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The Honorable Susan C. Schwab
United States Trade Representative
600 17th St. NW
Washington, DC 20508

Re: *Docket No. USTR-2008-0035*

Dear Ambassador Schwab:

The policies and practices of the United States Department of Commerce ("Commerce") with respect to subsidies allegations against the People's Republic of China could prolong a world-wide recession and even trigger a Depression because they treat all government involvement with manufacturing – including loans from state-owned banks, manufacturing from state-invested enterprises, and land-use zoning – as countervailable subsidies. The United States today hardly has a bank that is not state-owned, or a major manufacturing enterprise (particularly automobiles) that is not state-supported, or land that is not subject to municipal zoning requirements. Pursuit of subsidy allegations on these premises invites trade partners, beginning but not necessarily ending with China (and China is now the third most important destination for American exports), to treat U.S. exports the same way. Trade barriers around the world were a primary cause of the Great Depression. The policies and methodologies at issue here are a powerful incentive for the proliferation of such barriers again.

We are submitting this letter in response to the Office of the United States Trade Representative's ("USTR") request for comments, published in the *Federal Register* on November 13, 2008, on the *WTO Dispute Settlement Proceeding Regarding United States – Definitive Anti-Dumping and Countervailing Duties on Certain Products From China*. The policies and actions that the United States has taken in conjunction with other countries to prevent the collapse of the global financial system are understood to be essential to the welfare of the United States. Unfortunately, the cash bailouts and state acquisition of shares make many of the policies and practices at issue in this WTO proceeding hypocritical and, for the world economy, dangerous. We respectfully urge USTR to understand the potential global impact of Commerce's policies and methodologies, regardless whether they may be entirely consistent with an interpretation of U.S. trade law.

I. COMMERCE'S PRACTICES IN THESE CVD CASES UNDERMINE U.S. ECONOMIC RECOVERY

Commerce has embarked on a perilous course in the interpretation and application of U.S. countervailing duty law that, without hyperbole, could bring down the entire global trading system and the world economy with it. Every bank in the United States is now effectively state-owned or at least aggressively state-subsidized; the largest insurer in the United States is now state-owned; agriculture is overwhelmingly subsidized; many corporations, including famously the automobile industry, are now subsidized. All have been benefiting from massive direct financial contributions, the WTO's definition for "subsidy."[1] Consequently, as the United States applies its subsidies law against others, especially China, so it risks having subsidies laws applied against all U.S. products exported abroad. Worse, the tit-for-tat use of these methodologies around the world could become the 21st century equivalent of the Smoot-Hawley tariffs, which turned a recession into the Great Depression.

Commerce presumes that when a Chinese bank, fully or partially state-owned, loans money to a company fabricating products exported to the United States, those products are subsidized. Commerce further presumes that any Chinese industry designated in planning exercises as important or favored in some way must be subsidized. Commerce presumes that the products of any enterprise that is partially or fully state-owned is subsidized. Commerce presumes that land use rights sold by governments in industrial zones are subsidized. And Commerce presumes that subsidies pass through the chain of commerce attached to manufacturing inputs even when those inputs are bought and resold by unrelated private companies. Commerce places the burden of proof, that countervailing duties should not be applied to such products, on the Chinese producers and the Chinese Government.

As a result of the massive U.S. Government intervention in the financial and insurance markets and other steps the Treasury and Federal Reserve are taking to revive the U.S. economy, there likely would not be a single U.S. industry that could not be considered to have received lending or insurance from state-owned banks or insurers; inputs throughout U.S. manufacturing probably could not be obtained directly or indirectly from anything but state-owned or subsidized companies. Under the Commerce methodologies at issue here, almost everything exported from the United States could be countervailed. For example, in October the U.S. Treasury forcibly purchased equity stakes in the largest U.S. banks (*i.e.,* Bank of America, Wells Fargo, Citigroup, JPMorgan Chase, Goldman Sachs, Morgan Stanley, Bank of New York Mellon Corp, State Street Corp and Merrill Lynch) with the stated expectation that the banks would lend out federal government funds.[2]

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[1] Agreement on Subsidies and Countervailing Measures, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Article 1.1, Legal Instruments – Results of the Uruguay Round 33 I.L.M. 1125 (1994).

