

# GENERAL AGREEMENT ON TARIFFS AND TRADE

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Committee on Subsidies and  
Countervailing Measures

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## COMMUNICATION FROM THE UNITED STATES CONCERNING SUBSIDY DETERMINATIONS ON CERTAIN CARBON STEEL PRODUCTS

On August 24, 1982, the United States Department of Commerce made final determinations in the countervailing duty investigations concerning certain steel products from Belgium, the Federal Republic of Germany, France, Italy, Luxembourg, the Netherlands, the United Kingdom, Brazil and South Africa. The United States agrees that these investigations merit the Committee's attention, not the least because of the volume of trade affected. Nevertheless, it is essential that the steel cases of 1982 be viewed in a broader context. That is the purpose of this memorandum.

The European Communities have raised a number of issues concerning the calculation of the amount of a subsidy, in their memorandum of 9 July 1982 (updated 9 October 1982). These issues were taken into account in the final subsidy determinations in these cases; the explanatory pages from the determinations are attached as an appendix to this paper.

The issues raised in these cases are difficult ones for this Committee to resolve. In many cases, they reflect differences of viewpoint on basic issues of policy concerning the extent of government intervention in national economies. These differences were present throughout the Code negotiations, and contributed to the purposeful ambiguities and agreements-to-disagree that are embodied in the text of the Code. This original division on principles has been cast into high relief by the pressure of persistent overcapacity in a strategic, politically sensitive sector, the steel sector, at a time of difficulty for the world economy.

In the face of high unemployment, low capacity utilization, and growing import penetration, the United States Government has taken the approach of depoliticizing the steel investigations to the extent possible, considering the issues carefully and openly. Our reasoning has been exhaustively explained to the parties concerned.

We did not seek out these cases; they came to us, against our will, largely because earlier attempts to paper over basic problems through compromise had broken down. While the sheer extent and complexity of steel sector subsidies have been a catalyst here for the development of practice in the area of countervailing duties, the same issues would be confronted in any industry so subsidized. The issues before the Committee today should not be obscured by the fact that the steel sector is involved.

This Committee needs no reminding that the Subsidies Code is more than a code regulating countervailing duties. We support discussion in the Code of practice in the countervailing duty area, but we reserve the right to revert to the subsidies underlying the investigations.

The Agreement on Interpretation and Application of Articles VI, XVI and XXIII -- the Subsidies Code -- was the last to be concluded in the Tokyo Round, after long and difficult negotiations. Despite the length of these negotiations, the Code is ambiguous on certain issues which are central to countervailing duty proceedings. In some cases, this ambiguity was purposeful on the part of the negotiators, and in fact represents an agreement to defer interpretive decisions for the time being. This is reflected, for example, in footnote 15, in which the signatories recognized that many questions of calculation of the amount of subsidy remain open under the Code. Thus, we are now, and have been, effectively engaged in a continuing long-term process in the development of rules to govern subsidy practices and countermeasures.

The steel investigations have focused attention on a range of these issues. In the absence of international agreement, the United States has been forced to address many of these issues unilaterally in the course of previous investigations, as well as in the context of the steel investigations. The Code's provisions on countervailing duties, like the Antidumping Code provisions which were their paradigm, envision a developing process in which action by individual signatories is followed by discussion by the Code Committee.

Neither of the Codes envisions delay of individual signatories' actions against unfairly traded imports pending multilateral review. Indeed, this possibility was considered and rejected during the Subsidies Code negotiations. The timetables established in Article 2 of the Code do not allow us to await a Code decision on specific issues before reaching a final determination in an investigation. Therefore, in all of our investigations, whether involving steel or other products, we have made our decisions on these issues within our statutory deadlines, and have done so with the strictest adherence to the principles and rules established under Article 2.

Having made our determinations, we now invite further discussion of these issues by the signatories with a view toward taking another step in the direction of developing effective international discipline and consensus on an extraordinarily complex subject.

The U.S. statute which implements the provisions of the Code ensures that the United States makes its determinations regarding the nature and amount of subsidies in accordance with both the letter and spirit of the Code. The Congress and the Administration worked closely together to ensure that the implementing legislation brought our countervailing duty law into compliance with our obligations under the Code. The legislation was passed and signed into law in

that belief. The statute includes language not directly derived from the Code itself only in those instances where the Congress felt it was necessary to clarify ambiguities in order to establish fair and open procedures in the context of the United States' legal system of open and objective decision-making.

The United States believes that its adherence to the letter and spirit of the substantive Code provisions has been aided by the procedural provisions of our statute. These provisions embody an approach to the conduct of countervailing duty proceedings that is both systematic and transparent. The statute's procedural rules provide for full disclosure of the facts and reasoning that provide the basis for each decision. The rules also provide extensive rights of hearing and comment by all interested parties. Thus, all parties may be assured that each case is decided on its merits.

We understand that foreign and domestic parties may disagree with particular aspects of our reasoning in specific instances. Our statute ensures that all parties, whether or not they agree with our decisions, have the opportunity to be heard and have their views considered. We believe that the practice of the United States, not only in the steel investigations, but in all of the proceedings we have undertaken under our statute, shows that we have consistently fulfilled our obligations in this regard.

We believe that our system, which some view as intensely legalistic in its approach, has certain advantages. It enables us to resist pressures to attack politically vulnerable targets, and to deal with allegations of unfair trade practices in an evenhanded manner. In the long run, this appears to us to be the approach that is most advantageous to us and our trading partners and that most ensures fairness under the Code.

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The current problems in world steel trade date from at least the mid-1970's, when it became apparent that there would be serious excess capacity of steel production world-wide. The U.S. steel industry is now suffering through its worst period since the 1930's and subsidized imports have contributed to that suffering. The United States recognizes that it is not the only country with a steel industry in a severe recession, and appreciates the steps that some of our trading partners have taken in their efforts to reduce capacity. We in turn ask our trading partners to recognize that an artificial competitive edge created by government action should not be used to the injurious disadvantage of like industries in other countries.

In our view, that has occurred in the steel sector despite repeated efforts of the United States to reach an accommodation with all parties concerned. When antidumping petitions were filed in 1978 covering a range of steel products from a number of countries, the United States persuaded its own steel industry to withdraw its antidumping complaints by offering a compromise solution, the

Trigger Price Mechanism (TPM). The TPM was created in order to allow continued imports to the U.S., even where some may have allegedly been at less than fair value, while minimizing the risk of injury to the domestic industry by unfairly traded imports. In March, 1980, the original TPM collapsed because of sales by certain exporters at prices below trigger price levels. This resulted in the filing of antidumping petitions by the domestic industry. Later that year the United States Government again persuaded the domestic producers to withdraw their petitions, on the basis of a revised TPM effected with the agreement of the EC. However, the revised TPM also collapsed when certain EC producers decided to ship well below the trigger price levels despite overwhelming evidence of injurious subsidization and, perhaps, sales at less than fair value.

That massive subsidization of various European steel producers exists is beyond dispute. For example, the West German steelmakers' association has recently estimated that \$70 billion in government financial assistance has been spent or committed for other EC steel industries for the period 1975-1983. The issue is not whether subsidies exist, but rather in what amounts.

Some of our trading partners have argued that subsidies are not subsidies if they underwrite restructuring to eliminate outmoded, uneconomical production facilities. While we welcome this restructuring and recognize that it has in some cases resulted in reduction of excess capacity, subsidies used for this purpose have also had the effect of governments underwriting the modernization costs for some producers. These subsidies, however well intentioned, are not available to producers in the United States and many other countries, nor even in some of the EC member states. In these countries, producers themselves must raise capital to modernize, and must absorb the costs of closing inefficient or obsolete facilities.

