quantifying subsidy information that it is required to report to the WTO.

agreement states that countries attempting to identify and quantify subsidy 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. This provision has no expiration date and does not differentiate between China as a market or a nonmarket economy. 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.

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. 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 passed legislation—commonly referred to as section 421—implementing the second (involving application of safeguard measures).¹⁹ While Congress did not adopt legislation to implement China’s third import-relief commitment (regarding textile safeguards), existing legislation provides the U.S. interagency group responsible for processing textile safeguard cases²⁰ with authority to implement such measures.²¹

In contrast, U.S. trade law was not amended with regard to applying countervailing duties to China. Specifically, the legislation that implemented section 421 and facilitated the United States granting permanent normal trade relations status to China did not explicitly

¹⁹Section 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.

²⁰This interagency group, which is headed by the Commerce Department, is the Committee for the Implementation of Textile Agreements.

²¹See 7 U.S.C. 1854 and Exec. Order 11651, 37 Fed. Reg. 4699 (Mar. 3, 1972), as amended.

authorize Commerce to implement China's fourth commitment regarding application of third-country information in CVD cases. We found that U.S. trade law does not otherwise clearly state that Commerce may apply third-country information in such cases against foreign countries in general.²²

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

It Is Uncertain Whether Applying CVDs Would Result in Increased Protection

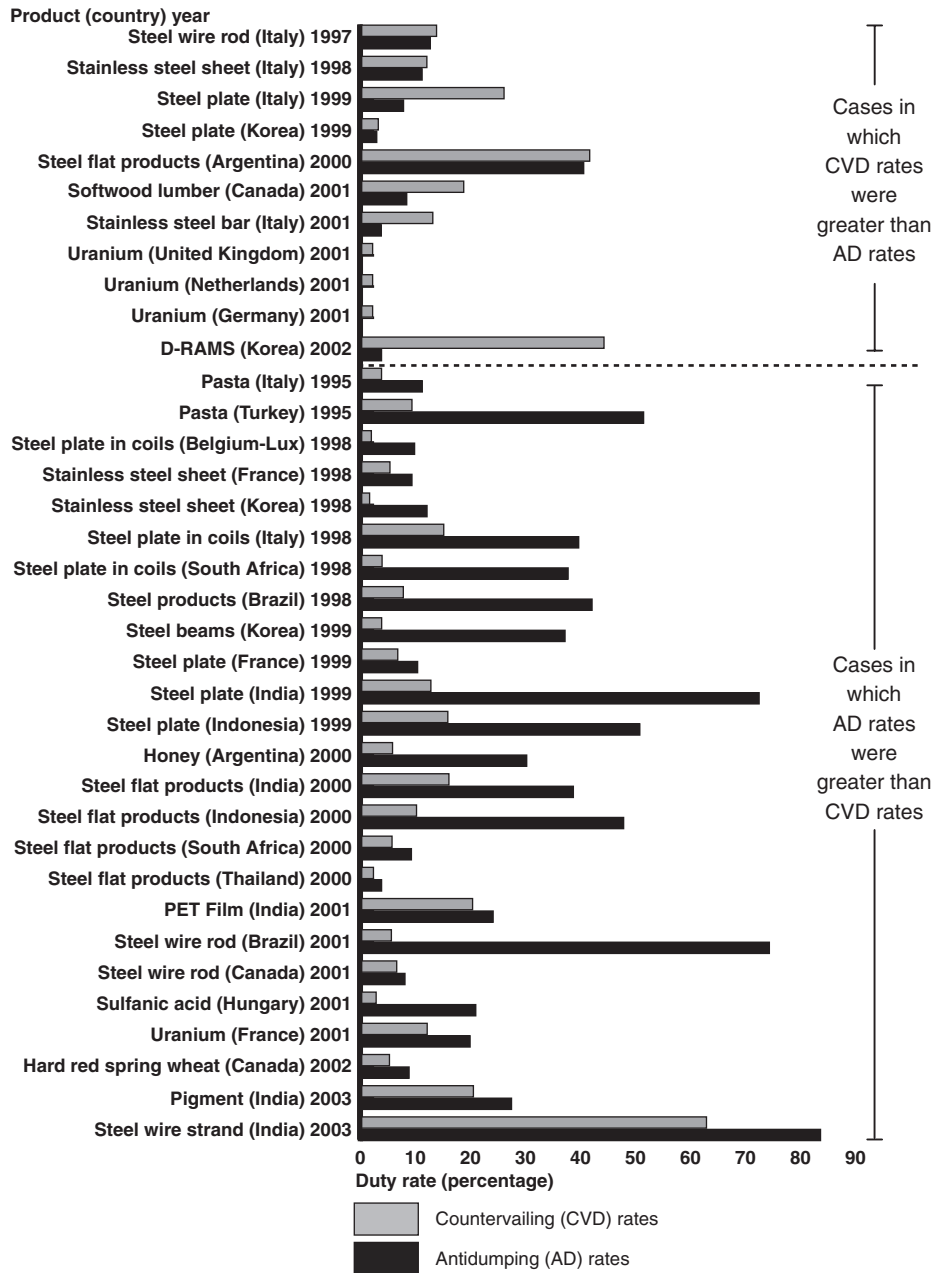
Making CVD procedures available to U.S. producers that believe they are injured as a result of unfairly subsidized Chinese imports would provide a mechanism for taking actions that specifically target Chinese government subsidies. However, it is unclear whether, on a net basis, applying CVDs would provide 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.

