

China-US Currency Subsidy Dispute from WTO Perspective: Review and Response

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Abstract. Since the new countervailing regulations came into effect, the U.S. Department of Commerce has conducted various countervailing investigations on Chinese enterprises for undervalued currency. This paper analyzes the core legal issues of undervalued currency subsidies, determines whether the exchange rate is undervalued and determines the elements and specificity of subsidies according to the Agreement on Subsidies and Countervailing Measures (SCM Agreement) and the WTO dispute settlement judicial mechanism, and proposes countermeasures in the face of the U.S. Department of Commerce's investigation.

Keywords: RMB exchange rate, subsidies, countervailing

1. Introduction: Recent Developments in the US-China Exchange Rate Subsidy Dispute

Since the reform and opening up, China's international current account surplus, the bilateral trade surplus with the U.S., and foreign exchange reserves began a four-decade-long phase of rapid growth. In order to reverse the huge trade deficit with China, the U.S. first identified China as a "currency manipulator" in May 1992 and six times thereafter, and creatively argued that the RMB currency was undervalued and constituted a subsidy due to distorted trade patterns. The U.S. took a relatively conservative approach to this argument in the early stages, with bills proposed by members of Congress on exchange rate subsidies ultimately failing, but on February 4, 2020, the U.S. debate on RMB Currency Subsidy quickly shifted to aggressive, with the U.S. Department of Commerce issuing a notice (Notice) making significant changes to its countervailing rules to formally define exchange rate undervaluation as a subsidy subject to countervailing measures.

On April 6, 2020, the Federal Register published the final version of the "Modification of Regulations Regarding Benefit and Specificity in Countervailing Duty Proceedings", which has since become a U.S. federal regulation.[1] Three months later, the U.S. Department of Commerce initiated a countervailing investigation into twist ties products from China, and on November 24, 2020, initially determined that the undervaluation of the RMB currency constituted a subsidy to Chinese twist ties products and imposed an undervaluation countervailing duty on China.[2] After the countervailing duty (CVD) investigation of twist ties from China, the U.S. Department of Commerce launched a number of countervailing investigations involving subsidies on the RMB currency on container trailer chassis, R-125 pentafluoro ethane, etc.

The above acts are not only a breakthrough of its past practice but also another concentrated manifestation of US-style economic and trade unilateralism and pressure tactics on China. With the continuous improvement of US domestic regulations on exchange rate subsidies and the launch of various countervailing investigations on exchange rate undervaluation, China will be in a passive position in the face of US allegations of undervalued RMB currency subsidies. Therefore, it is necessary for China to analyze the core legal issues in terms of WTO international law rules and dispute settlement judicial practice and make adequate preparations in advance, so as to make timely responses and legal responses in the face of the new round of US allegations of undervalued RMB currency subsidies. This paper will analyze the legal issues related to RMB currency subsidies in the context of WTO countervailing rules and WTO dispute settlement judicial practice, and propose a response to the RMB currency dispute between the US and China.

2. The RMB Currency Does Not Constitute a Subsidy under the WTO Framework

According to the provisions on subsidies of the 1994 General Agreement on Tariffs and Trade (GATT1994) and the Agreement on Subsidies and Countervailing Measures (SCM Agreement), the existence of a subsidy should have two elements: first, the government or public body within the territory of a Member provides financial contribution; second, the financial contribution benefits the recipient; and the subsidy needs to be “specific” in order to be prohibited or restricted. The following article analyzes the core legal issue of whether RMB currency constitutes a subsidy from the perspective of the constitutive elements and specificity of subsidies.

2.1 The Undervalued RMB Currency May Be Recognized as Financial Contribution

Under the WTO countervailing rules, in order to determine whether the undervalued RMB currency satisfies the requirement of the financial contribution for subsidies, two aspects should be determined, namely, whether the subject is eligible and whether the RMB remittance between the enterprise and the bank satisfies the form of financial contribution under the above rules.