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As noted above, many difficult issues have been raised in these investigations. In July, the EC circulated a memorandum outlining its positions on the items of major concern to the Community. The positions of the United States on these issues are contained in the Annexes to the final determinations. Appended to this communication are copies of these annexes as published in the Federal Register, which is the official gazette of the United States.

Appendix:

APPENDIX

PART I

METHODOLOGY

Several basic issues are common to many of the countervailing duty investigations of certain steel products, initiated by the Department of Commerce ("the Department") on February 1, 1982; e.g., government assistance through grants, loans, equity infusions, loss coverage, research and development projects and labor programs. This appendix describes in some detail the general principles applied by the Department when dealing with these issues as they arise within the factual contexts of these cases. This appendix, although substantially the same as Appendix B to the preliminary determinations (see "Preliminary Affirmative Countervailing Duty Determinations, Certain Steel Products from Belgium (47 Fed. Reg. 26300), does describe some changes in methodology. These changes are principally in the areas of the discount rate value, funds for loss coverage, and preferential loans with deferred principal payment.

Grants

Petitioners alleged that respondent foreign steel companies have received numerous grants for various purposes. Under section 771(5)(B) of the Tariff Act of 1930, as amended (the Act) (19 U.S.C.

1677(5)(B)), domestic subsidies are countervailable where they are "provided or required by government action to a specific enterprise or industry, or group of enterprises or industries" (emphasis added).

The legislative history of Title VII of the Act states that where a grant is "tied" to--that is, bestowed specifically to purchase--costly pieces of capital equipment, the benefit flowing from the grant should be allocated in relation to the useful life of that equipment. A subsidy for capital equipment should also be "front loaded" in these circumstances; that is, it should be allocated more heavily to the earlier years of the equipment's useful life, reflecting its greater commercial impact and benefit in those years.

Prior to these cases on certain steel products, the Department allocated the face value of the grant, in equal increments, over the appropriate time period. For large capital equipment, we used a period of half the useful life of the equipment purchased with the grant. In each year we countervailed only that year's allocated portion of the total grant. For example, a hypothetical grant of \$100 million used to purchase a machine with a 20-year life would have been countervailed at a rate of \$10 million per year (allocated over the appropriate product group) for 10 years, beginning in the year of receipt.

This allocation technique has been criticized for not capturing the entire subsidy because it ignores the fact that money has a changing value as it moves through time. It has been argued that \$100 million today is much more valuable to a grant recipient than \$10 million per year for the next 10 years, since the present value (the value in the initial year of receipt) of the series of payments is considerably less than the amount if initially given as a lump sum. We agree with this position and, as indicated in the preliminary determinations, have now changed our methodology of grant subsidy calculation to reflect this agreement. As long as the present value (in the year of grant receipt) of the amounts allocated over time does not exceed the face value of the grant, we are consistent with both our domestic law and international obligations in that the amount countervailed will not exceed the total net subsidy.

The present value of any series of payments is calculated using a discount rate. As indicated in the preliminary determinations, we considered using each company's weighted cost of capital at the time of the grant receipt as the appropriate measure of the time value of its funds. However, we lacked sufficient information to do so for the preliminary determinations, and instead used the national cost of long-term corporate debt as a substitute measure of a company's discount rate.

Between the preliminary and final determinations we reviewed the comments and suggestions of various interested parties, principally contained in the pre- and post-hearing briefs. In addition, we sought the advice of an outside consultant with experience in the field of international investment banking.

On the basis of those discussions and that advice, we determine that the most appropriate discount rate for our purposes is the "risk-free" rate as indicated by the secondary market rate for long-term government debt (in the home country of the company under investigation). The basic function of the "present value" exercise is to allocate money received in one year to other years. Domestic interest rates perform this function within the context of an economy. The foundation of a country's interest rate structure is usually its government debt interest rate (the risk-free rate). All other borrowings incorporate this risk-free rate and add interest overlays reflecting the riskiness of the funded investment.

When we allocate a subsidy over a number of years it is not the intention of the Department to comment on nor judge the riskiness of the project undertaken with the subsidized funds nor to evaluate the riskiness of the company as a whole. Nor do we intend to speculate how a project would have been financed absent government involvement in the provision of funds. Rather, we simply need a financial mechanism to move money through time so as to accurately reflect the

benefit the company receives. We believe that the best discount rate for our purposes is one which is risk free and applicable to all commercial actors in the country. Therefore we have used in these final determinations long-term government debt rates (as reflected in the secondary market) as our discount rates.

For costly pieces of capital equipment, we believe that the appropriate time period over which to allocate the subsidy is its entire useful life. In the past, we allocated the subsidy over only half the useful life in order to "front load" the countervailing duties, thereby complying with the legislative intent of the Act. However, so long as we allocate the subsidy in equal nominal increments over the entire useful life, it will still be effectively front loaded in real terms (as long as a positive discount rate is used) since money tomorrow is less valuable than money today.

For these steel investigations we have allocated a grant over the useful life of equipment purchased with it when the value of that grant was large (in these investigations, greater than \$50 million) and specifically tied to pieces of capital equipment. Where the grant was small (generally less than one percent of the company's gross revenues and tied to items generally expensed in the year purchased, such as wages or purchases of materials), we have allocated the subsidy solely to the year of the grant receipt. We construe that a grant is "tied" when the intended use is known to the subsidy giver and so acknowledged prior to or concurrent with the bestowal of the subsidy. All other grants--the vast majority of

those involved in these investigations--are allocated over 15 years, a period of time reflecting the average life of capital assets in integrated steel mills. The 15-year figure is based on Internal Revenue Service studies of actual experience in integrated mills in the U.S. Furthermore, we understand that a 15-year period is a common useful life adopted in some of the countries involved in these investigations for steel capital equipment. We are using this time period because we sought a uniform period of time for these allocations and this was the best available estimate of the average steel asset life worldwide. We could not calculate the average life of capital assets on a company-by-company basis, since different accounting principles, extraordinary write-offs, and corporate reorganizations yielded extremely inconsistent results.

#### Funds to Cover Losses

In the preliminary determinations we did not distinguish funds (either in the form of untied grants or equity infusions) which were available for loss coverage from other grants or equity infusions. We stated that since grants used for loss coverage often have the effect of helping keep the firm in business, we allocated the benefit over 15 years when the funds were in the form of a grant or used the appropriate equity methodology when the loss coverage funds were in the form of equity.

Between the preliminary and final determinations we reviewed the comments and suggestions of various interested parties principally contained in the pre- and post-hearing briefs. In addition, we sought the advice of the Department's accountants and outside consultants on the issue of the appropriate treatment of funds for loss coverage. Based on the above, we have decided not to allocate the subsidy benefit of these funds over time but rather to allocate them to the year of receipt.

We have done so on the advice of these accounting experts in order to reflect the nature of the liabilities giving rise to the loss. These liabilities are generally the basic costs of operations (e.g., wages, materials, certain overhead expenses) -- items generally expensed in the year incurred.

We calculated the magnitude of the loss from a company's financial statements beginning with net earnings and working back to a cash based measure of loss. We allocated to loss coverage only those grants and equity infusions which were truly cash inflows into the company and were actually available to cover losses.

In any instances in which infusions were specifically tied to loss coverage, we allocated such infusions accordingly. If infusions were not so tied, we concluded that general, untied grants were a more logical source of loss coverage assistance than general

infusions of equity. Accordingly, in making these allocations we treated funds available from grants as the primary source of monies available for loss coverage. We allocated funds available from equity infusions to loss coverage only in the absence of grants or after available grant funds had been exhausted.

