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COMPETITIVE CURRENCY DEPRECIATION: THE NEED FOR A MORE EFFECTIVE INTERNATIONAL LEGAL REGIME

By Jeffrey S. Beckington & Matthew R. Amon

I. INTRODUCTION

Flexible, stable exchange rates are critical to national and global economic well-being. Orderly exchange arrangements support and facilitate trade in goods and services as well as investments across national boundaries in a balanced and sustainable manner. The logic underlying these precepts is impeccable, but accomplishing and maintaining such flexibility, stability, and order are jeopardized when national governments ignore these practical axioms for self-serving, short-sighted, and mercantilist reasons.

Over the short-term, a country's enforced undervaluation of its currency can be expected to boost that country's jobs, exports, and foreign reserves, while reducing imports and siphoning foreign direct investment along with research and development from other countries. Such "beggar-thy-neighbor" gains, however, are contrary to the basic international goal of achieving efficient markets for the general welfare. They further run the risk of prompting other countries to misalign their own currencies in self-defense. At that point, the situation can deteriorate very quickly into destructively pervasive economic stagnation and worse.

The most serious and prolonged stretch of competitive currency depreciation that has occurred to date took place between the First and Second World Wars. The protectionist policies pursued by the major economic players of the age, combined with high tariffs and other restrictive measures, contributed significantly to the intensity and duration of the Great Depression. The experience also served as a catalyst for extraordinary efforts, which began during the Second World War, to create international institutions and compacts that would guard against and hopefully prevent a recurrence of exchange-rate undervaluation and similarly harmful practices. Toward these ends, the consensus reached at Bretton Woods in 1944 and then in the General Agreement on Tariffs and Trade ("GATT") in 1947 yielded a partial but unprecedented ceding of national sovereignty over monetary and trading affairs, respectively.

Both the Articles of Agreement of the International Monetary Fund ("IMF") and the GATT, which has been overseen by the World Trade Organization ("WTO") since the start of 1995, are remarkable accomplishments that have boosted standards of living around the world. Nevertheless, the first decade of the 21st century has witnessed a widespread recession that continues and conceivably could worsen. Among the factors that have been playing an influential role in this turmoil has been reliance by some countries, most promi-
nently the People’s Republic of China ("China"), upon governmentally enforced undervaluation of currencies. This practice has precluded the market from valuing currencies in line with the market’s fundamentals of supply and demand and increasingly is causing dangerous imbalances in countries’ flows of goods, services, and investments with one another.

The present predicament highlights that the international legal framework that was first put in place more than sixty years ago has not been strong enough to avoid the current round of competitive currency depreciation by national governments. The fact that there is no effective remedy to block this kind of behavior is at least somewhat surprising given the suffering of so many people during the Great Depression. One would think that the scars left by that implosion would serve as a compelling incentive for countries not to repeat the mistakes that led to that horrible time in the first place. In addition, this international legal inadequacy is especially worrisome because the international community’s population has grown substantially since the 1930s and 1940s, and countries have become so much more interconnected and dependent upon each other through trade and investment. If undervalued misalignment of currencies were to become prevalent in these circumstances, contemplation of the consequent damage and how many people could be adversely affected beyond what already has happened is sobering.

Any attempt to improve the international system that is now in place will certainly confront reluctance by national governments to delegate more sovereignty to international bodies and rules in such a nationally sensitive and vital area. At the same time, however, when national actions can have devastating, international ramifications that are like those seen during the Great Depression, prudence indicates that remedial steps are warranted and should be a top multilateral priority. As the drafters of the IMF’s Articles and the GATT recognized, a country’s undervalued misalignment of its currency and the resultant skewing of exchange rates constitute a monetary measure with extensive and undesirable repercussions for trade and investment internationally. In fact, if a country’s undervaluation of its currency is severe enough, the practical effect will be the undermining of that country’s tariff bindings and non-tariff commitments at the WTO.

With so much at stake, and in the hope that study of the past can encourage a constructive course of action for the future, this article initially reviews the difficulties that arose with competitive currency depreciation during the Great Depression and then focuses particularly upon (1) how the IMF’s Articles of Agreement and surveillance guidelines address exchange arrangements and manipulation of exchange rates, (2) the various ways that the WTO’s agreements, including the GATT foremost, take into account the effects that a national government’s undervalued misalignment of its currency has on international trade, and (3) the working relationship by the WTO and the IMF with one another in regard to exchange-rate and currency-related matters. This article addresses China’s undervaluation of its currency, the renminbi ("RMB"),\(^5\) to highlight the need for greater international consensus and cooperation to curb competitive currency undervaluation.\(^6\) This survey concludes by suggesting that, short of any amendments to their constitutional charters, the WTO and the IMF

\(^5\) Sometimes called the “yuan” by various authors. Strictly speaking, China’s currency is the renminbi, and the ‘yuan’ is that currency’s basic unit.

\(^6\) Though this article addresses at length the international debate concerning the Chinese undervaluation of the RMB, we are not arguing that China is necessarily engaging in the practice of currency manipulation, a serious charge with major international legal ramifications that requires an element of intent by a government to prevent effective balance-of-payments adjustment or to gain an unfair competitive advantage over other countries. In
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in tandem could clarify their respective roles and authority and could punctuate their commit-
ment to apply in a coordinated fashion the resources that each has to deter and hold in check
any resurgence of competitive currency depreciation.

II. COMPETITIVE CURRENCY DEPRECIATION BETWEEN THE FIRST AND
SECOND WORLD WARS AND ITS EFFECT ON THE GREAT DEPRESSION

Intentional currency undervaluation played an important part of the destructive beg-
gar-thy-neighbor policies that led to the Great Depression. The major but battered economic
players that emerged from the First World War employed aggressive nationalist economic
policies, including the undervaluation of their currencies, to gain a competitive trade advan-
tage in desperate economic times.7 When these same nations “emerged from World War II,
they shared a general revulsion against the extreme nationalist, beggar-thy-neighbor policies
of the recent past. This mood made possible the 1944 Bretton Woods Conference, at which
the International Monetary Fund (IMF) and the International Bank for Reconstruction and
Development (World Bank) were established, as well as the conclusion three years later of the
General Agreement on Tariffs and Trade (GATT).”8 Thus, after the Great Depression and the
Second World War, the international monetary system moved from an informally regulated
laissez-faire model to a genuinely international system whereby nations surrendered a degree
of economic sovereignty and accepted a measure of oversight by international institutions.9

Fast forward to the present where “the observer sees that the laissez-faire model has prevailed
to a surprising extent. Both the market for goods and the market for currencies have freed
themselves from government restraints to a degree that would amaze an economist who had
fallen asleep like Rip van Winkle in 1945.”10 The question before American policymakers
today is how they will respond to age-old nationalist policies like strategic currency
depreciation.

Professor Andreas Lowenfeld at the New York University School of Law has written
that an international legal regime governing the conduct of states in regard to monetary affairs
did not exist until the end of World War II, whereas trade agreements by then had existed for
many centuries.11 The reasoning behind that approach by the world’s major economic players
was a longstanding, widely held view that national monetary policy, as it relates to interna-
tional trade, was solely a sovereign prerogative.12 In this environment, each nation decided

2011, several major U.S. trading partners have undervalued currencies, and only space constraints limit this
article to discussing the most prominent example of currency undervaluation.

7 ANDREAS F. LOWENFELD, INTERNATIONAL ECONOMIC LAW, VOLUME IV: THE INTERNATIONAL MONETARY

8 DETLEV F. VAGTS, WILLIAM S. DODGE, & HAROLD HONGJU KOH, TRANSNATIONAL BUSINESS PROBLEMS 129-30

9 Id. at 128.

10 Id. at 130.

11 David A. Hartquist & Jeffrey S. Beckington, China’s Policy of Substantially Undervaluing the Renminbi: A
Challenge for the International Monetary and Trading System, Research Paper Prepared by the Trade Law
Advisory Group Under a Grant by the U.S. Small Business Administration, 2 U.S.-CHINA ECON. & SEC. REVIEW
China%27s%20Policy%20of%20Substantially%20Undervaluing%20the%20Renminbi.pdf [hereinafter
“TLAG”].

12 Id.
for itself how to value its currency and whether or not to engage in competitive currency depreciation. There were no international institutions to monitor and regulate potentially destructive economic behavior. Nations were left to their own domestic remedies to identify and correct currency abuse. The system was laissez-faire.