[2] Treasury Secretary Henry Paulson explained that "[w]hat we're doing is making clear to the banks how important it is to deploy the capital." Deborah Solomon & David Enrich, *Devil is in Bailout's Details: Government's $250 Billion Cash Injection Sparks Welter of Issues*, Wall St. J., Oct. 15, 2008, *available at* http://online.wsj.com/article/SB122398468353632299.html.

According to Treasury's November 25, 2008 transaction report, it had purchased equity stakes worth $161 billion in 53 U.S. financial institutions.[3] The justification for this program is that government equity infusions were needed because the inability to attract private investment had frozen these financial institutions' ability to continue lending to the rest of the economy. Pursuant to Commerce's methodology as applied routinely to imports, Commerce would find the full amount of these equity infusions to be countervailable subsidies because the government made them when the companies receiving them were not equityworthy (*i.e.,* unable to attract private investment).

Congress expected the banks to use the government funding to increase lending when it approved the Emergency Economic Stabilization Act. Concerned that banks have not been using enough of that money to make new loans, the Chairman of the Senate Banking Committee has stated that he and other lawmakers intend to require the banks to do more lending before Congress will authorize Treasury to spend the $350 billion second tranche of the Emergency Economic Stabilization Act.[4]

Commerce, using the methodologies it employed in the cases at issue here, likely would view a condition similar to the expressed intentions of Congress and the Treasury in foreign legislation to mean that loans provided by the recipient banks should be treated as "directed" by the government and, thus, countervailable to the borrower to the same extent as such a loan obtained directly from the government. Even were the size of the government's equity stakes in U.S. banks not enough to make them technically state-owned banks, the conditions upon those equity stakes would be the functional equivalent under Commerce's view of the countervailing duty laws.

The steps the U.S. Government has taken to stabilize financial markets include the nationalization of the largest insurance company in the United States. The U.S. Government now owns 77.9% of the equity of American International Group, Inc. ("AIG") and warrants to purchase an additional 2%.[5] Had the government not intervened in the market and purchased AIG, the company would have gone under. Again, in Commerce parlance, AIG was "unequityworthy."[6] Moreover, AIG unquestionably now is a state-owned company, and any foreign authority applying the Commerce methodologies at issue before the WTO would presume that insurance policies AIG issues would be countervailable subsidies to the policyholders. Such a

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[3] U.S. Department of the Treasury, Emergency Economic Stabilization Act - Capital Purchase Program Transaction Report (Nov. 25, 2008), http://www.treasury.gov/initiatives/eesa/transactions.shtml.

[4] John Dunbar, *Congress May Require More Lending for Bailout Help*, Wash. Times, Nov. 13, 2008, *available at* http://washingtontimes.com/news/2008/nov/13/congress-may-require-more-lending-for-bailout-h-1/.

[5] AIG Press Release, *U.S. Treasury, Federal Reserve And AIG Establish Comprehensive Solution For AIG*, (Nov. 10, 2008), http://phx.corporate-ir.net/phoenix.zhtml?c=76115&p=irol-newsArticle&ID=1224188&highlight.

[6] Commerce considers a firm to be equityworthy when, from the perspective of a reasonable private investor at the time of the equity infusion, the company shows an ability to generate a reasonable rate of return within a reasonable period of time. 19 C.F.R. § 351.507(a)(4)(i).

presumption could be devastating to U.S. exports because AIG is the dominant player in U.S. corporate insurance, with an 11 percent share of the U.S. market.[7]

The U.S. Government has not limited to the financial sector its intervention in ways that Commerce would find countervailable in foreign legislation. For example, in September 2008 Congress appropriated $25 billion for low interest loans to assist the U.S. automobile industry to develop more fuel efficient vehicles and retool to produce them.[8] Should these subsidies have their intended effect, the technologies developed would likely have benefits for many other industries, potentially opening up large segments of U.S. manufacturing to countervailing duty allegations based on the methodologies that Commerce has embraced in the cases at issue in this WTO proceeding.

By the time these comments are read, Congress probably will have provided tens of billions of dollars more to rescue the big three U.S. automakers from economic collapse. They will not have been "creditworthy" recipients of these loans. As Alabama Senator Richard Shelby said to the Chief Executive Officers of the "Big 3" automakers when they pleaded for a bailout during Senate hearings, "If you made this presentation to get a bank loan, I suspect that any sensible banker would summarily dismiss your request."

