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U.S. wakes up to the changed Chinese marketplace

But the new view won't necessarily lower duties against 'China Inc.'

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CHINA RECENTLY reached a milestone in its journey from a centrally planned, nonmarket economy to an entrepreneurial, market economy. The U.S. government acknowledged that in China's current economy "entrepreneurship is flourishing" and that the People's Republic "has dismantled its monopoly over foreign trade." See Countervailing Duty Investigation, Coated Free Sheet Paper from the People's Republic of China, Memorandum on Whether the Analytical Elements of the Georgetown Steel Opinion are Applicable to China's Present-Day Economy (March 29, 2007), http://ia.ita.-doc.gov/download/prc-cfsp/CFS%20China.Georgetown%20applicability.pdf, at 7. Welcomed words in some quarters, no doubt, but not cause for the confetti to start flying in Beijing quite yet.

These statements were made by the U.S. Commerce Department in its investigation into allegedly subsidized imports from China of coated paper and paperboard used for writing, printing or other graphics purposes. Commerce's recognition of the significant changes that have taken place in China's economy provided justification to reverse a 20-year-old interpretation of the U.S. countervailing-duty (CVD) law.

Countervailing duties are special import levies used to offset subsidies that foreign governments provide to certain industries. It is generally acknowledged, even under international trading rules, that subsidies distort markets and, therefore, taking action to counteract subsidized imports may be appropriate to prevent injury to a domestic industry in the importing country. The long-standing view of the U.S. government, however, has been that the concept of a "market-distorting" subsidy has no meaning in a centrally planned, nonmarket economy. For decades, therefore, the Commerce Department has held that the CVD law does not apply to countries, like China, that are considered to be nonmarket economies. Commerce's interpretation of the law was sustained by the U.S. Court of Appeals for the Federal Circuit. See *Georgetown Steel Corp. v. U.S.*, 801 F.2d 1308 (Fed. Cir. 1986).

There is no cause yet for confetti to start flying in Beijing.

The Commerce Department's view of China has now changed. Commerce still treats China as a nonmarket economy, but views it more like a market economy—in fact, just enough like a market economy to apply the CVD law. Although countervailing subsidized imports from any country can serve a legitimate remedial purpose, in the case of China the department's decision to apply the CVD law could turn out to be an exercise in pure protectionism. Whether this is so depends on how the department grapples with certain ramifications of its decision.

Those ramifications can be fully understood only by delving into the arcane details not only of how U.S. law counteracts subsidized imports, but also how it treats imports that are "dumped." Dumping is the practice of selling in an export market below the "normal value" of the product. Under U.S. anti-dumping law, the normal value of a product typically is determined based on home market prices, but also can be based on a "constructed value" (i.e., the cost of production plus expenses and profit). If the export price is less than the "normal value," there is dumping, and "anti-dumping duties" (AD duties) are imposed in an equivalent amount to offset the dumping. In the case of China, however, the situation is different.

Because Commerce considers China to be a nonmarket economy, it uses a special method to determine the "normal value" of imports from China that ignores actual domestic prices and costs in China. Instead, Commerce uses "surrogate values" from market economies (e.g., India) to construct the normal value that is used to determine whether Chinese imports are being dumped in the United States. The justification for using that surrogate value methodology is that prices and costs in a Soviet-style, centrally planned, nonmarket economy are not a reliable indicator of "market value." See 19 U.S.C. 1677b(c). Therein lies one connection to Commerce's recent decision to apply the CVD law to China.

Dominant private sector

In the coated-paper case, the department justified its decision to apply the CVD law to China, in part by noting that the private sector "dominates most of the industries" with "market forces now [determining] the prices of more than 90 percent of products traded in China." Additionally, "[w]ages between employer and employee appear to be negotiated, as opposed to government-set." Georgetown steel memo, at 5 and 6. Given this new market orientation in China, Commerce should be able, at least in many instances, to use Chinese prices and costs, instead of surrogate values,

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to calculate the normal-value benchmark used to determine whether imports from China are dumped.