For about 35 years prior to the outbreak of World War I, the major western countries – the United Kingdom, France, Germany, and the United States – all tied their currencies to gold, so that the rates of exchange among the franc, the mark, the pound, and the dollar were essentially fixed. Many other states in effect tied into what was known as the gold standard by linking their currencies to one of the key currencies and keeping their reserves either in gold or in one of those currencies. No international legal obligation required adherence to the gold standard, and it collapsed almost overnight at the start of World War I. But though the era of the gold standard was neither as long nor as smooth as it seemed in retrospect, the period before World War I brought to the minds of the planners of the post-World War II economy memories of fixed exchange rates, great expansion of trade, and the growth of transnational investment on a scale the world had not previously seen.

By contrast, the period between World War I and World War II seemed like a nightmare. The pound floated against the dollar from 1919 to 1925, while the dollar remained tied to gold. Then Britain returned to gold as well, pretty clearly at an overvalued rate. The French franc floated – generally down – for most of the 1920s, then was linked to gold, first de facto and then de jure, accompanied by a variety of exchange controls. Both the franc and the pound, it seems, were sustained by large capital exports from the United States; when these ceased at the close of the decade, Great Britain suspended gold payments, France did not. The United States abandoned the gold standard as one of the first acts of the Roosevelt presidency, and rejected a proposed dollar-franc-pound stabilization proposal at the London International and Monetary Conference of 1933, which broke up in disarray. As trade contracted sharply and unemployment increased worldwide, each of the major countries tried to use competitive devaluations, multiple exchange rates, trade restrictions, subsidies, and controls of various kinds to divert economic distress abroad.13

Professor Lowenfeld provides only a glimpse into the chaos that emerged from the ruins of the First World War. Federal Reserve Chairman Ben Bernanke recently observed, “The gold standard was meant to ensure economic and financial stability, but failures of international coordination undermined these very goals. . . . [S]ome of the lessons from [the interwar period] are applicable today. In particular, for large, systemically important countries with persistent current account surpluses the pursuit of export-led growth cannot ultimately succeed if the implications of that strategy for global growth and stability are not taken into

In the absence of global, mutually agreed trade rules with international institutions to enforce them, each nation was left to its own devices to recover from the war and fend off the predatory trade practices of former allies and foes alike. “The years between the onset of the Great Depression and the beginning of World War II saw competitive devaluations, all kinds of manipulations, and a severe reduction in trade and economic activity.”

Post-World War I economic planning, which had its genesis at the Paris Peace Conference of 1919, focused almost entirely upon reparations. The Allies demanded huge sums from the Axis powers, which were in poor economic shape. This in turn led Weimar-era Germany into a destructive period of unprecedented hyper-inflation, dual exchange rates, import tariffs, and debt. It seemed the whole world was trapped in a period of “competitive currency devaluation, uneconomic barter deals, multiple currency practices, and unnecessary exchange restrictions—by which governments vainly sought to maintain employment and uphold living standards.”

Currency manipulation was a serious international problem in the interwar period. Governments flailed about in self-interested and ultimately vain attempts to gain a competitive advantage over their equally desperate neighbors. Currency devaluation was myopically seen as an easy solution to boost employment and revitalize exporting industries. At the time, the prevailing view was that each country had a sovereign right to value its currency at whatever level best fit the country’s agenda. These efforts represented countries’ uncoordinated attempts to fill a legal vacuum in the absence of international consensus and coordination.

“Almost surely because competitive currency depreciation was being practiced on an unprecedented scale and was generating such widespread damage to international trade, many important trading nations felt an imperative to take corrective action against undervalued imports into their territories at the same time that a good number of them were undervaluing their own currencies to aid their exports.” The predatory trade practices that marked the interwar period strongly influenced American policymakers to initiate strong protectionist policies, including the Smoot-Hawley Act of 1930, which pushed U.S. tariffs to prohibitive levels.

14 Press Release, *Rebalancing the Global Recovery*, FED. RESERVE BOARD (Nov. 18, 2010) (Remarks made by Ben S. Bernanke, Chairman of the Board of Governors of the Federal Reserve System at the Sixth European Central Bank’s Central Banking Conference in Frankfurt, Germany, 15-16), available at http://federalreserve.gov/newsevents/speech/bernanke20101119a.pdf [hereinafter “Bernanke”]. Chairman Bernanke further remarked that both the U.S. and France ran large current account surpluses with their accompanying influxes of gold, but both refused to play by the informal rules of the period. Neither allowed the gold reserves to recirculate to their domestic currency supplies, resulting in persistently undervalued currencies. Policies like those adopted by France and the U.S. created deflationary pressures in deficit countries, which ultimately contributed to the Great Depression. Chairman Bernanke is a well-known expert on the Great Depression.

15 International Economic Law 1984, supra note 7, at 14. Prof. Lowenfeld cites Nazi-era Germany under Hjalmar Schacht (Germany’s central banker) as the most egregious currency manipulator. The economic unrest caused in large part by German economic instability contributed to the rise of the National Socialist Party and Adolph Hitler.

16 Id.

17 Id. (referencing PROCEEDINGS AND DOCUMENTS OF THE UNITED NATIONS MONETARY AND FINANCIAL CONFERENCE, BRETON WOODS, N.H., Vol. 1, 1118 (July 1944)).

18 TLAG, supra note 11, at 3.

19 Id. at 9.

20 Vagts, Dodge, and Koh, supra note 8, at 129 (“Through intense logrolling, the U.S. Congress set more than 20,000 tariff levels, item-by-item, with an average ad valorem rate on dutiable imports of nearly 53%. Germany, in economic difficulties before 1933, followed an autarkic policy. Other countries more or less reluctantly followed suit, with the strategy of defensive retaliation. Within a year after Smoot-Hawley went into
However, by utilizing such parochial options, national governments came to realize that competitive currency practices are destructive and should be subject to limiting regulation.\textsuperscript{21}

An interesting glimpse into national efforts to curb competitive currency practices can be found in a 1933 study by the U.S. Federal Trade Commission ("FTC"), which examined antidumping duties worldwide.\textsuperscript{22} A common reaction to competitive currency depreciation in the interwar period was the unilateral imposition of antidumping duties.\textsuperscript{23} The FTC examined dumping of various types — including "exchange dumping" — and described the considerable extent to which currency undervaluation was actionable under the antidumping laws of many countries.

Almost all countries that have passed antidumping legislation, with the exception of the United States, have included provisions to prevent exchange dumping or the importation of goods from foreign countries with depreciated currency. In some cases this is the only form of dumping for which duties are imposed, and in a number of countries it has been the most important part of the antidumping administration.

The exchange situation after [World War I] and especially depreciation of currency in Germany, served as immediate cause for a number of laws and regulations, including those in Great Britain and the Colonies, Belgium and Spain. The lowering of currency values during the recent depression period led to further steps in Europe and in Argentina, and renewed activity in Canada.

The laws vary, some provide for duties equal to the currency depreciation, but the later measures have sought to equalize costs of production. If the currency of a country is low and prices and wages have not risen, the workers are paid amounts equivalent to the lower currency price, and costs of production are therefore low. But if the rise in internal practices and wages has kept pace with the depreciation of the currency, then the cost of production is not low and there is less need for special duties.\textsuperscript{24}

The FTC Report demonstrates three points: (1) that the world's major economic powers considered strategic currency undervaluation to be illegal;\textsuperscript{25} (2) that nations asserted a right to counter the undervaluation's negative domestic effects; and (3) that there was no universal understanding of when a currency was actually undervalued. Consider the following examples from the FTC Report for illustration:

\textsuperscript{21} TLAG, supra note 11, at 3.
\textsuperscript{22} Id. at 6-9 (quoting Antidumping Legislation and Other Import Regulations in the United States and Foreign Countries — Report Prepared for the Federal Trade Commission by the Export Trade Section of the Commission Relative to Antidumping Legislation and Other Import Regulations in the United States and Foreign Countries, S. Doc. No. 112, 73d Cong., 2d Sess. (Jan. 11, 1934) [hereinafter "FTC Report"]).
\textsuperscript{23} TLAG, supra note 11, at 6.
\textsuperscript{24} FTC Report, supra note 22, at 9-10.
\textsuperscript{25} At the same time, major international powers like France and the United States were complicit in the act.
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The United Kingdom: Under Great Britain’s Act of 1921, additional duties for exchange dumping were imposed on imports if the exporting country’s currency was depreciated by 33.5% or more of the par value of the exchange.26