We generally treated such cash inflows as covering the losses incurred in the previous fiscal year and allocated the subsidy benefit flowing from such funds to the year of their receipt. An exception was made where losses were continually covered by a special arrangement with the government (as through the use of a special reserve account). In these cases, since the funds for loss coverage were accessible as the losses arose, we allocated the benefit flowing from these funds to the period in which the losses occurred.

#### Loans and Loan Guarantees for Companies Considered Creditworthy

In these investigations, various loan activities give rise to subsidies. The most common practices are the extension of a loan at a preferential interest rate where the government is either the actual lender or directs a private lender to make funds available at a preferential rate, or where the government guarantees the repayment of the loan made by a private lender. The subsidy is computed by comparing what a company would pay a normal commercial lender in principal and interest in any given year with what the

company actually pays on the preferential loan in that year. We determine what a company would pay a normal commercial lender by constructing a comparable commercial loan at the appropriate market rate (the benchmark) reflecting standard commercial terms. If the preferential loan is part of a broad, national lending program, we use a national average commercial interest rate as our benchmark. If the loan program is not generally available--like most large loans to respondent steel companies--the benchmark used instead, where available, is the company's actual commercial credit experience (e.g., a contemporaneous loan to the company from a private commercial lender). If there were no similar loans, the national commercial loan rate is used as a substitute rate. Finally, where a national loan-based interest rate was not available, an average industrial bond rate was used as best evidence.

For loans denominated in a currency other than the currency of the country concerned in an investigation, the benchmark is selected from interest rates (either national or company-specific, as appropriate) applicable to loans denominated in the same currency as the loan under consideration (where possible rates on loans in that currency in the country where the loan was obtained; otherwise, loans in that currency in other countries, as best evidence). The appropriate discount rate remains the risk-free rate as indicated by the secondary market rate for long-term debt obligations of the company's home country government. The subsidy for each year is calculated in the foreign currency and converted at an exchange rate applicable for each year.

After calculating the payment differential in each year of the loan, we then calculated the present value of this stream of benefits in the year the loan was made, using the risk-free rate (as described in the grants section of this appendix) as the discount rate. In other words, we determined the subsidy value of a preferential loan as if the benefits had been bestowed as a lump-sum grant in the year the loan was given. This amount was then allocated evenly over the life of the loan to yield the annual subsidy amounts. We did so with one exception: where the loan was given expressly for the purchase of a costly piece of capital equipment, the present value of the payment differential was allocated over the useful life of the capital equipment concerned.

For loans not tied to capital equipment with mortgage-type repayment schedules, this methodology results in annual subsidies equivalent to those calculated under the methodology previously employed by the Department whereby we considered the difference in total repayments in each year of a loan's lifetime to be the subsidy in that year. For loans with constant principal repayments (i.e., declining total repayments), loans with deferral of repayments, and loans for costly capital equipment, the present value method results in even allocations of the subsidy over the relevant period. This effectively front loads countervailing duties on these loan benefits in the same manner as grants are front loaded.

A loan guarantee by the government constitutes a subsidy to the extent the guarantee assures more favorable loan terms than for an unguaranteed loan. The subsidy amount is quantified in the same manner as for a preferential loan.

If a borrowing company preferentially received a payment holiday from a government lending institution or from a private lender at government direction, an additional subsidy arises that is separate from and in addition to the preferential interest rate benefit. The subsidy value of the payment holiday is measured in the same manner as for preferential loans, by comparing what the company pays versus what it would pay on a normal commercial loan in any given year. A payment holiday early in the life of a loan can result in such large loan payments near the end of its term that, during the final years, the loan recipient's annual payments on the subsidized loan may be greater than they would have been on an unsubsidized loan. By reallocating the benefit over the entire life of the loan through the present value methodology described above, we avoid imposing countervailing duties in excess of the net subsidy. Where we have sufficient evidence that deferral of principal is a normal and/or customary lending practice in the country under consideration, then such deferral has not been considered as conferring an additional subsidy.

Loans and Loan Guarantees for Companies Considered Uncreditworthy

In a number of cases petitioners have alleged that certain respondent steel companies were uncreditworthy for purposes of these investigations at the time they received preferential loans or guarantees, and that they could not have obtained any commercial loan without government intervention.

Where the company under investigation has a history of deep or significant continuing losses, and diminishing (if any) access to private lenders, we generally agree with petitioners. This does not mean that such a company is totally uncreditworthy for all purposes. Virtually all companies can obtain limited credit, such as short-term supplier credits, no matter how precarious their financial situation. Our use of the term uncreditworthy means simply that the company in question would not, in our view, have been able to obtain comparable loans in the absence of government intervention. Accordingly, in these situations neither national nor company-specific market interest rates provide an appropriate benchmark since, by definition, an uncreditworthy company could not receive loans on these or any terms without government intervention. Nor have we been able to find any reasonable and practical basis for selecting a risk premium to be added to a national interest rate in order to establish an appropriate interest benchmark for companies considered uncreditworthy. Therefore, we continue to treat loans to an uncreditworthy company as an equity

infusion by or at the direction of the government. We believe this treatment is justified by the great risk, very junior status, and low probability of repayment of these loans absent government intervention or direction. To the extent that principal and/or interest is actually paid on these loans, we have adjusted our subsidy calculation (which is performed using our equity methodology, infra) to reflect this. We have applied the rate of return shortfall (the amount by which the corporate rate of return on equity was lower than the national average rate of return on equity) only to the outstanding principal in the year which we are measuring subsidization. From this amount, we additionally subtract any interest and fees paid in that year. Moreover, in no case do we countervail a loan subsidy to a creditworthy or uncreditworthy company more than if the government gave the principal as an outright grant.

#### Short-Term Credits

In all our cases, even the most financially troubled companies regularly receive short-term supplier credits. We find this type of debt different and easily distinguishable from the loans previously discussed. Where a company receives private-sourced supplier credits we have found this countervailable only where they were at preferential rates because of explicit government direction.

Where supplier credits were not given at a preferential rate directed by the government, we found no subsidy. Furthermore, since the risk involved and basis for giving supplier credits is qualitatively different than for long-term loans, we did not interpret the presence of supplier credits as an indication of creditworthiness.

### Equity

Petitioners allege that government purchases of equity in respondent steel companies confer a subsidy equal to the entire amount of the equity purchased. Many respondents claim that such equity purchases are investments on commercial terms, and thus do not confer subsidies on these companies.

It is well settled that neither government equity ownership per se, nor any secondary benefit to the company reflecting the private market's reaction to government ownership, confers a subsidy. Government ownership confers a subsidy only when it is on terms inconsistent with commercial considerations. An equity subsidy potentially arises when the government makes equity infusions into a company which is sustaining deep or significant continuing losses and for which there does not appear to be any reasonable indication of a rapid recovery. If such losses have been incurred, then we consider from whom the equity was purchased and at what price, or,

absent a market value for the equity, we examine the rate of return on the company's equity and compare it to the national average rate of return on equity.

If the government buys previously issued shares on a market or directly from shareholders rather than from the company, there is no subsidy to the company. This is true no matter what price the government pays, since any overpayment benefits only the prior shareholders and not the company.