Using Chinese prices and costs is not the sole issue, however. Frequently, AD and CVD cases are brought simultaneously against the same imports. In a normal case, the law recognizes that subsidies provided specifically to support exports may lower the export price of a product, but will have no effect on its normal value, which is based on domestic prices and costs. As a result, the dumping calculation—which compares the export price (which can be affected by the export subsidies) to the normal value (which is not)—will capture the effect of the export subsidies. To avoid "double-counting" the subsidy (i.e., in both the subsidy calculation and the dumping calculation), the law requires that Commerce offset the AD rate by the amount of any export subsidies. See 19 U.S.C. 1677a(c)(1)(C). The special method used in AD cases against China presents a directly analogous situation.

As the Federal Circuit noted in *Georgetown Steel*, when it comes to nonmarket economies "Congress elected to deal with the [subsidy] problem under the anti-dumping law and not under the countervailing duty law." *Georgetown Steel*, 801 F.2d at 1318. Commerce's surrogate-value methodology is designed to calculate a normal value that is free of all subsidies, not just export subsidies. As a result, the comparison of the Chinese export price (which can be affected by any subsidies provided by the Chinese government) to the normal value (which is not because it's a surrogate value) will capture the effect of any Chinese subsidies—not just export subsidies. Thus, now that Commerce is applying the CVD law to China, it will need to make some corresponding changes in the way it applies the AD law if it wants to avoid double-counting Chinese subsidies.

Application of the CVD law to China raises other significant issues that undoubtedly will have the policymakers at Commerce burning the midnight oil. For example, the department normally calculates company-specific AD duty rates. In Chinese cases, however, the department continues to view all Chinese companies producing the subject merchandise as a single entity comprising affiliated companies all under common government control—"China Inc." To obtain a company-specific AD rate, Chinese exporters have to prove to Commerce that they are not subject to government control—i.e., that they are not part of China Inc. All other exporters receive a single AD duty rate assigned to China Inc., which is virtually always punitive and is more often than not high enough to lock those Chinese exporters out of the U.S. market.

As Commerce acknowledged in the paper case, in recent years it has determined that "many more companies' export activities are independent from the [People's Republic of China] Government," thus entitling these companies to their own, separate rate. Georgetown steel memo at 10. In fact, the vast majority of Chinese exporters that actually participate in anti-dumping cases receive a separate AD rate. Nevertheless, the department has maintained the China Inc. policy; many Chinese exporters believe that they are thereby unfairly subject to a punitive anti-dumping duty rate. Given that Commerce itself has confirmed that most Chinese companies are no longer government-owned or -controlled, Chinese exporters and U.S. importers argue that it is time to dissolve China Inc. Commerce has normal rules for dealing with groups of affiliated companies in AD cases, and those rules, they argue, should be adequate to address affiliation issues in Chinese cases, including any remaining government control that may exist in certain sectors.

Dissolve 'China Inc.'?

These are not radical ideas. Commerce has recognized China's transition away from the "Soviet-style" economy of the 1980s. Logically, therefore, Commerce could revise those aspects of the special policies it applies in AD cases against China that have their roots in that now defunct "Soviet-style" economy. If China's progress towards a market economy is sufficient to warrant applying the CVD law to its exports to the United States, an argument could be made that its progress is sufficient to warrant changes in how Commerce applies the AD law to China.

Commerce recently issued its preliminary determination in the anti-dumping investigation on imports of coated paper from China. Preliminary Determination of Sales at Less than Fair Value and Postponement of Final Determination, Coated Free Sheet Paper from the People's Republic of China, 72 Fed. Reg. 30758 (June 4, 2007). Although Commerce acknowledged in that decision that double-counting and possible market-economy treatment for specific exporters were issues, it deferred any decision on those issues until the final determination. In the interim, Commerce has requested public comment on the issue of market-oriented enterprises. See Antidumping Methodologies in Proceedings Involving Nonmarket Economies: Market-Oriented Enterprise, 72 Fed. Reg. 29302 (May 25, 2007).

So the question remains: Will Commerce align its anti-dumping duty policy with its new countervailing-duty policy? Some are betting that protectionism will prevail and a host of new cases will be filed, such as the pair of AD/CVD petitions filed on June 7, 2007, concerning imports of circular welded carbon-quality steel pipe from China. Others are betting that the department will move toward a more market-oriented policy for China—but given current political realities, they should consider hedging their bets.

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