Canada: In Canada, circulars issued in 1922 designated Germany, Austria, Hungary, Russia, Czechoslovakia, and the Kingdom of the Serbs, Croats, and Slovenes as countries with undervalued currencies—apparently without any accompanying calculations—and set the amount of the special duties as the difference between (a) the imported product’s lower price in Canada due to the exporting country’s undervaluation of its currency, and (b) the price prevailing for similar goods in the United Kingdom or, if there was no manufacture or production in the United Kingdom, with reference to the price for similar goods that would be paid in any European country with a “normal currency.”27

South Africa: South Africa’s Act of 1925 originally called for an exchange dumping duty equal to the difference between (a) the export price of goods imported into South Africa from a country with a depreciated currency and (b) the export price of similar, undumped goods imported into South Africa from a country whose currency in relation to South Africa’s currency was not depreciated by more than 5 percent.28

France: France introduced in early 1931 an “exchange compensation sur-tax” to counter the effect on imports’ prices of foreign currencies’ depreciation from their legal par. In a decree in December 1931, France revised its initial methodology so that the focus of the exchange surtaxes was on offsetting the effect of currency depreciation on the manufacturing costs of foreign products. This goal was achieved by calculating the difference between (a) the product’s present price in the exporting country expressed in gold and (b) the price in force in the exporting country with its currency depreciated. Under this decree, France applied its surtax against products from 24 countries at rates between 7 and 25 percent.29

Taking a different path in the 1930s, the United States treated currency devaluations as export subsidies. “Until the Uruguay Round Agreement on Subsidies and Countervailing Measures (SCM Agreement), subsidy discipline was largely a national affair. For a variety of reasons widely viewed as legitimate, national governments provided subsidies to industries; if foreign companies suffered from subsidized import competition they could petition their own national governments to offset these subsidies by imposing tariffs—countervailing duties—on imports of the subsidized products. There was relatively little international consensus on ei-

26 FTC Report, supra note 22, at 10.
27 Id.
28 Id. at 11.
29 Id. at 12-13.
ther subsidy disciplines or the application of national countervailing duty ("CVD") law, and what international remedies against subsidies existed were often ineffective. 30

For example, in F. W. Woolworth Co. v. United States, the U.S. Court of Customs and Patent Appeals found that the Nazi-era German government had provided illegal export subsidies in the form of a dual and undervalued exchange rate to its export-oriented businesses.31 In Woolworth, the court considered the question of whether to uphold countervailing duties imposed by U.S. Customs on the importation of goods into the United States from Germany.32 At the time, Germany maintained both “free-exchange” and “registered” reichsmarks that had drastically different exchange values against the U.S. dollar.33 An American importer purchased certain china tableware from a German exporter with a combination of some “free” and mostly “registered” reichsmarks. The “registered” reichsmarks were significantly undervalued by the German government relative to the U.S. dollar at a level much below the exchange rate for the “free” reichsmarks. The lower price paid in U.S. dollars than if the china tableware had been purchased only with “free” reichsmarks effectively constituted an export subsidy.34 Affirming the trial court’s decision upholding the countervailing duties, the appeals court stated:

It is not possible to escape the conclusion from the record that the German Government by various devices and through different authorized governmental agencies was seeking to aid its manufacturers in invading foreign markets with their goods to compete in such markets with domestic producers. To this end various devices and practices were resorted to by and with the authority, encouragement, and aid of the German Government. Among such was the control of the registered marks and the limitations placed upon their use.35

Even as the Second World War raged, forward-thinking economists like Harry Dexter White and John Maynard Keynes laid the intellectual and diplomatic framework for an international trading system with foundations firmly rooted in a stable international exchange system. Among the principal lessons drawn from the interwar period was the recognition that

31 F. W. Woolworth Co. v. United States, 28 CCPA 239, 248 (1940) [hereinafter “Woolworth”].
32 Id. at 246-47.
33 Id. at 244-45.
34 TLAG, supra note 11, at 4.
35 Woolworth, supra note 31, at 248. More recently in the late 1980s and early 1990s, China operated a dual exchange rate system through various regional “swap centers” whereby Foreign Invested Enterprises (“FIE”) could obtain RMB at dramatically advantageous rates compared to the official RMB/dollar rate. Commentators have attributed the availability of substantially undervalued currency to China’s dramatic economic rise beginning in the middle to late 1990s; see also TLAG, supra note 11, at 47-48, quoting United States v. Hammond Lead Products, Inc., 440 F.2d 1024, 1030-31, cert. denied, 404 U.S. 1005 (1971) (“Nothing, at least in the short range, stimulates exports more than a devaluation of the currency. After devaluation, the exporter gets more home currency for each article he exports, and with it can purchase more goods and services at home, and he obtains these benefits largely at the expense of the producer for the home market who now gets paid in devalued currency. Yet we do not assess countervailing duties against countries because they devalue their currencies. Why? The only valid reason is that these devaluations have been encouraged by our government, in the effort it has expended since Bretton Woods for a worldwide system of freely convertible currencies.”).
orderly exchange arrangements are essential to international trade, investment, and ultimately, prosperity.36

III. A GROWING RECOGNITION THAT NATIONAL SOVEREIGNTY OVER MONETARY AND TRADING AFFAIRS SHOULD BE REDUCED IN THE INTEREST OF INTERNATIONAL PROSPERITY

"We need an orderly and agreed method of determining the relative exchange values of national currency units, so that unilateral actions and competitive exchange depreciations are prevented." John Maynard Keynes37

The difference between post-war planning in 1919 and in 1945 could not have been more striking. "In contrast to World War I when post-war economic planning had been unsystematic and focused primarily on the issue of reparations, post-war planning [after World War II] began almost with the start of the war, particularly in the United States and also in Great Britain."38 The United States set the reconstruction of a multilateral system of regulated world trade as its primary policy objective.39 Then Secretary of the Treasury Henry Morgenthau clearly saw new international financial institutions as the best alternative to the beggar-thy-neighbor anarchy that had reigned during the interwar period.40 Ultimately, the principal foci of post-war planning were monetary and trade matters, which were seen as inextricably linked.41 The drafters of both the IMF's Articles of Agreement and the GATT recognized that no international trading system can function and prosper without an orderly international exchange system.42

Two central figures dominated efforts to plan for a new post-war monetary order, Harry Dexter White for the United States and John Maynard Keynes for Great Britain. After initially working independently of one another and drafting respective plans in 1942, the two collaborated on a program for postwar international monetary cooperation.43 From the outset, the international community understood that competitive currency depreciation, high tariffs, and nontariff barriers can devastate national economies and international trade and investment.44 Keynes and White were clear in their basic thinking.

They started from the premise that exchange rates were a matter of international concern, and that they should be relatively stable. This meant that governments would assume the obligation to maintain the value of their currencies, and to alter applicable rates of exchange, if at all, only in accordance with a set of rules to be worked out, which would require some form of concurrence from the organization to be created. Changes in exchange

36 TLAG, supra note 11, at 10.
38 Lowenfeld, supra note 13, at 14.
39 Id.
40 Id.
41 Id. at 15.
42 TLAG, supra note 11, at 1.
43 Lowenfeld, supra note 13, at 15. John Maynard Keynes then worked for the British Treasury while Harry Dexter White was U.S. Treasury Secretary Morgenthau's assistant for international finance.
44 TLAG, supra note 11, at 10.
rates would be permitted to correct fundamental long-term distortions, but not to correct short-term imbalances or situations that could be dealt with in other ways. In addition, both the White and Keynes plans assumed international rules of conduct would be a part of the charter of the new institution.\footnote{Lowenfeld, supra note 13, at 16. It is important to emphasize that both White and Keynes envisioned a new international economic order governed by rules “designed to prevent recurrence of the restrictive beggar-thy-neighbor practices of the interwar years.” Moreover, the distinction drawn by White and Keynes — of relying on changes in exchange rates to correct fundamental long-term distortions, but using other measures to deal with short-term imbalances or similar situations — is still recognized by economists as valid today. For example, Michael Mussa, a Senior Fellow at the Peterson Institute for International Economics, echoing the thinking by White and Keynes, recently proposed that short-term imbalances should be addressed by other, presumably domestic means. “According to Mussa, the IMF should deem measures that display the following two features as manipulation: (1) the measure affects the exchange rate or balance of payment, and (2) the measure’s domestic objectives could have been achieved by some other measure that did not affect the exchange rate or the balance of payment.” Bryan Mercurio & Celine Sze Ning Leung, Is China a “Currency Manipulator”?: The Legitimacy of China’s Exchange Regime Under the Current International Legal Framework, 43 Int’l. Law. 1257, 1278 (Fall 2009) [hereinafter “International Lawyer”].}