If the government buys shares directly from the company (either a new issue or corporate treasury stock) and similar shares are traded in a market, a subsidy arises if the government pays more than the prevailing market price. The Department has a strong preference for measuring the subsidy by reference to a market price. This price, we believe, rightly incorporates private investors' perceptions of the company's future earning potential and worth. To avoid any effect on the market price resulting from the government's purchase or speculation in anticipation of such purchase, we used for comparison a market price on a date sufficiently preceding the government's action. Any amount of overpayment is treated as a grant to the company.

It is more difficult to judge the possible subsidy effects of direct government infusions of equity where there is no market price for the shares (as where, for example, the government is already sole owner of the company). Government equity participation can be a

legitimate commercial venture. Often, however, as in many of these steel cases, equity infusions follow massive or continuing losses and are part of national government programs to sustain or rationalize an industry which otherwise would not be competitive. We respect the government's characterization of its infusion as equity in a commercial venture. However, to the extent in any year that the government realizes a rate of return on its equity investment in a particular company which is less than the average rate of return on equity investment for the country as a whole (thus including returns on both successful and unsuccessful investments), its equity infusion is considered to confer a subsidy. This "rate of return shortfall" (the difference between the company's rate of return on equity and the national average rate of return on equity) is multiplied by the original equity infusion (less any loss coverage to which the equity funds were applied) to yield the annual subsidy amount. Under no circumstances do we countervail in any year an amount greater than that which is calculated treating the government's equity infusion as an outright grant.

#### Forgiveness of Debt

Where we have found that the government has forgiven an outstanding debt obligation, we have treated this as a grant to the company equal to the outstanding principal at the time of forgiveness. Where outstanding debt has been converted into equity (i.e., the government receives shares in the company in return for eliminating

debt obligations of the company), a subsidy may result. The existence and extent of such subsidies are determined by treating the conversions as an equity infusion in the amount of the remaining principal of the debt. We then calculate the value of the subsidy by using our equity methodology, supra.

#### Coal Assistance

As explained in detail in our notice of "Final Affirmative Countervailing Duty Determinations: Certain Steel Products from the Federal Republic of Germany" in this issue of the Federal Register, we have analyzed and verified aspects of the German coal subsidy program as it applies to steel. Based upon the verified information in the records of these investigations, we have determined that this particular program does not confer a countervailable benefit on either non-German or German steel producers.

As we stated in some of the preliminary determinations reached on June 10 (47 Fed. Reg. 26309), benefits bestowed upon the manufacturer of an input do not flow down to the purchaser of that input if the sale is transacted at arm's length. In an arm's length transaction, the seller generally attempts to maximize its total revenue by charging as high a price and selling as large a volume as the market will bear.

The application of these principles to sales of German coal outside Germany is as follows. The records of these transactions show that the prices charged for subsidized German coal outside Germany certainly do not undercut the freely available market prices. Therefore, non-German purchasers of subsidized German coal do not benefit from German coal subsidies.

In support of this conclusion, we note that if non-German steel producers did benefit from German coal subsidies, they would attempt to purchase German coal rather than unsubsidized coal from other sources including the U.S., since there are no restrictions on their ability to do so. The fact that they purchase significant amounts of unsubsidized U.S. coal indicates that the subsidies on German coal do not flow to non-German coal consumers.

Moreover, it is extremely unlikely that the German government would significantly subsidize non-German coal consumers unless compelled to do so by obligations with respect to the European Communities. Since there is no evidence of such obligation, we conclude that the German government is not in fact subsidizing non-German coal consumers.

For these reasons, we determine that non-German steel producers do not benefit from subsidization of German coal.

### Research and Development Grants and Loans

Grants and preferential loans awarded by a government to finance research that has broad application and yields results which are made publicly available do not confer subsidies. Programs of organizations or institutions established to finance research on problems affecting only a particular industry or group of industries (e.g., metallurgical testing to find ways to make cold-rolled sheet easier to galvanize) and which yield results that are available only to producers in that country (or in a limited number of countries) confer a subsidy on the products which benefit from the results of the research and development (R&D). On the other hand, programs which provide funds for R&D in a wide range of industries are not countervailable even when a portion of the funds is provided to the steel sector.

Once we determine that a particular program is countervailable, we calculate the value of the subsidy by reference to the form in which the R&D was funded. An R&D grant is treated as an "untied" grant; a loan for R&D is treated as any other preferential loan.

### Labor Subsidies

To be countervailable, a benefit program for workers must give preferential benefits to workers in a particular industry or in a particular targeted region. Whether the program preferentially

benefits some workers as opposed to others is determined by looking at both program eligibility and participation. Even where provided to workers in specific industries, social welfare programs are countervailable only to the extent that they relieve the firm of costs it would ordinarily incur--for example, a government's assumption of a firm's normal obligation partially to fund worker pensions.

Labor-related subsidies are generally conferred in the form of grants and are treated as untied grants for purposes of subsidy calculation. Where they are small and expensed by the company in the year received, we likewise allocated them only to the year of receipt. However, where they were more than one percent of gross revenues we allocated them over a longer period of time generally reflecting the program duration.

Comments by Parties to the Proceeding

o GRANTS

Comment 1

Respondents claim that the present value methodology used in these investigations does not provide a "real" value and that it is based on assumptions which do not reflect the realities of the manufacture of the products under investigation.

DOC Position

The present value concept is a widely recognized tool of financial and economic analysis. Its utility and necessity derive from the fact that money has a time value. For example, as stated above, \$100 million today is considerably more valuable to a grant recipient than \$10 million per year for the next ten years. To move a sum of money through time without adjusting the nominal amount would seriously understate the value of the money. So long as the present value (in the year of grant receipt) of the amounts allocated over time does not exceed the face value of the grant, the amount countervailed will not exceed the total net subsidy.

Comment 2

Petitioners argue that grants and preferential loans awarded expressly for the benefit of products not under investigation should also be considered countervailable benefits for the product(s) under investigation. They base their argument on the contention that aid thus received is fungible.

DOC Position

We have not viewed all aid received for any purpose by companies under investigation as fungible, and thus equally beneficial to all products made by the company in question. While the law clearly envisions reaching subsidies which benefit the product under investigation indirectly, as well as directly, it would distort and be inconsistent with the clear intent of the statute, as reflected in its legislative history, to allocate to products under investigation any portion of benefits clearly tied to products not under investigation. This is particularly true since we are compelled to allocate fully to the products actually being investigated any subsidies directly tied to them. To allocate tied subsidies fully to the products to which they are tied and simultaneously to allocate any part of the same subsidies to other products would result in double-counting, which would be inconsistent with both the Act and the Subsidies Code.

o LOANS AND LOAN GUARANTEES FOR COMPANIES CONSIDERED CREDITWORTHY

Comment 3

Petitioners allege that the Department has improperly applied offsets to preferential loan benefits by subtracting principal and interest paid on the loans in 1981 and by the use of a "grant cap".

DOC Position

In calculating the subsidy flowing from a loan to a creditworthy company, we must take account of principal and interest paid because, by definition, the subsidy is equal to the difference between what the company actually paid and what it should have paid as expressed by our benchmark loan.

When calculating the subsidy arising from a loan to an uncreditworthy company, for purposes of these final determinations, we recognize the effect on the subsidy of principal and interest repayments. We believe it is appropriate to apply the rate of return shortfall only to the outstanding principal in 1981, recognizing that prior year paybacks of principal are equivalent to disinvestment of equity. We then subtract interest paid in 1981 not because it is an offset but because it is a legitimate payment on their debt. These funds, therefore, are not available to benefit the company and should not be included in the gross subsidy amount.