²²Commerce regulations do provide for application of third-country information to CVD cases—but only in some circumstances. For 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.

CVD Rates Tend to Be Lower Than Antidumping Duties

If CVDs were applied to China, U.S. companies may experience substantial difficulty in competing with Chinese companies that owe their existence to favorable government actions in the past because legitimately applied CVDs could be minimal. U.S. CVDs vary but 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, which are currently only applied to market economies, with antidumping duties imposed on the same products over the last decade. 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 in which 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.

Note: This figure compares “all others” duty rates. See GAO-05-474 for more detail.

Under the WTO subsidies agreement and U.S. law, CVD rates are limited to the levels required to offset the amount of the subsidies.²³ 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 CVD 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.

Change in Methodology May Lower Antidumping Duties:

If administrative actions reclassified China as a market economy (in whole or in part), Commerce would have to change its 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. Based on our analysis, we believe a change to a market economy methodology would lower AD duties for some Chinese companies. Duties would likely decline for Chinese companies not assigned individual rates. Individual company rates would likely diverge, with those that do cooperate with Commerce receiving rates that are substantially lower than those that do not cooperate. In any case, as we explain in another report, it appears that the actual trade impact of the NME antidumping methodology will decline. As the portion of total export trade conducted by Chinese companies assigned individual rates increases, the country-wide rates that largely account for the comparatively high average rates applied to China decline in importance.²⁴

²³See article 19 of the WTO Agreement on Subsidies and Countervailing Measures, and 19 U.S.C. §1671(a).

²⁴GAO, *U.S.-China Trade: Eliminating Nonmarket Economy Methodology Would Lower Antidumping Duties for Some Chinese Companies*, [GAO-06-231](#). (Washington, D.C., Jan. 10, 2006.)

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.”²⁵ 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.²⁶ 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 on market economies, 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 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.

Commerce Lacks Clear Authority to Adjust for Potential Double Counting of Domestic Subsidies

If Commerce were to apply CVDs to China while it retains its NME status, another potential source of double counting could emerge with regard to another type of subsidy. In principle, double counting of actionable domestic subsidies generally does not occur when analysts employ information from exporting countries themselves to determine duty rates. However, it may occur when analysts use third-country information. 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.

²⁵WTO General Agreement on Tariffs and Trade, art. VI.5.

²⁶19 U.S.C. §1677a(c)(1)(C).

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.²⁷

Economists, trade law practitioners, and Commerce officials we consulted disagreed on whether, in practice, antidumping duties derived using third-country information effectively offset all of the subsidy benefits enjoyed by Chinese exporters.²⁸ 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 its NME methodology to calculate antidumping duties on the same products against which it also applied CVDs.

Commerce lacks clear authority to make such corrections when domestic subsidies are involved. 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. As a result, Commerce officials observed that the department would have no choice but to apply both duties without making such adjustments. While at least two U.S. courts have suggested that double counting to compensate for the same unfair trade practice is generally considered improper, they have not ruled on the specific question of whether double counting of actionable domestic subsidies, in particular, is improper. Commerce officials stated that, theoretical arguments aside, interested parties finding

²⁷In 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.

²⁸For example, some experts believe 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 be distorted by subsidies provided by other governments.

fault with Commerce's decision making would have to prove that there was actual double counting.

Conclusions

Congress is considering legislation that would authorize Commerce to apply CVDs to China as an NME country; however, substantial practical questions about how such cases would proceed remain unanswered, and the results that they would produce are uncertain. 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.

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.

As a result, we recommended that the Secretary of Commerce analyze and report to Congress on Chinese subsidies and the potential methodological approaches it might employ. Unfortunately, the Secretary disagreed with our recommendations, saying that this would be too speculative. He commented that it would not, therefore, be meaningful or appropriate to prepare such a report before an actual case was filed and that such a report could prejudice the outcome of future actions.

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, we suggested that Congress 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.²⁹

In response, Commerce took the position that there is no explicit statutory bar to its application of CVD law to NME countries and stated that the department would carefully consider any CVD petition. We modified our report to clarify the point 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 authority to take such an action, and that 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 a change in Commerce policy.

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; 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 situation, such corrections might be too difficult, and China would be placed 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.

²⁹We limit this matter for congressional consideration to situations involving NME countries because we believe that it is unlikely that double counting problems involving domestic subsidies will arise in companion antidumping and countervailing duty actions against market economy countries.

Mr. Chairman and Members of this Commission, this concludes my prepared statement. I would like to acknowledge Adam Cowles, Assistant Director, who helped prepare this statement and led our work on China trade remedies. I would be happy to answer any questions that you may have.

Related GAO Products

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