White particularly stressed the close link between monetary measures and international trade and investment. As he noted, lowering barriers to international trade “... cannot be done until there is assurance of orderly exchange rates and freedom in exchange transactions for trade purposes. A depreciation in exchange rates is an alternative method of increasing tariff rates; and exchange restriction is an alternative method of applying import quotas.”\footnote{TLAG, supra note 11, at 10 (quoting H.D. White, The International Monetary Fund: Some Criticisms Examined, 23 Foreign Affairs 195, 208 (1944-45) (emphasis added) [hereinafter “H.D. White”].} Also of central importance, White observed, “The world needs assurance that whatever changes are made in exchange rates will be made solely for the purpose of correcting a balance of payments which cannot be satisfactorily adjusted in any other way. The world needs assurance that exchange depreciation will not be used as a device for obtaining competitive advantage in international trade; for such exchange depreciation is never a real remedy. It inevitably leads to counter measures, and the ultimate effect is to reduce the aggregate volume of trade. This is precisely what happened in the period of the 1930’s when competitive exchange depreciation brought wider use of import quotas, exchange controls and similar restrictive devices.”\footnote{H.D. White, supra note 46, at 199.} The founders of the IMF understood clearly the danger to world trade of artificially depressing the value of currencies. Unless all players are held to the same rules, they lose faith in the system and resort to reciprocal tactics.

In marked contrast to so-called modern arguments heard in some circles today that nations have an absolute sovereign right to set the value of their currencies according to national preference,\footnote{See, e.g., International Lawyer, supra note 45, at 1268 “General international law recognizes a state’s freedom to issue currency and inherent sovereignty to determine the value of that currency. As an inherently sovereign act, exchange control or currency regulation is a domestic measure, which is encompassed in a state’s domestic jurisdiction. China (and indeed, any country) is free to impose whatever exchange rate policy to the exclusion of any state scrutiny. Indeed, this situation is what the Chinese authorities have traditionally maintained when pressured to revalue the RMB.”; Writing during the Second World War, Keynes addressed this sort of claim succinctly by stating; “It is quite true that in some quarters the feeling might prevail that freedom to manipulate the value of currency is an important instrument of government. But clearly, if this view is pressed, it stands in the way of all currency agreements whatever.” Sir Joseph Gold, Exchange Rates in...} White and Keynes believed that each nation has a certain right to value...
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its currency but that some ceding of sovereignty in this area is necessary and desirable. As Keynes remarked, membership in (what would later become) the IMF required no greater a surrender of sovereign rights than is required in any commercial treaty. In his words, "Surely it is an advantage, rather than a disadvantage, of the scheme that it invites the member States and groups to abandon that license to promote indiscipline, disorder, and bad-neighborliness which, to the general disadvantage, they have been free to exercise hitherto."49

The United Nations Monetary and Financial Conference opened on July 1, 1944 in Bretton Woods, New Hampshire, and concluded on July 22, 1944. Forty-four governments accepted the invitation of President Roosevelt to come together for the purpose of promoting international economic stability. U.S. Secretary of the Treasury Henry Morgenthau was elected president of the Conference.50 "The IMF came into formal existence in December 1945, when its first 29 member countries signed its Articles of Agreement. It began operations on March 1, 1947."51 From its very beginnings, the IMF's charter has expressed that one of the IMF’s purposes is to “promote exchange stability, to maintain orderly exchange arrangements among members, and to avoid competitive exchange depreciation.”52 The founders of the International Monetary Fund created at Bretton Woods a gold-based, par-value system of exchange rates that the IMF would oversee. The signatory countries hoped that the arrangement would foster a new era of global peace and prosperity via international trade bolstered by orderly exchange arrangements and fair currency standards.53 The par-value system in the IMF’s Articles of Agreement represented a historic and “radical departure” from the principle that each nation may adjust its currency’s exchange rate as it sees fit.54 The new system emphasized stability of exchange rates, but wisely allowed for some flexibility as well. As White explained, “Stability of exchange rates is not, however, identical with rigidly fixed rates that cannot be changed under any circumstances. The difference between stability and rigidity in exchange rates is the difference between strength and brittleness. It is the difference between an orderly adjustment, if the conditions warrant it, and eventual breakdown and painful readjustment.”55

INTERNATIONAL LAW AND ORGANIZATION 27 (ABA 1988) [hereinafter “Joseph Gold”]; The debate over whether a country has a unilateral, unfettered right to value its currency continues to this day. Michael Mussa at the Peterson Institute lamented in a 2007 article that the then U.S. Treasury Secretary John Snow and IMF Managing Director Rodrigo de Rato agreed with Premier Wen Jiabao that each signatory nation to the IMF’s Articles of Agreement has an unquestionable, sovereign right to adjust its currency’s value. Mussa calls this belief a “logical absurdity” and reminds policymakers that though signatory nations have considerable discretion in determining their exchange arrangements and exchange-rate policies, these arrangements and policies “must comport with the obligations of members set out in this Article (IV) and, more generally, with other obligations that members have under the Articles.” Michael Mussa, IMF Surveillance over China’s Exchange Rate Policy, Paper Presented at the Conference on China’s Exchange Rate Policy, PETERSON INST. FOR INT’L ECON. 8-9 (Oct. 19, 2007) (parenthetical material added) [hereinafter “Mussa”].

49 DeVries and Horsefield, supra note 37, at 12-14, ¶¶49, 50, and 52.
52 IMF, supra note 3, at art. I(iii).
53 TLAG, supra note 11, at 13 (quoting Fred M. Vinson, After the Savannah Conference, 24 FOREIGN AFFAIRS 622, 623 (1945-46)).
54 Joseph Gold, supra note 48, at 28.
55 H.D. White, supra note 46, at 195, 199.
IV. POST-WAR POLICYMAKERS UNDERSTOOD THAT EXCHANGE-RATE UNDervaluation is a Threat to the International Trading System – The Formation of the GATT

"It was well recognized at the time of drafting GATT that currency par value manipulation and exchange controls could be used to protect domestic markets against imports." John H. Jackson

The mid-twentieth century witnessed an unprecedented international vision and effort to create institutions to regulate and harmonize international economic relations. The diplomats, economists, and statesmen who created the IMF and the World Bank profoundly hoped that agreed frameworks for trade and development would prevent a replication of the Great Depression and the Second World War. While work was progressing on the monetary side of matters during World War II, and the Bretton Woods system came to be in mid-1944, "it was recognized that there should in addition be established an international organization for trade, an International Trade Organization (ITO)." Soon after the [Bretton Woods] conference, and one of the first tasks for the United Nations after it was established, was the drafting of a charter for an ITO." This trade work, however, did not move ahead as quickly due to the demands and turmoil of the war and the sheer size and daunting nature of the task of devising a set of rules to govern international trade on a global scale, something never before undertaken.

Although the United States was an early champion of an international legal framework for trade in goods, even as the IMF and World Bank began operations by World War II's end, indications were that the U.S. Congress quite possibly would not follow the U.S. President's lead on international trade issues. It was evident to U.S. policymakers, however, that a stable post-war economic order would require broad international consensus and cooperation on three fronts: exchange policy; trade policy; and investment. In this setting, the U.S. and its allies intensely negotiated what fundamental principles should define the post-war era of international trade and investment. From late 1946 into 1948, fifty-three nations cooperated in drafting what came to be called the Havana Charter, which would have created the International Trade Organization to facilitate free trade via the reduction of tariff rates and rules of non-discrimination. From these talks emerged the General Agreement on Tariffs

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57 Id. at 5.

58 TLAG, supra note 11, at 25.

59 Id. at 25; see also John H. Jackson, William J. Davey, and Alan O. Sykes, Legal Problems of International Economic Relations 217-222 (5th ed. 2008) [hereinafter "International Economic Relations"].


61 "The debates concerned such fundamental issues as how to reconcile freedom of trade and open competition with the objectives of full employment and economic growth: how much sovereignty would countries be prepared to delegate to an international institution and an international charter; what sanctions would be available to ensure conformity with the rules; what departures from the rule of nondiscrimination could be tolerated to accommodate regional grouping." Id. at 84.