We apply a "grant cap" (the amount of subsidy allocated to the year of review if the original principal had been received as a grant rather than a loan) because a loan cannot be worth more to a company than an outright grant of the same amount. This capping by the grant amount is not distortive, nor does it lead to an understatement of the subsidy because the grant methodology incorporates in it the time value of money.

Comment 4

Petitioner argues that respondent steel companies, absent government backing, would not have been able to borrow at "average" or "national" rates and that our use of these rates as benchmarks understates the subsidy.

DOC Position

When the Department is measuring the subsidy flowing from a preferential loan, the benchmark rate (our choice of rate which we believe reflects the unsubsidized cost of debt to which this firm has access) of first choice is one which reflects loans of similar magnitude and duration actually received by the firm in a private transaction without government influence. In those situations where comparable private loans were not available, this benchmark rate had to be estimated. We chose a national average rate since we had no evidence a given firm was perceived as more or less risky than the "average" firm by lenders at the time the preferential loan was received.

o LOANS AND LOAN GUARANTEES FOR COMPANIES CONSIDERED UNCREDITWORTHY

Comment 5

Respondents argue that the Department's method of determining uncreditworthiness was unfair in that it was based on hindsight which was not available to a lender at the time it made a decision whether or not to provide funds to a company.

DOC Position

As outlined in each of these notices in which uncreditworthiness was found, all determinations as to the creditworthiness of firms were based upon information reasonably available to a potential lender at the time a loan was given. For instance, although British Steel Corporation's financial results for the fiscal year 1976/77 were a major factor pointing to uncreditworthiness, in our final determinations we found it uncreditworthy beginning in fiscal year 1977/78, when the lending community could reasonably have known of the weakness of the firm's financial position in the preceding year. This approach allows the potential lender time to evaluate its behavior in light of the changed circumstances of the firm.

Comment 6

Petitioners state that to the extent that the Department calculates the benefit from a loan to an uncreditworthy company as if it were a grant, failure to use a discount rate to reflect the greater risk of providing credit to uncreditworthy firms which could not borrow at any average or national rate leads to an understatement of the true value of the subsidy received.

DOC Position

We disagree. Although we used the average national debt rate as the discount rate in the preliminary determinations, we did not intend this to imply that the choice of the discount rate reflected our speculation as to the riskiness of the company or the cost of alternative financing. As discussed in the Grants section of this appendix, we view the discount rate as simply a financial tool to move money through time. It is not our intention to embed in this rate any project-specific risk or company risk. For this reason we are changing the discount rate used in these final determinations to the risk-free rate, a rate equally accessible to all companies (including very risky ones) country-wide.

Comment 7

Petitioners allege that the provision of supplier credit to an uncreditworthy company constitutes a subsidy because once the firm becomes uncreditworthy, absent government support, suppliers would require cash payments instead of extending credit.

DOC Position

Government subsidization of a company does not convey benefits over and above the actual subsidy (whose measurement is described earlier in this appendix). Private supplier credits are countervailable only where they are at a preferential rate due to government guarantees or direction. There is no benefit from rates and terms the petitioner may argue to be preferential resulting from the private sector's commercial reaction to government ownership.

Regarding the presence of supplier credits as it affects the Department's evaluation of creditworthiness, since the risk involved and the basis for giving supplier credits is qualitatively different than for long-term loans, we did not interpret the presence of supplier credits to be an indication of creditworthiness.

Comment 8

Petitioners argue that the Department should have used the methods for calculating benefits to uncreditworthy firms which they proposed in their petitions. U.S. Steel had proposed the "Sossin method" and counsel for the Five proposed a "creditworthiness proxy".

DOC Position

The Sossin method, developed by Howard B. Sossin of the Columbia University Business School, represents an attempt to adapt the Option Pricing Model for use in valuing loan guarantees. This model has applications in analysis of a number of complex financial transactions, such as measuring the effects of risk on the value of corporate debt, the effect of mergers, acquisitions, scale-expansions and spin-offs on the relative values of debt and equity claims on a firm, and the value of commodity options, forward contracts and futures contracts.

The Department decided not to use the Sossin method for several reasons. First, the model itself contains numerous simplifying assumptions which cast doubt on its applicability and non-arbitrariness for these investigations. In addition, we would have had to adapt the method greatly to make it applicable on a

firm-specific basis, posing an immense administrative burden given the information and technical expertise necessary to calculate the benefits.

The "creditworthiness proxy" method proposed by counsel for the Five would use the cash-to-debt-service ratio for each firm. If a firm under investigation for possible subsidization is granted a loan when its ratio is less than 2:1, the amount by which its income is below twice the debt payments would be considered to be a subsidy in that year.

This method also poses several serious problems. First, as there is no direct relationship in this formula between specific benefits and the calculation of subsidies, its use by the Department would place it in violation of both the Act and the GATT Subsidies Code. Second, the ratio chosen is arbitrary and does not represent a reasonable benchmark for uncreditworthiness across companies. While a 2:1 ratio may indeed be a common "rule of thumb" popular in American banking circles, we have no compelling evidence indicating its applicability and general use in each of the nine countries examined in these cases. We cannot and do not intend to impose American standards of banking practice upon foreign firms.

o EQUITY

Comment 9

Respondents claim that our determination whether government infusions of equity into a steel company are consistent with commercial considerations must take into account the fact that private stockholders or creditors of companies in financial trouble often inject additional capital into the company in the hopes of recouping as much of their original investment as possible.

DOC Position

We agree that government ownership of a company does not confer a subsidy per se, and that the government may act based upon commercial considerations with respect to decisions whether to increase its equity ownership in a firm. Our determination whether such action is in fact on terms consistent with commercial considerations necessarily depends upon the facts of each individual case. In our investigations of certain steel products from Luxembourg, for example, we found an instance in which private persons as well as the government invested equity in MMR-A, a Luxembourg steel company which arguably was in financial trouble. In view of the participation of those private persons, we considered the government's action not to confer a subsidy because it was

consistent with commercial considerations as evidenced by the private purchasers' behavior. In other situations, however, we think that, based upon the facts presented, no stockholder, governmental or private, would have injected further equity into the company based upon commercial considerations.

Comment 10

Respondents argue that the use of an average rate of return on equity in a country sets an unfair standard for measuring the rate of a cyclical industry like steel, because such a standard by definition will indicate subsidization in the troughs of the cycles.

DOC Position

The Department's methodology does not penalize firms simply because they are in the trough of a cycle. A subsidy only arises when an original equity investment is unsound, i.e. inconsistent with commercial considerations.

We recognize that steel is a cyclical industry, but neither the Act nor the GATT Subsidies Code immunize subsidies to a company in the bottom of its cycle from countervailing duties. Unsubsidized companies in cyclical industries survive by using revenues from the peak of a cycle to offset the years in the cycle's trough.

Comment 11

Respondents argue that premiums paid over market value of stock are common in takeovers where the objective is to gain control of a firm, and that therefore such a payment should not be considered a subsidy.

DOC Position

Payment of a premium over market value for stock (including where the objective is to gain control) is a special commercial circumstance which occurs under fairly unique conditions. Payment of such a premium for stock in a firm in weak or distressed financial condition is unlikely, for as a firm approaches near-bankruptcy, its market price of equity falls to the liquidation value range. Furthermore, it is highly unlikely for a control premium to be warranted when the government is the sole bidder for the troubled firm. Therefore in the absence of compelling evidence that a premium payment by a government was warranted and motivated by commercial conditions (as evidenced, for example, by similar competing private bids), the Department has a strong preference for measuring a subsidy by the difference between the market price of the stock and the stock price paid by the government. We believe that this market price correctly incorporates private investors' perceptions of the worth of the stock.

o COAL ASSISTANCE

Comment 12

Petitioners reject the Department's view that a party receiving a benefit on the production of its merchandise is not assumed to share that benefit with an unrelated purchaser. They maintain that a party may market its products at a lower price than it would be able to charge absent the subsidy in order to secure or hold on to a larger share of the market, and thus to increase its profitability by realizing lower unit costs and increased unit sales.