Regarding the definition of “financial contribution entity”, the government's definition is very clear and needs no further explanation, while the definition of “public body” is not further explained in the SCM Agreement. In WTO dispute settlement judicial practice, the following three approaches have been adopted to identify “public bodies”: first, in the United States Countervailing Duty Measures on Certain Products from China, the U.S. side supported the Panel’s determination that Chinese state-owned enterprises and state-owned commercial banks constitute “public bodies” through the government's ownership or absolute control of the entities[3], although there are also views that the government's ownership or absolute control of the entities is only supporting evidence, and not absolute evidence.[4] Second, in that case, China supported the panel's determination of “public body” based on whether its entity performed governmental functions.[5] And third, Third, the panel and the Appellate Body, in that case, determined the nature of Chinese state-owned enterprises and state-owned commercial banks through the government's authorization of entities with the authority to own and perform governmental functions[6], which was later applied in the United States Countervailing Measures on Certain Pipe and Tube Products from Turkey.[7]

According to the method used to determine the “public body” in the WTO dispute settlement judicial practice mentioned above, Chinese state-owned banks may constitute an eligible subject of financial support. First, the Chinese government has an absolute controlling stake in state-owned banks, with the four largest state-owned banks in China (Industrial and Commercial Bank of China, Agricultural Bank of China, Bank of China, and China Construction Bank) all accounting for more than 59% of the total equity of the banks, and the change in the equity structure of the four largest state-owned banks has remained almost constant from 2013 to the present. Second, Chinese state-owned banks perform certain governmental functions. Chinese state-owned banks are under the direct control of the government's Ministry of Finance and the Central Huijin Investment Ltd., and their daily operations have obvious “governmental” characteristics. Its state-owned properties determine that it must obey the government's macro-control, implement the state's industrial policy, and help the state accomplish its economic goals.[8] Therefore, if the U.S. considers Chinese state-owned banks as a "public body" on the grounds that they play the role of executors and leaders in the implementation of the Chinese government's economic policies, it is likely to be supported by the WTO panel and the Appellate Body.

In addition, other foreign exchange-designated banks in China are more autonomous than state-owned banks, and the boundaries between banks and the government are clear, so they do not constitute “public body” according to the above criteria.[9]

With regard to the nature of the financial support examination, the four forms of financial support provided for in the SCM Agreement can be summarized as having a common essential characteristic: the existence of a transfer of funds from the government or a “public body” to a private party. The judicial practice of WTO dispute settlement bodies, such as the panel decision in the United States Measures Treating Export Restraints as Subsidies[10], also tends to analyze whether there is a transfer of funds from the government to private parties to determine whether there is a financial contribution. Private remittances through Chinese state-owned banks may be found to qualify as a direct transfer of funds and constitute a financial contribution.

2.2 The RMB Currency Does Not Constitute a Conferred Benefit

Under the SCM Agreement, a subsidy should confer a benefit on the recipient, and there are four exclusions from conferring a benefit. The cases of Canada Measures Affecting the Export of Civilian Aircraft, Korea Measures Affecting Trade in Commercial Vessels, EC, and Certain Member State-large Civil Aircraft show that the determination of “conferred benefit” should be made on a “free market” basis.[11] Only if the RMB currency is found to be undervalued compared to the “free market” basis can the fact of “conferred interest” be determined. Based on the above decisions, there are three ways to determine the level of the RMB in the “free market”: by referring to the RMB exchange rate in China, by referring to the RMB exchange rate in the offshore market, and by estimating the RMB Real Equilibrium Exchange Rate (REER).[12]

First, the level of the RMB currency in China is to some extent representative of the level of the exchange rate in the “free market”. Compared to the previous RMB currency mid-price, which was determined directly by the central bank, the current RMB currency formation mechanism is based on market supply and demand, adjusted by reference to the closing rate and a basket of currencies. The exchange rates of the currencies in the basket are determined by the exchange rate formation mechanism of the currency countries and are not influenced by the Chinese government, while the reference closing rate reflects the supply and demand situation in the reference RMB market.[13] From this perspective, the current RMB currency formation mechanism reflects market forces to a considerable extent. Second, the level of the offshore RMB is not bound by the RMB currency formation mechanism adopted in China's interior and is determined by the supply and demand for the RMB in the offshore market. But at the same time, the offshore RMB is not separate from the onshore RMB, and the exchange rate fluctuations between the two affect each other. The offshore RMB and onshore RMB exchange rates are also essentially the same. This suggests that there is no material difference between the reference offshore rate and the onshore rate as a “free market” benchmark. Third, the estimation of the RMB REER as a benchmark for the “free market” is a creative approach unilaterally proposed by the U.S. Department of Commerce in the Notice, which essentially bases the determination of the exchange rate level on a virtual REER that does not actually exist and relies on theoretical derivations and mathematical calculations, which itself is contrary to the free exchange rate system stipulated in the IMF Agreement and is not in line with WTO multilateral rules, and greatly increases the subjective discretion of the competent authorities in the enforcement process. In summary, the RMB cannot be considered “off-market” and the actual RMB exchange rate cannot be considered to be undervalued relative to the RMB exchange rate in the “free market”, and thus cannot be considered to constitute a conferred interest.