62 Vagts, Dodge, and Koh, supra note 8, at 130.
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and Trade, or GATT for short. The original GATT articles were drawn from traditional provisions that were common in bilateral agreements and addressed such subjects as duty valuations, national treatment, quantitative restrictions, subsidies, antidumping and countervailing duties, and state trading.

The ITO, in retrospect, proved to be overly ambitious for the time with its envisioned institutionalizing of extensive international trade rules and ultimately failed to gain approval by the U.S. Congress. In the latter part of 1947, recognizing that the legislatures of the United States and other countries were hesitant to go forward with the ITO, and facing an impending expiration in mid-1948 of the United States’ authority under U.S. domestic law to negotiate trade agreements, twenty-two countries agreed to a Protocol of Provisional Application of the GATT, which became effective on January 1, 1948. With an eye toward having some international legal discipline in place over international trade, the GATT was supposed to be a temporary instrument to be replaced at the upcoming Havana Conference by the International Trade Organization. Instead, the U.S. Congress failed to act affirmatively on the Havana Charter and did not formally endorse any trade agreement stemming from this period until 1994 when the World Trade Organization was put in place. Nevertheless, the GATT from the beginning has embodied a postwar revulsion against excessive national separatism. Very importantly, the GATT provided a set of “commercial policy principles to guard against the value of the tariff concessions being eroded by other, non-tariff restrictions.” The drafters of the GATT, in concurring with the drafters of the IMF’s Articles of Agreement, understood the strong link between sustainable international trade and development and orderly, stable exchange arrangements.

The guiding economic premise underlying the GATT-WTO system is open trade for the purpose of raising global standards of living for everyone. Eight successive rounds of negotiations sponsored by the GATT since 1947 have resulted in a progressive reduction of tariffs and non-tariff barriers to trade in goods and, beginning with the Uruguay Round completed in 1994, trade in services. Technological innovation, investment, lower prices for goods and services, and growth in the world’s gross domestic product have been the goals. This liberalizing has created export opportunities and spurred international competition.

The success achieved in raising standards of living has stemmed from the GATT and its authors’ resolve that the world’s economy after the Second World War must be purposefully

63 Reisman, supra note 60, at 84.
64 Id. at 84-85.
66 Reisman, supra note 60, at 85; Jackson, supra note 56, at 6, 8 (“It is well known that the GATT was never intended to be an organization. It was negotiated in the 1947-1948 period, at the same time as negotiators prepared a Charter for an ITO.”).
67 Vagts, Dodge, and Koh, supra note 8, at 130-131.
68 Id. at 130.
70 John Jackson, World Trade and the Law of GATT 479 (1969) [hereinafter “Law of GATT”] The legislative history of the act authorizing participation in GATT by the United States records strong congressional complaints against foreign use of these devices. “It was well recognized at the time of drafting GATT that currency par value manipulation and exchange controls could be used to protect domestic markets against imports.”
71 Kevin Kennedy, Competition Law and the World Trade Organisation: The Limits of Multilateralism 3 (Sweet & Maxwell 2001) [hereinafter “Kennedy”].
remade and not the product of national accident. It is at least as true today as then that there
must be effective international machinery in place to undergird multilateral, intergovernmental
rules. Otherwise, the global economic system will be in the same sort of predicament that
it faced following the First World War.\textsuperscript{72} As has been observed, governments must undertake con-
tcrete obligations, not just amorphous, vague commitments. That lesson from the futile
experience of the League of Nations was taken to heart by the international community after
the Second World War.\textsuperscript{73} The results in the GATT, while perhaps not as precise or strictly
enforceable as some might have preferred, still provided a workable foundation for fostering
balanced international trade and investment with the support of orderly exchange
arrangements.

V. COMPETITIVE CURRENCY DEPRECIATION ERODES THE
STRENGTH AND UTILITY OF THE GATT

"There are compelling reasons for the WTO to address exchange rate undervaluation .... An
undervalued exchange rate is both an import tax and an export subsidy and is hence the
most mercantilist policy imaginable.\textsuperscript{74} Arvind Subramanian and Aaditya Mattoo

If there is a single, more devastating way than competitive currency depreciation to
distort the benefits that should flow from international trade based upon true comparative
advantage, it is difficult to imagine what that measure might be. A country’s extensive under-
valuation of its currency has far-reaching effects. Results over the short term, and perhaps
over the long term as well, generally are favorable for that country, but come at the expense
and to the detriment of other countries. Eventually, if the undervaluation is pervasive, pro-
tracted, and extreme enough, the damage to all concerned will be considerable. Just how
corrosive and destabilizing currency undervaluation can be was demonstrated during the years
between the First and Second World Wars. By distorting costs and prices across the board,
this insidious practice takes a huge toll on healthy, sustainable economic growth and develop-
ment and strains relations internationally. As turned to next, this one step acts in ways that
weaken and prevent the GATT’s most vital principles from functioning as intended.

A. Article I of the GATT and the Principle of Most-Favored-Nation
(“MFN”) Treatment

GATT Article I:1 requires that each member state of the WTO behave in a non-
discriminatory manner toward all other member states in certain broad regards. In particular,
as relevant, a violation of Article I:1 is established if there is (1) an advantage of the type
covered by Article I:1, (2) which advantage is accorded by a member state to products im-
ported and sold in the member state from one or more other member states, but (3) that
advantage is not accorded immediately and unconditionally to like products from all member

\textsuperscript{72} WILLIAM DIEBOLD JR., FROM THE ITO TO GATT – AND BACK?, THE BRETON WOODS-GATT SYSTEM:
RETROSPECT AND PROSPECT AFTER FIFTY YEARS 153 (Institute for Agriculture and Trade Policy 1996)
[hereinafter “Diebold”].

\textsuperscript{73} Id.

\textsuperscript{74} Arvind Subramanian and Aaditya Mattoo, CURRENCY UNDervaluation and Sovereign Wealth Funds: A New
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states. GATT Article I:1’s prohibition against this sort of discrimination includes both \textit{de jure} and \textit{de facto} discrimination.

Article I:1 of the GATT provides:

With respect to customs duties and charges of any kind imposed on or in connection with importation or exportation or imposed on the international transfer of payments for imports or exports, and with respect to the method of levying such duties and charges, \textit{and with respect to all rules and formalities in connection with importation and exportation, and with respect to all matters referred to in paragraphs 2 and 4 of Article III, any advantage, favour, privilege or immunity granted by any contracting party to any product originating in or destined for any other country shall be accorded immediately and unconditionally to the like product originating in or destined for the territories of all other contracting parties.}

GATT Art. I:1 (addendum omitted; emphasis added).

When Country A intervenes in exchange markets over a prolonged period of time on a large scale and thereby significantly undervalues its currency relative to the currency of Country B, that action can reasonably be seen under GATT Article I:1 as a rule and a formality in connection with Country A’s importation of products and then with the treatment of those products after importation into Country A. In the latter regard, as addressed further below, GATT Article III generally requires that one member state’s laws, regulations and requirements affecting the internal sale, offering for sale, purchase, distribution, or use of imported goods from another member state must be applied non-discriminatorily to those imports, such that the imports into Country A from Country B in the example must be treated by Country A after importation within its territory no less favorably than like products originating in Country A. Article I:1 of the GATT thus obligates a member state of the WTO like Country A to grant national treatment extended to any member state’s products after importation into Country A on a MFN basis equally to like products once imported into Country A from all member states.

This duty of non-discrimination under GATT Article I:1 is undercut, however, when Country A undervalues its currency relative to Country B’s currency, and Country C’s currency through normal market forces loses value against Country B’s currency. In this scenario, Country A’s currency becomes relatively stronger in relation to Country C’s currency than to Country B’s currency due to Country A’s large-scale, protracted interventions in exchange markets and the resulting undervaluation of its currency relative to Country B’s currency.

At that point, Country A’s maintenance through rules and formalities of an undervalued exchange-rate regime \textit{vis-à-vis} Country B’s currency confers an advantage upon Country C and its currency that has lost value against Country B’s currency due to market forces rather than to Country A’s large-scale, protracted interventions in exchange markets. Country C will have an advantage over Country B, because the prices of Country C’s exports to Country A denominated in Country A’s currency will be less expensive and hence more competitive in


Country A than the products of Country B with its artificially overvalued currency relative to Country A's currency.