DOC Position

We agree that there is more than one way to seek to achieve maximum profitability. In these investigations, in fact, assistance to coal has been provided to enable some coal companies to sell below their cost of production. However, the German coal companies do not sell below the prices of coal as sold in Europe and elsewhere. In fact, German steel producers are required to pay a slight but significant premium for German coal. Under these circumstances, we disagree with petitioners' argument that German steel companies are indirectly subsidized through German coal subsidies.

Comment 13

Petitioners argue that the Department should have considered German coal subsidies to subsidize all steel companies purchasing that coal, both German and non-German, because the intent of the coal subsidies is to stabilize coal supplies to the ECSC steel industry and to insure that industry against the risk of adverse price developments on the world market. Petitioners claim that without this subsidized coal, the ECSC steel companies would have had to pay higher world market prices.

DOC Position

For the reasons indicated supra, we believe that it is too speculative to consider possible effects on world prices for coal in the hypothetical absence of German subsidization of its coal industry. However, if coal prices would rise in that event, we believe that they would rise throughout the world. We do not believe that prices would rise more for European purchasers of coal rather than non-Europeans.

As also indicated in detail supra, we believe that the real economic effect of German subsidies is to penalize, not to assist, German steel companies. As a result of the German coal policy, German steel companies are required to pay a slight premium above the world

market price for their coal purchases. Non-German purchasers of subsidized German coal similarly receive no demonstrable price advantage.

Comment 14

Petitioners argue that the ECSC and the FRG government, through an "intense program of coordinated subsidy financing," have assisted the German coal and steel industries in order to sustain production at cost efficient levels, in significant part by producing for export.

DOC Position

Although the arguments seem ambiguous, we believe that petitioners mean to imply that the German and ECSC coal assistance programs constitute an export subsidy for steel. If so, then we disagree, since in both cases coal assistance is provided without the establishment of any condition concerning the exportation of steel produced using that coal.

Comment 15

Petitioners object to the Department's alleged requirement that a subsidy on an input be demonstrated to confer an unfair competitive advantage. Petitioners imply that in so doing, the Department is

usurping the jurisdiction of the International Trade Commission which is authorized to determine injury.

#### DOC Position

Under the Act, the Department is required to determine whether respondents have received subsidies within the meaning of the Act. To do so, the Department seeks to determine whether or not respondents have received directly or indirectly an economic benefit. Whereas this is relatively easy in the case of the direct bestowal of a grant, it is quite difficult with regard to indirect subsidies allegedly conferred through the subsidization of inputs used in a final product. In this more complex area, we believe it is required for the Department to consider whether there is an economic benefit to foreign manufacturers of the final product of subsidies bestowed on manufacturers of an individual input. This is quite distinct from the ITC's determination whether imports of the final product into the United States injure a U.S. industry. The Department therefore disagrees with petitioners on this issue.

#### Comment 16

Respondents argue that they pay more for their coal than would otherwise be the case if the FRG coal assistance program and import restrictions were not in effect.

DOC Position

As indicated in detail supra, we agree. Largely on this basis we have determined that FRG assistance to its coal producers does not indirectly subsidize either FRG steel producers or non-German steel producers.

Comment 17

Respondents argue even that if Germany entered the world market for coal and world coal prices were driven up, they would be the same to all purchasers.

DOC Position

We have no firm basis upon which to predict possible effects on world coal prices by cessation of German subsidization of its coal industry.

o LABOR SUBSIDIES

Comment 18

Respondents argue that the Department's treatment of labor programs is not related to possible benefits to the production of the products under investigation, but rather is based on whether programs benefit employees or employers.

DCC Position

Labor programs are countervailable only to the extent that they relieve the company of some or all of its labor-related obligations. Direct assumption of a cost of production, such as absorption in whole or part of the wage bill, is indeed a subsidy on the products produced by the company.

PART 2

GENERAL AND GATT-RELATED ISSUES

o General Issues

Comment 1

Some of the petitioners contend that many of the conclusions in our preliminary determinations were erroneous insofar as they found that particular programs of general applicability and availability within a country do not give rise to domestic subsidies. They assert that subsidies must be found to exist from any governmental programs providing benefits, regardless whether those programs are generally available.

DOC Position

Section 771(5) of the Act, in describing governmental benefits which should be viewed as domestic subsidies under the law, clearly limits such subsidies to those provided "to a specific enterprise or industry, or group of enterprises or industries." We have followed this statutory standard consistently, finding countervailable only the benefits from those programs which are applicable and available only to one company or industry, a limited group of companies or industries, or companies or industries located within a limited

region or regions within a country. This standard for domestic subsidies is clearly distinguishable from that for export subsidies, which are countervailable regardless of their availability within the country of exportation. We view the word "specific" in the statutory definition as necessarily modifying both "enterprise or industry" and "group of enterprises or industries". If Congress had intended programs of general applicability to be countervailable, this language would be superfluous and different language easily could and would have been used. All governments operate programs of benefit to all industries, such as internal transportation facilities or generally applicable tax rules. We do not believe that the Congress intended us to countervail such programs. Further, our conclusion is supported by the clear Congressional intent that "subsidy" be given the same meaning as "bounty or grant" under section 303 of the Act. Never in the history of the administration of this law or section 303 of the Act has a generally available program providing benefits to all production of a product, regardless whether it is exported, been considered to give rise to a subsidy or a bounty or grant. In enacting the Trade Agreements Act of 1979, Congress specifically endorsed that interpretation of section 303. Finally, the fact that the list of subsidies in section 771(5) is not an exclusive one in no way compels the conclusion that domestic benefits of general availability must or can be considered subsidies. Indeed, in view of the statute and its legislative and administrative history, we doubt that we are free to

treat such generally available benefits of domestic programs as subsidies; certainly we are not compelled to do so.

Comment 2

Petitioners contend that our preliminary negative determinations regarding critical circumstances were erroneous. They allege that, in determining whether imports were "massive" within the meaning of section 703(e) of the Act, we acted inconsistently with the law and past practice by examining imports in the period subsequent, rather than prior, to initiation of these cases, thereby denying petitioners the ability to provide adequate documentation to support their allegations. They also disagree with our characterization of the import levels as not being massive.

DOC Position

This issue is moot. Under section 703(e) of the Act, in order to determine that critical circumstances exist, we must determine that "(A) the alleged subsidy is inconsistent with the Agreement, and (B) there have been massive imports of the class or kind of merchandise which is the subject of the investigation over a relatively short period." Section 355.29(e) of the Commerce Regulations (19 C.F.R. 355.29(e)) on critical circumstances provides, inter alia, that we will determine "whether the alleged subsidy is an export subsidy inconsistent with the Agreement" (emphasis added). For purposes of

this law, then, under existing regulations, a subsidy may be viewed as inconsistent with the Agreement only if it is an export subsidy. Since all of the subsidies determined to exist in the cases in which we are issuing final determinations in these notices are domestic, rather than export, subsidies, we are precluded from determining that critical circumstances exist in any of these cases.