2.3 The Undervalued RMB Currency is Not Subsidy-specific

The elementary standard of specificity of subsidies is derived from the legislative practice of the U.S. countervailing duty, whose legislative purpose is to regulate subsidies that distort the allocation of resources, i.e., non-universal subsidies granted to specific enterprises or industries. In the SCM Agreement, the WTO also provides for three kinds of specificity, namely, subsidies to specific enterprises or industries, subsidies to enterprises or industries in designated areas, and prohibited subsidies. According to the WTO countervailing rules and dispute settlement practice,

even if there is a currency undervaluation of RMB, it does not constitute a subsidy because it does not have the specificity under the WTO countervailing rules.

Undervalued RMB currency applies to the entire of China, all industries, enterprises, and individuals, and does not target exporters or industries. Exporters are the recipients of the exchange rate policy, and it is an expansion of the scope of the special subsidy to consider an exporter's exports as special just because they comply with one of the measures of the exchange rate policy. A country's currency policy is based on national conditions rather than on the expansion of export performance and applies to all enterprises and residents rather than to one or a few specific areas.[14] Based on the reformed exchange rate formation mechanism of China based on China's economic development rather than granting benefits to export enterprises to increase exports, the undervalued RMB currency subsidy is not targeted at specific enterprises or industries and does not have a specificity.

With respect to geographical specificity, according to the SCM Agreement and WTO dispute settlement practice, a "particular area" must be specified and the boundaries must be clear to constitute geographical exclusivity.[15] However, the Central Bank of China's regulations on the RMB currency is applicable to all foreign exchange designated banks in China, and there is no "specific area" for the RMB "undervalued currency subsidy", therefore, it does not constitute geographical specificity.

Article 3 of the SCM Agreement divides prohibited subsidies into export subsidies and import substitution subsidies, and the RMB currency issue does not involve import substitution subsidies, and therefore only determines whether it constitutes an export subsidy. Legally, there is no provision in China's existing laws and regulations to promote exports by changing the level of the RMB exchange rate; in fact, there is no actual direct link between the undervaluation of the RMB currency and China's export trends. Thus, there is no significant correlation between the volume of China's exports and the level of the RMB currency[16], and thus an undervalued RMB currency does not constitute an export subsidy and thus does not constitute a prohibited subsidy.

3. Response to Countervailing Investigations on the RMB Currency

It is important to study the international law issues of the RMB currency under the perspective of WTO rules to provide a guarantee for China to promote the reform of the RMB currency mechanism in a proactive and controllable manner. For the threat and determination of the U.S. countervailing tax on undervalued RMB currency against China, the previous article has found that the U.S. determination of the RMB exchange rate subsidy issue cannot be supported by multilateral WTO rules by analyzing the core legal issues of RMB currency countervailing under WTO rules. The Notice, which means the U.S. dispute on China's RMB currency issue at the legal level In the face of such a serious and complex situation of exchange rate issue, in order to safeguard the national interests in the international community, China should respond well on all fronts and at multiple levels externally.

In order to ease the pressure on the RMB currency mechanism and maintain exchange rate sovereignty, the Chinese government can actively respond to the lawsuit and properly address the legal allegations of the United States. In the countervailing case against China's twist ties, the U.S. Department of Commerce frequently applied the "adverse facts available" rule (AFA) in its preliminary rulings because the Chinese companies under investigation refused to respond to the lawsuit after submitting information as required. In order to reduce the possibility of applying the AFA rule, the Chinese enterprises under investigation should make every effort to submit and respond to the countervailing questionnaire in order to actively respond to the lawsuit, and make every effort to complete the information requests from the U.S. Department of Commerce within the scope of their capabilities.

Meanwhile, according to the previous analysis, according to the SCM Agreement and past WTO dispute settlement judicial practice, the RMB currency does not constitute a subsidy in the sense of

WTO countervailing rules, and the U.S. decision to undervalue RMB currency resulting in subsidies and the imposition of countervailing duties is not justified. Use the authoritative and compulsory trade dispute settlement body to regulate trade disputes between countries and safeguard China's basic interests.

In order to maintain the effectiveness of the U.S.-China consultations and put them into practice, China can strengthen its bilateral consultations with the United States by replying to the bilateral Strategic and Economic Dialogue. China and the U.S. have now conducted several rounds of U.S.-China economic dialogues, and have already exchanged in-depth views and reached results in several areas. Promote the strengthening of bilateral consultations related to the RMB currency, reach sustainable and enforceable bilateral agreements, clarify the rights and obligations as well as commitments of both China and the U.S., and promote the substantive resolution of the RMB exchange rate dispute between China and the U.S.

All authors contribute the same to this article

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