With reference to GATT Article I:1, Country C will certainly have an advantage over Country B in this situation, both in connection with the importation of goods into Country A as well as with their sale and distribution in Country A after importation. Like products from countries like Country C that have currencies that have fallen in value against Country B’s currency due to the workings of the market are more attractive and affordable for buyers in Country A than imports from Country B. This phenomenon occurs because the currency of Country A is automatically strengthened against Country C’s weakened currency, but not against Country B’s currency, because Country A’s currency has been linked and artificially reduced in value in relation to Country B’s currency as the result of Country A’s large-scale interventions in exchange markets over a protracted period of time.

In this way, the advantage to Country C caused by the rules and formalities underlying Country A’s practice of undervaluing its currency relative to Country B’s currency is automatically and unconditionally enjoyed by products imported into Country A from Country C, but not by Country B’s like products. The most-favored-nation precept of GATT Article I:1 suffers. Country B is deprived of the positive benefits and stimulus to exports attributable to the fluctuations in a flexible exchange rate that reflects market conditions. This discriminatory outcome derives from Country A’s enforced undervaluation of its currency against Country B’s currency.

**B. Article II of the GATT and Tariff Bindings**

GATT Article II builds upon the concept of MFN treatment and illustrates a further instance in which another of the GATT’s centrally important mechanisms to boost trade in goods across national boundaries can be vitiated by a country’s undervalued exchange-rate regime. Article II is the provision that the GATT’s drafters put in place to address the severe problem of prohibitively high tariffs that many countries historically imposed on imports to protect their domestic industries, notably in the period between World War I and World War II. Since 1947, countries’ tariff levels have progressively and substantially been reduced through successive rounds of negotiations conducted under the GATT’s auspices and now at the WTO. Lowering tariff barriers has been an integral part of the overall effort to facilitate international trade. Under Article II:1 of the GATT, “ordinary customs duties” and “all other duties or charges of any kind” in excess of a member state’s tariff bindings are forbidden. Also very importantly, GATT Article II:1(a) directs that the tariff bindings set forth in a member state’s schedules of concessions shall be effected on a MFN basis.77

Within this framework, Article II of the GATT contains obligations designed to guard against a member state’s skewing of tariff bindings by means of currency measures. Thus, GATT Article II:3 stipulates that no member state shall alter its method of converting currencies so as to impair the value of any of its tariff concessions. Similarly, Article II:6(a) of the GATT elaborates that bound specific duties and charges of a member state that is also a member of the IMF may be adjusted to take account of a reduction in the par value78 of that

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77 See Vagts, Dodge, and Koh, supra note 8, at 132.
78 See Specific Duties: Report of the Working Party, L/4858, B.I.S.D. 275/149, 150 (Jan. 29, 1980) (hereinafter “Specific Duties”). In April 1978, the IMF’s Articles of Agreement were amended to acknowledge that the IMF’s members were no longer required to maintain gold-based, par values for their currencies and could
member state’s currency as long as (1) the par value is reduced consistently with the IMF’s Articles of Agreement by more than twenty per cent and (2) the WTO’s Member States jointly concur that such adjustments will not impair the value of the Member State’s tariff concessions, “due account being taken of all factors which may influence the need for, or urgency of, such adjustments.”

As complicated an area as the relationship between bound tariffs and exchange rates is, and notwithstanding the intricacies of GATT Article II:6(a), the impact on a country’s imports when that importing country has a policy of fundamentally undervaluing its currency can be considerable. With reference to the preceding illustration, for instance, assume that Country A persistently undervalues its currency by 30 percent in relation to Country B’s currency. At the undervalued exchange rate, in other words, 10A = 1B, while without this undervaluation the exchange rate would be 7A = 1B (10A − 7A = 3A/10A = 30 percent). If Country A employs an ad valorem tariff of 5 percent and a buyer in Country A imports a widget from Country B worth 700B, that widget is valued by Country A at the time of importation at 7,000A with the undervalued exchange rate (700B x 10A/1B = 7,000A), but is valued at only 4,900A if the exchange rate is not undervalued by 30 percent (700B x 7A/1B = 4,900A). Further, Country A’s ad valorem tariff of 5 percent at the undervalued exchange rate is 350A (7,000A x .05 = 350A), but is only 245A if the exchange rate is not undervalued (4,900A x .05 = 245A), a difference of 105A (350A − 245A = 105A).

When the economists run the math, therefore, Country A’s tariff binding of 5-percent ad valorem yields a considerably greater amount of duties on products imported into Country A from Country B when Country A’s currency is significantly undervalued than when it is not significantly undervalued relative to Country B’s currency. This difference increases in proportion as the extent of the undervaluation grows. A claim that Country A has bound its tariff, therefore, at 5-percent ad valorem is technically correct, but is not an accurate statement as a practical matter, because the importer in Country A has a greater absolute tariff to pay in Country A’s currency (350A) than if Country A were not undervaluing its currency (245A). As a result, the importer in Country A might not be willing and able to import the more expensive widget from Country B. In these circumstances, GATT Article II’s intended purpose and discipline are not really achieved. From Country B’s vantage, the worth of instead adopt exchange arrangements such as floating exchange rates and exchange rates fixed against another currency, a basket of currencies, or an international unit of account. This major shift by the IMF precipitated the formation in May 1978 of a GATT Working Party to consider how Article II:6(a) of the GATT should be applied as a result.

As explained by the Working Party, Article II:6(a)’s purpose is to permit adjustment of bound specific duties to offset the inflationary erosion or depreciation of a contracting party’s currency in which the specific duties were defined in negotiations.

In the course of its analysis, the Working Party additionally considered the circumstances in which a currency’s appreciation causes a drop in import prices and an increase in the ad valorem incidence of specific customs duties. It was observed that the lower import prices normally would lead to a decline in the competitiveness of the domestic industry and greater import penetration. After opining that in neither case would impairment occur as to the competitive opportunities resulting from specific duty concessions, the Working Party agreed not to pursue this matter, noting that Article II:6(a) does not deal with currency appreciations and that dispute settlement could be pursued by a contracting party that considered the value of specific duty concessions impaired by currency appreciation in a particular case.

A specific duty or tariff is a flat charge per unit or quantity of goods, such as $3.00 per ton, while an ad valorem duty or tariff is a charge that is a percentage of the imported goods’ value, such that a 5-percent ad valorem duty on goods with an entered value of $50.00 would be $2.50.
Country A's tariff concession has been seriously impaired by Country A's deliberate under-valuation of its currency in relation to Country B's currency, and the quantity of imports into Country A from Country B can be expected to decline.

C. Article III of the GATT and Non-Discriminatory National Treatment for Imports

Article III of the GATT complements GATT Article I. Together, Article I and Article III of the GATT are the international trading system's linchpins for dealing even-handedly with products regardless of their origin or destination. Whereas Article I speaks to MFN treatment for products in connection with their importation and exportation, Article III of the GATT focuses upon so-called national treatment once products have been imported. Article III:4 gives the essence of the GATT's notion of national treatment.

The products of the territory of any contracting party imported into the territory of any other contracting party shall be accorded treatment no less favorable than that accorded to like products of national origin in respect of all laws, regulations and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution or use. 80

An early report by the WTO's Appellate Body elaborated upon the proper role of Article III.

The broad and fundamental purpose of Article III is to avoid protectionism in the application of internal tax and regulatory measures. More specifically, the purpose of Article III "is to ensure that internal measures 'not be applied to imported or domestic products so as to afford protection to domestic production.'" Toward this end, Article III obliges Members of the WTO to provide equality of competitive conditions for imported products in relation to domestic products. "[T]he intention of the drafters of the Agreement was clearly to treat the imported products in the same way as the like domestic products once they had been cleared through customs. Otherwise indirect protection could be given." 81

Notably, GATT Article III's requirement that conditions of competition be equal has long been sweepingly interpreted. 82 Generally speaking, therefore, Article III of the GATT stipulates (1) that a law, regulation, or requirement, which (2) affects the internal sale of an imported product, (3) must accord no less favorable treatment to that imported product than to the domestic like product.