### Comment 3

Some respondents claim that our adoption in the preliminary determinations of a number of new methodologies for the ascertainment and calculation of subsidies was procedurally deficient as a matter of law. They assert that these new methodologies conflict with past practice and, therefore, cannot be implemented in any case before rulemaking procedures have been completed, which procedures would have to provide published notice of proposed changes and opportunity to comment.

### DOC Position

We do not agree that the methodologies employed in these cases have to be the subject of rulemaking procedures or that such methodologies could not be employed until such procedures have been completed. The adoption of these methodologies is neither rulemaking nor adjudication within the meaning of the Administrative Procedure Act. Some of the methodologies employed cannot be said to be in conflict with

any past practice under sections 701 or 303 of the Act, for they address issues and factual situations which, to the best of our knowledge, have not previously been encountered. Others, such as the present value methodology of valuing money over time, do represent a departure from past methods for determining the existence or size of subsidies. However, the prior practice, with which the methodology used in these cases has been alleged to be inconsistent has never been prescribed in the Commerce Regulations or, before that, the Customs Regulations.

Decisions as to the use of such methodologies are not matters requiring rulemaking procedures, but are questions of policy left to the judgment and discretion of the Department and decided on a case-by-case basis, applying the law, as we understand its requirements and intent, to the facts of each case. While the Department could prescribe such methodologies in its regulations, we have not chosen to do so. Unless and until that occurs, no rulemaking procedures can be considered necessary before changing prior methodologies. At the outset of these investigations, respondents may have anticipated that certain prior methodologies would be employed in place of ones actually used, but they have no legal right to the maintenance of such prior practices.

Further, our preliminary determinations and subsequent disclosures to all interested parties fully explained these methodologies and each respondent took advantage of its opportunity to comment upon

them, both orally and in writing. We took all of these comments fully into account in reaching our final determinations. As such, each respondent fully participated in the decision-making process to the extent of its legal rights, and cannot properly be viewed as having been denied any such rights. Moreover, there is no substantial evidence in the record in any of these cases which would support a conclusion that the respondent governments, when establishing or administering the programs investigated, relied to their detriment on prior methodologies. Indeed, it would be difficult to conclude that these governments in any way considered the possible consequences under the U.S. countervailing duty law before taking the actions which resulted in countervailable benefits to the products under investigation.

#### Comment 4

Some respondents contend that many of the benefits received by the steel companies investigated, such as aids for restructuring, are directly analogous to procedures and benefits common to bankruptcy proceedings. As such, they are consistent with normal commercial considerations and should not be considered subsidies.

#### DOC Position

No respondent has furnished us any evidence that it has been subject to formal bankruptcy proceedings, or that its restructuring or other

procedures actually employed remotely resemble normal bankruptcy procedure in its country. In the absence of any such evidence the contention of respondents is entirely too speculative a basis upon which to base a determination in these cases.

Comment 5

Respondents allege that the use of the present value methodology is inconsistent with U.S. law.

DOC Position

The use of the present value concept is fully consistent with the countervailing duty law. Section 701(a) states that where the Department determines there to be subsidization and, where appropriate, the ITC determines there to be injury, "... then there shall be imposed upon such merchandise a countervailing duty ... equal to the amount of the net subsidy." So long as the present value (in the year of grant receipt) of the amounts allocated over time does not exceed the face value of the grant, the amount countervailed will not exceed the total net subsidy.

o GATT-Related Issues

Comment 6

The European Communities (EC) assert that in order for a countervailable subsidy to exist under the GATT, there must be a charge on the public account. In support of this contention, the EC cites in particular item (1) of the Illustrative List of Export Subsidies (the List), included as an annex to the Agreement on Interpretation and Application of Articles VI, XVI and XXIII of the General Agreement on Tariffs and Trade (the Code). Item (1) of the List defines as an export subsidy, "Any other charge on the public account constituting an export subsidy in the sense of Article XVI of the General Agreement."

DOC Position

Item (1) does not limit the definition of subsidy to a charge on the public account, but rather makes clear that such a charge is included in the universe of subsidies which constitute on their face prohibited export subsidies. Items (c) and (d) of the List show that preferential treatment for exports, without regard to a charge on the public account, can also constitute a subsidy on its face. These items define as subsidies:

(c) Internal transport and freight charges on export shipments, provided or mandated by governments, on terms more favorable than for domestic shipments.

(d) The delivery by governments or their agencies of imported or domestic products or services for use in the production of exported goods, on terms or conditions more favorable than for delivery of like or directly competitive products or services for use in the production of goods for domestic consumption, if (in the case of products) such terms or conditions are more favorable than those commercially available on world markets to their exporters.

Item (1), cited by the EC, derives from the original illustrative list of subsidies of 1960, which represented an agreed interpretation of Article XVI:4 of the GATT. However, the Department notes that this list also includes items (c) and (d) of the current List. Since the negotiation of Article XVI:4 in the 1950's, there has never been a consensus on an interpretation such as that advanced by the EC. Rather, it has been generally accepted that the range of activities covered by the term subsidy as used in the GATT is quite broad, including charges on the public account as well as certain activities which do not necessarily involve such a charge.

Comment 7

The EC argues that subsidies other than export subsidies cannot be considered countervailable under the Code unless such subsidies "(a) adversely affect the conditions of normal competition. In the absence of any such distortion, subsidies, other than export subsidies, are recognized as important instruments for the promotion of social and economic policy objectives against which no action is envisaged by the Code." The EC further argues that the Department considered regional aids countervailable "(w)ithout taking into consideration any disadvantages incurred by companies having to operate in economically retarded and remote areas. ... This approach does not take into account, that under GATT and the Code countervailable subsidies are only those, which adversely affect the conditions of normal competition." In support of this contention, the EC cites Article 11 of the Code, "Subsidies other than export subsidies".

DOC Position

The language of Article 11 does not prejudice the right of any signatory to the code to countervail against non-export subsidies. The language of the Article is the result of compromise between the United States and the EC at the time of the negotiation of the Code; the United States proposed to include an illustrative list of domestic subsidies, while the EC position was that such subsidies

should not be considered countervailable. The Department notes that, while no list of domestic subsidies was incorporated per se in the Code, examples of such subsidies are included in Article 11. In contrast, the position of the EC was not adopted, as no such prohibition regarding the countervailability of domestic subsidies appears in the Code. The fact that certain subsidies are not prohibited by the Code is not relevant to a determination as to whether such subsidies confer a countervailable benefit in a specific case.

In addition, the Department notes that Article 11:3 of the Code states, "(t)he above form of (non-export) subsidies are normally granted either regionally or by sector." Article 11:2 states:

Signatories recognize , however, that subsidies other than export subsidies ... may cause or threaten to cause injury to a domestic industry of another signatory or serious prejudice to the interests of another signatory or may nullify or impair benefits accruing to another signatory under the General Agreement, in particular where such subsidies would adversely affect the conditions of normal competition. Signatories shall therefore seek to avoid causing such effects through the use of subsidies. In particular, signatories when drawing up their policies and practices in this field, in addition to evaluating the essential internal objectives to be achieved, shall also weigh, as far as practicable, possible adverse effects on

trade. They shall also consider the conditions of world trade, production (e.g. price, capacity utilization etc.) and supply in the product concerned.

While there is no agreed definition of the term "normal competition" in the context of the GATT, the term can reasonably be construed to include comparative advantage, a concept about which little, if any, serious dispute exists among economists. The argument of the EC flows against the logic of comparative advantage. Subsidies used to alter the comparative advantage of certain regions with respect to the production of a certain product or products are by definition distortive of trade and the allocation of resources, and, therefore, must affect normal competition, including competition with producers in the market of the importing country. There is no evidence that the governments of the countries in question, with regard to most of the programs and benefits under consideration, specifically sought to avoid causing injury to the domestic industries of other Code signatories, or even considered possible adverse effects on trade, as required by Article 11:2.