Beneficiaries of the financial contributions to General Motors, Ford, and Chrysler likely will include the many industries that serve the automobile industry, including parts manufacturers and steel. Countless other industries are lining up, seeking financial contributions which, to avoid a deepening and prolonged recession through the spiral of unemployment, unpaid taxes, and diminishing essential services, the Government may have to provide.

The Federal Reserve, in an attempt to alleviate the credit freeze, has opened up a Commercial Paper Funding Facility to purchase up to $1.8 trillion in commercial paper issued by U.S. companies.[9] Although the Federal Reserve has not disclosed information about individual transactions, publicly available information indicates that, as of November 19, 2008, the Federal Reserve held approximately $270 billion in commercial paper issued by major U.S. manufacturers and exporters.[10] Some of those companies include: General Electric; Chrysler; Ford; IBM; Harley Davidson; and General Motors.[11] Commerce would treat all of these purchases of commercial paper as countervailable subsidies because the purpose is to provide credit to specific

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[7] *See* Simon Challis, *AIG Woes Offer Double Benefit For Insurance Rivals*, September 17, 2008, http://www.insurancejournal.com/news/national/2008/09/17/93795.htm.

[8] *See* James Martinez, *$25 Billion Auto Industry Loan Package Approved by President Bush* Sept. 30, 2008, http://www.motorauthority.com/carmakers-seek-50-billion-in-loans-from-us-congress.html.

[9] *See* David Lawder, *FACTBOX-US Commits Over $5.704 Trln in Financial Rescues,* ThomsonReuters, Nov. 24, 2008, http://www.cnbc.com/id/27896555/site/14081545/for/cnbc/.

[10] *Id.*

[11] *See* Dow Jones Newswires, *Cos Participating In US Govt's Commercial Paper Program*, Nov. 14, 2008, http://news.morningstar.com/newsnet/ViewNews.aspx?article=/DJ/200811141245DOWJONESDJONLINE000688_univ.xml.

companies when they cannot obtain it from private markets, which under Commerce's methodologies would mean the companies are "uncreditworthy" and entitled to no loans of any kind.

Following the financial crises of 2008, there is hardly a U.S. export that would not, by Commerce's presumptions and reckoning, be subsidized and subject to countervailing duties. Should the United States continue on its present course, blocking Chinese imports because of presumed and alleged countervailable subsidies, the United States must now expect its trading partners to do the same.

These legal principles cannot be applied selectively or exclusively to China, and most countries now have infused cash into their financial institutions and often have taken ownership positions. While China is trying to develop an automobile industry, for example, especially one deploying twenty-first century green technologies, it would have every incentive to limit or deny the importation of American cars by applying countervailing duty laws in exactly the same way the United States is applying those laws to Chinese products. Koreans may have reservations about the safety of untested American beef, but they also now have powerful routine trade law reasons, based on massive U.S. agricultural subsidies, to block U.S. exports of beef.

The list of products potentially exposed to countervailing duties, following the principles the United States has been applying to China, is without limit. There may be nothing in the world trading system now that is entirely the product of free markets because, with the financial meltdown of 2008, there are no purely free markets on the model idealized in the United States and enforced in U.S. trade laws.

The Historical Risks

The October 1929 Stock Market Crash did not bring down the world economy. To the contrary, nine months later, in mid-1930, the stock market was again peaking. Instead, Depression followed because of many errors, most notably the Smoot-Hawley Tariff that started a domino effect closing markets. Economists and trade specialists have assured the world since, often with sincere smugness, that such foolishness could not happen again, that the principles of free and fair trade and open markets are well understood and respected.

Although it is certainly true that consecutive rounds of world trade negotiations have lowered or eliminated most tariffs, conspicuous cases remain, particularly U.S. tariffs on sugar and cotton, as examples. But the remaining tariffs are not the most important threat.

The more important threat is embedded in the application of U.S. trade laws, particularly as interpreted and applied by Commerce. Product-by-product Commerce shuts off markets by imposing tariffs pursuant to its notions of dumping and subsidies, often in defiance of world trade rules (*e.g.,* the application of zeroing in dumping cases has been struck down in every form repeatedly but Commerce and Congress refuse to let it go; the presumptions about state ownership described above contradict U.S. domestic policy). With global infusions of cash, the indignities of presumptions visited

upon China now become applicable potentially to every country and every product. They also are applicable to almost everything produced in the United States.