80 GATT, supra note 4, at art. III:4 (emphasis added).
82 See, e.g., Panel Report, Italian Discrimination Against Imported Agricultural Machinery, ¶ 12, B.I.S.D. 78/60 (Oct. 23, 1958) With respect to Article III:4, "[t]he selection of the word 'affecting' would imply, in the opinion of the Panel, that the drafters of the Article intended to cover in paragraph 4 not only the laws and regulations which directly governed the conditions of sale or purchase but also any laws or regulations which might adversely modify the conditions of competition between the domestic and imported products on the internal market."
A national government’s enforced undervaluation of its currency vis-à-vis another country’s currency is at odds with GATT Article III’s standard of non-discrimination through national treatment. This problem is shown by further scrutinizing the circumstance in which Country A’s currency is undervalued by 30 percent relative to Country B’s currency. As presented in the context of GATT Article II, that 30-percent undervaluation would lead to a widget imported by Country A from Country B and worth 700B being valued at the time of entry into Country A at 7,000A with the undervalued exchange rate, but at just 4,900A if there were no undervaluation. An ad valorem tariff of 5 percent thus would yield 350A of duties in the former setting, but only 245A of duties in the latter setting.

This unfair advantage due to the fundamental misalignment of Country A’s currency in relation to Country B’s currency is compounded if Country A imposes indirect taxes, such as a value-added tax (“VAT”) of 10-percent ad valorem, on consumption in Country A. Application of that VAT against the widget from Country B will yield revenue of 700A at the undervalued exchange rate (7,000A x 0.10 = 700A) but a much lower amount in revenue of 490A without undervaluation (4,900A x 0.10 = 490A). From the vantage of an importer and each subsequent user of the widget in Country A, therefore, the undervaluation of Country A’s currency against Country B’s currency means both much higher import duties and then much greater indirect taxes in comparison with the duties and taxes that would be assessed and collected if there were no undervaluation.

With reference to GATT Article III’s elements, Country A’s enforced undervaluation of its currency (1) entails and constitutes a law, regulation, or requirement, which (2) affects the sale, offering for sale, purchase, distribution, or use in Country A of the widget from Country B, such that (3) Country A treats a widget from Country B less favorably than a like widget of Country A, because the indirect tax imposed by Country A on that like widget of domestic origin is not affected and not magnified by the undervaluation of Country A’s currency as the indirect tax on Country B’s widget is. Certainly this arrangement has the effect of affording further discriminatory protection to domestic production in Country A notwithstanding Article III of the GATT.

D. Articles VI and XVI of the GATT and Subsidies

"The General Agreement is hostile to subsidies.”  David Palmeter83

Throughout the history of the GATT, the subject of subsidies has commanded a great deal of attention. As one well-known scholar has remarked in his illuminating overview of this area, “No question in international trade law is as contentious, and as complicated, as the question of subsidies.”84 As time has gone by, the international legal framework and provisions addressing subsidies have been expanded and refined. More of the same sort of controversy, scrutiny, and debate can be expected in the future, because subsidies come in seemingly endless and imaginative guises, often are appropriate tools for governments to advance legitimate policies, but also frequently support selected companies and programs to the disadvantage of non-recipients and the efficient working of the free market. Reaching a consensus on whether a given subsidy should be seen as falling in the first category or in the second category can be a challenging exercise.

83 DAVID PALMETER, THE WTO AS A LEGAL SYSTEM 74 (Cameron May 2003) (internal citations omitted) [hereinafter “Palmeter”].

84 International Economic Law 2003, supra note 13, at 200.
As germane to this discussion, the authors of the GATT were concerned with the subsidizing, negative impact that currency measures can have on international trade. Most prominently, the addenda to Articles VI:2 and VI:3 of the GATT state that “[m]ultiple currency practices can in certain circumstances constitute a subsidy to exports which may be met by countervailing duties. . . . By ‘multiple currency practices’ is meant practices by governments or sanctioned by governments.” Along these lines, a 1960 GATT report under Article XVI:5 of the GATT stated that “. . . there was a clear obligation to notify to the CONTRACTING PARTIES multiple exchange rates which have the effect of a subsidy.”

Although the GATT does identify that some “multiple currency practices” are problematic from the standpoint of being an export subsidy, exactly what those currency practices and circumstances are has never been pinpointed or defined in the GATT or by the GATT’s jurisprudence. This omission might be attributable to an absence of agreement by the member states beyond the rule expressed, or possibly to a gentlemen’s understanding that the GATT’s contracting parties did not want to repeat the interwar years’ competitive currency depreciation and toward this end would exercise their national sovereignty carefully and responsibly under the IMF’s Articles of Agreement. Other factors might explain the GATT’s silence in this regard. In any event, it is probably the case that the reference to “multiple currency rates” reflects the fact that the IMF’s original Articles of Agreement, as mentioned earlier, instituted a gold-based, par-value system of exchange rates, so that a country’s departure from its rate—absent approval of that departure by the IMF—would mean that that country would have “multiple currency rates,” and the question would then arise of whether the country should be treated as having bestowed on its exporters a subsidy that could be countervailed under GATT Articles VI and XVI. In addition, the provision quoted above from GATT, Ad Article VI, paras. 2-3, note 2, has not itself been amended directly. In the Uruguay Round that led to the World Trade Organization’s founding, however, the member states reached an Agreement on Subsidies and Countervailing Measures that amplifies upon Articles VI and XVI of the GATT.

Among the ASCM’s signal achievements is the guidance it contains as to what is a subsidy, how the amount of a subsidy is to be measured, and when a subsidy will or will not give rise to legal rights and obligations under the ASCM. In particular, a subsidy exists under the ASCM when (1) there is a governmental financial contribution and (2) the recipient of that contribution receives a benefit from that contribution. If a subsidy is found according to

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85 GATT, supra note 4, at ad art. VI, ¶ 2-3, note 2.
87 Agreement on Subsidies and Countervailing Measures, 1994 WL 761483 (G.A.T.T.) [hereinafter “ASCM”].
88 Moreover, in the event that GATT Articles VI and XVI are ever found to be in conflict in any way with the ASCM, the ASCM is to prevail. See id. at General Interpretative Note to Annex 1A, reprinted in Uruguay Round Agreements Act, Statement of Administrative Action, H.R. Doc. No. 103-316, Vol. 1 at 1338 (1994).
89 Article 1.1 of the ASCM reads (footnote excluded):

Article 1
Definition of a Subsidy

1.1 For the purpose of this Agreement, a subsidy shall be deemed to exist if:
(a)(1) there is a financial contribution by a government or any public body within the territory of a Member (referred to in this Agreement as “government”), i.e. where:
(i) a government practice involves a direct transfer of funds (e.g. grants, loans, and equity infusion), potential direct transfers of funds or liabilities (e.g. loan guarantees);
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these criteria, the ASCM then distinguishes between subsidies that are “specific” and subsidies that are not “specific.” Only a subsidy with the requisite “specificity” can lead to consequences under the ASCM. Export-contingent subsidies are specific by definition and prohibited as having no redeeming qualities from the perspective of the WTO. Both export-contingent subsidies and domestic subsidies deemed to be specific under Article 2 of the ASCM can be offset by an importing country through the imposition of countervailing duties if an industry in the importing country shows that it is materially injured by such subsidized imports.

Whether a government’s enforced undervaluation of its currency is and should be treated as a specific subsidy has proved in recent years – most prominently with respect to China’s RMB – to be a highly charged political question as well as a divisive legal issue that has precipitated a range of opinions. While the best hope in the abstract for a final resolution of this debate logically would seem to be a multilaterally agreed, negotiated clarification in an amendment to the ASCM or possibly recourse to dispute settlement at the WTO, how realistic

(ii) government revenue that is otherwise due is foregone or not collected (e.g. fiscal incentives such as tax credits);
(iii) a government provides goods or services other than general infrastructure, or purchases goods;
(iv) a government makes payments to a funding mechanism, or entrusts or directs a private body to carry out one or more of the type of functions illustrated in (i) to (iii) above which would normally be vested in the government and the practice, in no real sense, differs from practices normally followed by governments; or
(a)(2) there is any form of income or price support in the sense of Article XVI of GATT 1994; and a benefit is thereby conferred.

Article 14 of the ASCM sets forth guidelines for calculation of the amount of a subsidy in terms of the benefit to the recipient, not the cost to the government. Also importantly, when a governmental action gives rise to a benefit, a subsidy is conferred regardless whether any payment occurs; see, e.g., Panel Report, Brazil – Export Financing Programme for Aircraft, WT/DS46/R (Apr. 14, 1999). The yardstick of the benefit is whether the recipient is “better off” than it would otherwise have been, absent that contribution. See Appellate Body Report, Canada — Measures Affecting the Export of Civilian Aircraft, ¶ 157 WT/DS70/AB/R (Aug. 20, 1999).

