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Countervailing Duty Tariffs May Increase Under a New Rule Regarding Currency Undervaluation

Commerce published a new rule effective April 6 which makes the investigation of currency undervaluation as a countervailable subsidy much more likely; countervailing duty tariffs could increase significantly.

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International Trade

The U.S. Department of Commerce (“Commerce”) recently published a new rule which makes it much more likely that the agency will investigate currency undervaluation as a countervailable subsidy. The new rule applies to countervailing duty (“CVD”) investigations or administrative reviews initiated on or after April 6, 2020. Under this new rule, Commerce could determine a foreign producer received a subsidy when it sold goods in the United States and then exchanged its U.S. dollars for an undervalued currency. While the currency practices of China are expected to be a target under the new rule, the rule could apply to any country with an undervalued currency.

Typically, for Commerce to find that a subsidy given to a foreign company is countervailable, the subsidy must be “specific” to an enterprise or industry (or group thereof). Put differently, subsidies that are generally available in an economy are not normally countervailable. Subsidies can also be “specific” if they are limited to a geographic region or contingent on exports. If Commerce finds a subsidy specific, it may impose a tariff (or “duty”) on imports to offset the competitive advantage a company producing that import receives from the subsidy. The new rule amends Commerce’s regulations to make a finding of specificity for currency undervaluation much more likely. The rule provides that enterprises that buy or sell goods internationally will normally be considered a group for purposes of establishing that a subsidy is specific. This definition is likely broad enough to cover essentially any company that exports goods. This is a stark departure from Commerce’s prior practice, under which Commerce has declined to even initiate an investigation on currency undervaluation because of a lack of specificity.

The amount of CVD tariffs imposed on imports is based on the competitive advantage, or “benefit,” a foreign company receives from the subsidy; the higher the benefit the higher the tariff imposed. The new rule establishes a two-step approach for measuring the benefit a company receives from undervalued currency. First, Commerce will determine if a currency is undervalued by comparing the gap between a country’s current real effective exchange rate (“REER”) to its equilibrium REER, *i.e.*, “the REER that achieves an external balance over the medium term that reflects appropriate policies.” For such undervaluation to be actionable, Commerce normally will require a showing of governmental action on the exchange rate, (beyond monetary and credit policy) as having contributed to the currency undervaluation.

Second, Commerce will determine the amount of any benefit by assessing "firm-specific circumstances" but such an assessment will not include any offset to the benefit resulting from increased costs that a company faces due to undervalued currency, *e.g.*, higher prices for imported inputs. Finally, Commerce's new rule explains that it will consider the U.S. Department of the Treasury's analysis of currency undervaluation, governmental involvement, and existence of a benefit, in determining whether a countervailable subsidy exists.

Notably, Commerce's rule provides the agency with broad discretion. Although Commerce has outlined this two-step approach to measuring benefit, it is not confined to this approach. Instead, the regulation explains what will "normally" be considered currency undervaluation and thus does not preclude Commerce from finding a countervailable subsidy based on currency undervaluation in other circumstances.

Commerce's new rule also raises questions about whether this new approach for analyzing currency is consistent with the World Trade Organization ("WTO") Agreements. For example, during the rulemaking commentators questioned whether an exchange of currency is a financial contribution and specific within the meaning of the WTO Agreement on Subsidies and Countervailing Measures.

Companies importing merchandise into the United States that is, or might be, subject to CVD tariffs should be aware of this new rule because it has the potential to meaningfully increase the total amount of tariffs imposed. For example, by one rough estimation, CVD tariffs on imports from China could increase by more than 10 percent in absolute terms based on a currency undervaluation subsidy, *e.g.*, a CVD tariff of 15 percent could increase to more than 25 percent. While China is a likely target of this new rule, the rule is not limited to any particular country. In this regard, a 2019 International Monetary Fund report calculated a negative REER gap and therefore potential currency undervaluation for seventeen countries or customs areas, including Argentina, China, the Euro Area, Germany, Indonesia, Japan, Korea, Malaysia, Mexico, the Netherlands, Poland, Russia, Sweden, Switzerland, Thailand, Turkey, and Singapore. This list is merely illustrative and should not be considered determinative of the countries that Commerce would find have devalued their currency for CVD proceedings. It nevertheless demonstrates the wide potential reach of Commerce's new rule.

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Covington has an experienced group of attorneys that have successfully represented clients in CVD investigations before Commerce and the International Trade Commission. If you have any questions concerning the material discussed in this client alert, please contact the following members of our International Trade Group:

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