The protectionist mantra has always included a claim of superiority for American companies competing in free markets, and a complaint about the inability of American companies to compete against foreign enterprises benefiting from the largesse and indulgence of foreign governments. Arguably, American competitors have never been operating entirely without government support themselves, whether through export assistance from the Foreign Commercial Service, from special tax arrangements, from state government concessions to attract and hold industry, or countless other subsidizing mechanisms. But since September 2008, no plausible argument remains. American companies, by virtue at least of their banking and insurance relationships, are, by Commerce Department methodologies and standards, heavily subsidized.

USTR is in the business of opening foreign markets, but as long as it supports Commerce's views on Chinese subsidies it should expect those markets progressively to close against U.S. products, in China and elsewhere. As markets close, Smoot-Hawley effectively returns, not through one massive tariff bill, but through hundreds of administrative decisions. We may all then experience what we were assured could never happen again. As the financial meltdown began with subprime mortgages in the United States, so the race for protectionism would have begun with the U.S. interpretation of countervailable subsidies as applied to China and other countries.

The Trade Law Mechanism That Would Keep These Subsidies From Being Countervailable Is Not Applicable And Has Been Emasculated

Not all subsidies are countervailable. The principal failsafe in the trade law is the "specificity" test. It provides that subsidies for general use, not targeting any particular industry or enterprise or group of industries or enterprises, are not countervailable.

Commerce has labored long and hard to emasculate the specificity test. Recently it persuaded the United States Court of Appeals for the Federal Circuit that manpower training offered to every enterprise in Quebec, regardless of industry, constituted a countervailable subsidy because not every company received the same nominal financial contribution. Instead, companies received contributions according to the number of job positions for which they were training new personnel. Companies large and small must receive, by this rationale, identical nominal support in order to escape a finding that the support is "specific" to the larger companies that receive, nominally, more support than others. Of course, governments do not provide identical nominal support to companies large and small, and consequently Commerce considers virtually all assistance – such as worker retraining in hard times – to be specific and hence countervailable.

In the Chinese cases, Commerce found the sale of land use rights to companies locating in industrial parks to be a countervailable subsidy. It did not matter that the companies paid neither more nor less than companies outside the industrial parks, nor that the industrial parks provided no services any different from conditions

outside them. It did not matter that many different enterprises representing many different industries were located in the park. Commerce said they were "specific" beneficiaries of land use rights simply because the rights were inside an industrial park.

The specificity test evolved in the trade law to stop governments from targeting certain industries for international competitive advantage. It takes two forms: *de jure,* when the law specifies to whom the contributions are made, and *de facto* when there are specific beneficiaries despite an apparently general program or allocation. Congress, as it selectively assists the automobile industry, and massively has assisted agriculture, has done exactly what the specificity test was designed to prevent, providing *de jure* assistance that makes countervailability virtually automatic. But, due to the jurisprudence Commerce so zealously has pursued, this *de jure* targeting may not matter. Were Congress to provide the same benefits on the same rationale to all industries (and steel and automobile parts could not be far behind), nominally some companies inevitably would receive more than others. The contributions would then be, by Commerce's reasoning, *de facto* countervailable.

II. COMMERCE'S METHODOLOGIES FOR MEASURING ALLEGED SUBSIDIES IN CHINA USING FOREIGN BENCHMARKS IS NOW UNWORKABLE

There Could Be No Comparable Commercial Loans Anywhere

The recent massive government interventions into financial markets to prevent a collapse of the global financial system have made Commerce's methodology for measuring subsidies in China obsolete, even were it lawful. Commerce has rejected the use of benchmarks within China for determining and measuring subsidies on the grounds that the Chinese Government's ownership of land and enterprises, and its intervention into the financial sector, creates significant distortions, such that no benchmark in China, even one based, for example, on loans made by private foreign banks operating in China, can be a reliable market benchmark.