Finally the Department notes that Article 4 of the Code, "Imposition of countervailing duties", makes no distinction between domestic and export subsidies.

Comment 8

In objecting to the methodology used by the Department to calculate the subsidies found to exist by virtue of grants, preferential loans and loan guarantees (See Appendix 2, Methodology), the EC argues that "Article VI of the GATT provides that a countervailing duty may not exceed the amount of subsidy 'determined to have been granted'. The use of the word 'granted' rather than 'received' and the absence of any reference to 'value' or 'benefit' indicates clearly that the countervailable amount is the financial contribution of the government rather than the much more nebulous benefit to the recipient." (Emphasis in the EC brief).

DOC Position

The position of the Department with respect to the need for a specific financial contribution of the government is discussed above. With respect to the calculation of the amount of the subsidy, the Department believes that the use of the word "granted" in Article VI:3 does not control the question of calculation of the amount of a subsidy, but merely refers to the existence of the subsidy. In fact, as the EC itself notes, Footnote 15 to the Code states, "An understanding among signatories should be developed setting out the criteria for the calculation of the amount of subsidy." Were the amount of subsidy always equal to a charge on the public account, such an understanding would be unnecessary.

Article 4:2 of the Code states, "No countervailing duty shall be levied on any imported product in excess of the amount of the subsidy found to exist...." The position of the Department is that the subsidy is the benefit received by the producer or exporter. In no way does the language of Article 4 of the Code or Article VI of the GATT mandate a methodology to be used by signatories in the calculation of a subsidy as long as no consensus to the contrary exists (as referred to in Footnote 15). As a matter of general interpretation of the Code and the GATT, the omission of language dealing with a specific issue must be seen as a purposeful decision on the part of the signatories to leave the question open. (See Comment 9 and DOC Position, below.)

#### Comment 9

The EC has criticized the Department for making unilateral interpretations of various provisions of the Code, in particular with respect to determinations as to whether certain specific practices are subsidies and with respect to the methodologies employed in calculating the value of a subsidy.

#### DOC Position

The Department will follow, as far as U.S. law permits, the mandatory provisions of the Code, as well as any interpretations on which a consensus exists among all Code signatories including the

United States. However, the Code does not require inaction by signatories with regard to areas not clearly covered by the Code or by agreed interpretations of the Code. Such a requirement would be inconsistent with practice under the GATT as it has developed since its inception in 1947. The fact that the Code is silent with respect to whether a specific practice constitutes a subsidy does not mean that no signatory may make a determination with respect to that practice in the course of a proceeding. The fact that the signatories have not agreed on a methodology for the calculation of the amount of a subsidy does not mean that no signatory may adopt a methodology in the absence of such agreement, since the inability to calculate the amount of the subsidy found to exist would clearly frustrate the intent of the Code and the GATT.

Comment 10

The EC objects to the Department's use of average return on investment as a measure of the commercial reasonableness of a government infusion of equity in the absence of a market price for shares. The EC argues that "It follows from the GATT that the decisive criterion is the cost to the Government and therefore the investment should be treated as a long-term loan by the Government and the long-term return should be measured against the rate at which the Government borrowed money to make the investment."

DOC Position

The Code notes in Article 11:3 that possible forms of non-export subsidies include "(g)overnment subscription to, or provision of, equity capital." However, the Code and the GATT are silent on the question of precisely when such activity does constitute a subsidy and, where found, how such a subsidy should be calculated. The position of the EC with respect to this issue turns on defining a subsidy as the cost to the government. As discussed above in the response to Comment 6, the Department rejects this position. In any event, the equity infusions in question were not long-term and had no provisions for repayment. Accordingly, it is not possible to conclude that the decision of the Department is inconsistent with the GATT or the Code. (See Appendix 2 for a discussion of the methodology employed by the Department with respect to equity infusions.)

Comment 11

The EC avers that "This distinction (between creditworthy and uncreditworthy companies) is a complete innovation and is not provided for anywhere in the GATT. Since the GATT criterion for the determination of a subsidy is the financial contribution of the government, the creditworthiness of the companies is irrelevant."

DOC Position

The fact that the GATT does not address this issue specifically does not preclude consideration of the issue where it arises in the course of a proceeding. As discussed above, the Department does not agree that the only criterion for the determination of the existence of a subsidy under the GATT is the financial contribution of the government. Therefore, the question of the creditworthiness of a borrower is relevant because a loan to a company unable otherwise to obtain credit is a greater benefit to that company than a comparable loan to a company which is able to obtain financing on its own.

Comment 13

The EC argues that the Code must be interpreted in its entirety, and that the various provisions must be considered in relation to each other. In particular, the EC emphasizes that the List prescribes by implication the manner in which subsidies must be determined to exist and must be calculated.

DOC Position

The Department agrees that the Code must be interpreted as a whole. This includes the Code's distinction between subsidies which are prohibited per se and subsidies which are prohibited only under certain circumstances. The subsidies which are enumerated in the

List are prohibited per se under Article 9, and, hence, actionable under "Track II", as provided for under Articles 12, 13, 17 and 18. As its title implies, the List is illustrative of the types of practices which constitute grounds for the invocation of Track II dispute settlement procedures. The list is thus descriptive of prohibited practices, not dispositive of the calculation of the value of any subsidy conferred under any particular practice. Thus there is no inconsistency between the Department's calculation of benefits conferred by export subsidies compared with benefits conferred under domestic programs, since the Department employs uniform methodologies without regard to any distinction between the two types of subsidies.

Comment 14

The EC states that "Appendix B (of the Preliminary Determinations) contains a disturbing assertion: 'In the absence of special circumstances, a party receiving a benefit on the production of its merchandise is not assumed to share a benefit with an unrelated purchaser.' (47 Fed. Reg. 26307, 26309 (1982) emphasis supplied) The implication is that the existence of a countervailable subsidy, i.e., 'benefit' can be assumed in certain circumstances...." The EC asserts that the Code requires that the elements necessary for the imposition of countervailing duties be established by positive factual evidence. Further, the EC adds that "The only instance in

which Title VII permits a presumption is under section 771(7) (E) (i)...."

DOC Position

The Department agrees that determinations as to the existence of a subsidy should be based on verified facts. However, this is possible only insofar as the facts are made available to the Department during the course of a proceeding. As a matter of normal procedure, the Department requests information from all interested parties, including the foreign government involved, in order to establish the facts upon which its determinations may be based. The Department followed this procedure in the instant cases. In those instances where the Department has been forced to make a determination on the basis of incomplete information, the responsibility rests with the interested parties who, despite the requests of the Department, failed to provide such information to the Department in a timely manner.

Where incomplete information has formed the basis of decisions of the Department in particular cases, there is no contravention of the obligations of the Department with respect to the Code or the statute. Article 2:9 of the Code provides:

In cases in which any interested party or signatory refuses access to, or otherwise does not provide, necessary information

within a reasonable period or significantly impedes the investigation, preliminary and final findings, affirmative or negative, may be made on the basis of the facts available.

Furthermore, Section 776(b) of the Act provides:

In making their determinations under this title, the administering authority and the Commission shall, whenever a party or any other person refuses or is unable to produce information requested in a timely manner and in the form required, or otherwise significantly impedes an investigation, use the best information otherwise available.