Unfortunately for Commerce, were its rationale to be applied to the United States or almost any other developed country, it would be unable to find any market that would qualify. Certainly, with the Treasury and the Federal Reserve having intervened in U.S. financial markets in excess of $5.7 trillion in the last three months,[12] Commerce would have to find the U.S. financial market so distorted by government intervention that no financial benchmark could be obtained from the United States under the rationale it has applied to China.

Out-Of-Country Land Value Comparisons Are Nonsensical And Zoning Is Universal

The methodology requiring the use of surrogate values in other countries, upon which Commerce relies in both dumping and subsidies analysis, suffers from the same infirmities for valuations other than commercial loans. Commerce has used out-of-country benchmarks to value land in China -- commercial land in Bangkok, for

[12] *See* Lawder, *supra*, note 9, at 4.

example, for rural land in Shandong Province. The only expert witness to testify on any subject pertaining to China at a Commerce Department hearing, a Ph.d. economist with unassailable professional credentials as an international expert on real estate and land use, demonstrated on a Commerce Department record that, as a matter of land use economics, using land in another city as a benchmark, let alone in another country, is nonsensical. Yet, Commerce held to the Bangkok benchmark because of alleged dominant government interest in Chinese land making any internal comparison impossible.

Federal, state and local governments in the United States routinely intervene in land use markets for everything from rent control in New York City to federal subsidization of real estate mortgages all across the country. The United States' housing and property market is not, never has been, and could not be "free" while mortgage interest is forgiven on income taxes. Local governments routinely distinguish among commercial, industrial and residential uses for property taxes.

Commerce, in the Chinese cases, went even further, to find that the sale of land use rights in China is "specific," and hence countervailable, entirely because the land in question was located in an area zoned for industrial use. Of course, almost every municipality in the world engages in land use planning and zoning. Every square inch of the Washington, D.C. metropolitan area is zoned for specific land uses.

Industrial facilities are located in industrial zones, homes in residential zones, almost everywhere. Zoning is a normal function of the police power of any government and has been since ancient times. If location in an area zoned for industrial use were the criterion for determining whether government benefits are specific and hence countervailable, then the location of almost every manufacturing facility in the United States would be countervailable. Yet, that is the standard Commerce has set against China in the cases here.

III. FIXING THE PROBLEM

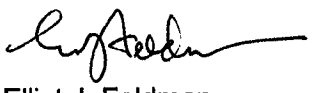
The concepts of subsidies and free markets cannot be considered the same in December 2008 as they may have been considered as recently as mid-September 2008. The application of trade laws relying on pre-meltdown concepts and definitions, without consideration for the potential of reciprocal treatment, invites global financial catastrophe.

There may be a need for legislation, and for global negotiation, to fix this problem, but Commerce and the International Trade Commission probably have enough regulatory discretion to create the necessary breathing space. Indeed, Commerce probably could provide a temporary fix on its own. U.S. courts, for example, have permitted zeroing, although contrary to repeated WTO decisions, strictly on the grounds of Commerce's exercise of discretion. Commerce exercises similar discretion in using out-of-country benchmarks, and Commerce could readjust at its own discretion the many assumptions it makes as to state ownership, creditworthiness and equityworthiness. There is, therefore, a temporary fix available, but Commerce must receive Executive Branch guidance to apply it.

USTR should call for a moratorium on the application of a subsidies regime against China, and other countries, especially as to state ownership of, or major investment in, banks, insurance companies, trading companies, manufacturing facilities, public utilities, and land. Rules as to "creditworthiness" and "equityworthiness" should be suspended, and the United States should call upon other countries to act the same way. Both steps should be undertaken – a moratorium and a suspension -- at least until negotiations with trading partners to adjust for the radical changes in the U.S. and world economy can get underway. Alternatively, application of the subsidies regime should be halted until Congress can address the new problem. Whatever perceived unfair trade advantage may emerge from alleged subsidies would be more than offset by a trade war arising from the mutual assured destruction of countervailing goods now tainted by the hands of governments, for they are tainted everywhere, including especially in the United States.

USTR should now call for new multilateral negotiations, perhaps as part of the Doha Round, to reconsider the meaning of "countervailable subsidy." Even as a definition in international trade law emerged only for the first time in the Uruguay Round, it already has been rendered dangerously obsolete. Until such time as a new definition can be reached, application of the old one should be suspended. The alternative could be a trade war the likes of which has not been seen since the Great Depression.

Respectfully submitted,



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