90 Article 3 of the ASCM states in its entirety:

Article 3: Prohibition

3.1 Except as provided in the Agreement on Agriculture, the following subsidies, within the meaning of Article 1, shall be prohibited:
(a) subsidies contingent, in law or in fact, whether solely or as one of several other conditions, upon export performance, including those illustrated in Annex I;

4 This standard is met when the facts demonstrate that the granting of a subsidy, without having been made legally contingent upon export performance, is in fact tied to actual or anticipated exportation or export earnings. The mere fact that a subsidy is granted to enterprises which export shall not for that reason alone be considered to be an export subsidy within the meaning of this provision.

5 Measures referred to in Annex I as not constituting export subsidies shall not be prohibited under this or any other provision of this Agreement.

(b) subsidies contingent, whether solely or as one of several other conditions, upon the use of domestic over imported goods.

3.2 A Member shall neither grant nor maintain subsidies referred to in paragraph 1.
either of these scenarios might be is unclear. The intricacy, magnitude, and sensitivity of this subject thus far have proved to be so daunting as to stymie an acceptable, effective solution.91

Nevertheless, for present purposes and at the risk of oversimplification, application of the ASCM and GATT Ad Article VI, paras. 2-3, note 2, very plausibly supports the conclusion that currency undervaluation is a prohibited, countervailable export subsidy under the WTO’s agreements in the situation in which a country’s government has engaged in large-scale, protracted intervention in exchange markets and thereby has been able to suppress its currency’s value significantly below what that value would be if set by market fundamentals. This behavior by China has caused the RMB to be undervalued relative to the U.S. dollar for some years now, and other countries have similarly undervalued their currencies, at least in some cases probably in order for those countries to remain competitive with China. The outcome of China’s policy is that the RMB’s real exchange rate with the U.S. dollar is estimated by nearly all observers to be undervalued by as much as 30 – 40 percent. This rate is set by the Chinese government such that a Chinese exporter, in exchange for U.S. dollars from its sales to customers in the United States, receives more RMB from the Chinese government’s banks than if the real exchange rate between the RMB and the U.S. dollar were in equilibrium.92

In the ASCM’s context, China’s actions yield a direct transfer of funds (RMB for U.S. dollars), in what amounts to a financial contribution by the Chinese government’s banks to the Chinese exporter within the meaning of Article 1.1(a)(1)(i) of the ASCM. This transfer also confers a benefit per Article 1.1(b) of the ASCM upon the Chinese exporter, because the Chinese exporter receives more RMB than if the RMB were not undervalued, and so is “better off” with the extra RMB to spend in China. At this juncture, the Chinese government’s undervaluation of the RMB can reasonably be described as a subsidy under the ASCM. The specificity of this subsidy can likewise be shown under the ASCM, because the Chinese company involved is not eligible for the extra RMB on its domestic sales in China and must export to establish its eligibility. This export-contingency is not dissolved by the fact that other Chinese holders of U.S. dollars obtained from non-export activities (such as foreign direct investment in China) also are eligible for the undervalued exchange rate.93

Once again, the practice of currency undervaluation works at cross-purposes with a fundamental rule of the World Trade Organization, in this instance the ban against export-contingent subsidies.

91 A sense of this matter’s political and legal intensity can be seen from the report and additional views issued by the Committee on Ways and Means of the U.S. House of Representatives in September 2010 in conjunction with H.R. 2378, the Currency Reform for Fair Trade Act. See H.R. Rep. No. 646, 111th Cong., 2d Sess. (2010). This bill passed the House on September 29, 2010, by a vote of 348 – 79, but died in the 111th Congress when no vote was taken in the Senate before adjournment sine die.

92 How the equilibrium value and extent of the RMB’s undervaluation might most correctly be computed is beyond the scope of this article and is considered in the companion article by Dr. Fred Bergsten. See, e.g., Correcting the Chinese Exchange Rate: An Action Plan, before the H. Comm. on Ways & Means, 111th Cong. (2010) (statement of Dr. C. Fred Bergsten, Peterson Institute for International Economics).

E. Article XI of the GATT and Elimination of Quantitative Restrictions

"...[E]xchange restriction is an alternative method of applying import quotas." Harry Dexter White

Article XI of the GATT is designed generally to eliminate quantitative restrictions on imports. Article XI:1 provides that "[n]o prohibitions or restrictions other than duties, taxes, or other charges, whether made effective through quotas, import ... licenses or other measures, shall be instituted or maintained by any contracting party on the importation of any product of the territory of any other contracting party ..."95 This language has been interpreted expansively to encompass all measures other than duties, taxes, or other charges that restrict the importation of products,96 and whether or not the measure actually has diminished imports, because the GATT’s purpose is interpreted as being the establishment and maintenance of conditions of competition for imports.97 A system by an importing country of setting minimum prices for imports, and of requiring additional security to enforce that system, for example, was struck down under GATT Article XI.98

Undervaluation by a country’s government of its currency does restrict and, if severe enough, prohibit imports, as commented earlier, by raising the prices for imports expressed in the importing country’s currency. That restriction or prohibition, made effective through the measure by the importing country’s government of undervaluing its currency, is not unlike the system just noted of minimum prices. The upshot of each measure is ultimately high-enough minimum prices in the importing country’s currency such that the conditions of competition in the importing country have been altered to the disadvantage of imports and an almost certain diminishment of the quantity of imports. Indeed, as Harry Dexter White pointed out, exchange restrictions act as an alternative to import quotas.99

F. Article XV of the GATT – Exchange Arrangements

Article XV is a candidate for the “most obscure provision in GATT.” Henry Dexter White100

1. Background

Article XV of the GATT is entitled, “Exchange Arrangements.” More than any other Article of the GATT, Article XV recognizes the close and extensive interdependence that exists between exchange action and trade action but does so in a somewhat general, inexact fashion. In light of the critical nature of its subject, Article XV’s obscurity is odd.

94 H.D. White, supra note 46, at 195, 208.
95 There are exceptions to Article XI:1: see, e.g., GATT, supra note 4, at art. XI:2. As when export prohibitions or restrictions are temporarily necessary to relieve critical shortages of foodstuffs.
99 H.D. White, supra note 46, at 195, 208.
One might reasonably think that Article XV would have been much more prominent than it has been. But, in fact, since the negotiations in the early years of 1946-48, at no time has there been any revision to GATT Article XV or any subsequent agreement that has expanded upon and clarified Article XV, such as the ASCM has done with Article VI and Article XVI of the GATT as to subsidies. For whatever political reasons, foremost probably the proclivity of nation states to guard their sovereignty over monetary affairs very jealously, member states of the WTO have left Article XV’s broad and, in places, amorphous language unchanged. Further, there has been very little occasion over the years when Article XV has been invoked or brought into play. The result of this history is that Article XV’s reach and utility have not yet been explored to any great extent and remain in key regards to be defined by any future negotiations and experiences. In any event, it should be kept in mind that Article XV’s acknowledgement of the interactive overlapping of exchange measures and trade measures stems directly from the terribly damaging competitive currency depreciation that was rampant between the two World Wars. GATT Article XV needs to be considered in that perspective as the result of a collective international effort intended to prevent the recurrence of that kind of bedlam.

2. Article XV’s Central Terms

There are three paragraphs and one interpretative note of Article XV that are, at least potentially, of principal importance to the issue of competitive currency depreciation. The first, GATT Article XV:4, states that “[c]ontracting parties shall not, by exchange action, frustrate* the intent of the provisions of this Agreement, nor, by trade action, the intent of the provisions of the Articles of Agreement of the International Monetary Fund.” GATT, Ad Article XV, para. 4, was included in 1946 to elaborate on the meaning of Article XV’s word, “frustrate,” and is worth quoting in full.

The word “frustrate” is intended to indicate, for example, that infringements of the letter of any Article of this Agreement by exchange action shall not be regarded as a violation of that Article if, in practice, there is no appreciable departure from the intent of the Article. Thus, a contracting party which, as part of its exchange control operated in accordance with the Articles of Agreement of the International Monetary Fund, requires payment to be received for its exports in its own currency or in the currency of one or more members of the International Monetary Fund will not thereby be deemed to contravene Article XI or Article XIII. Another example would be that of a contracting party which specifies on an import license the country from which the goods may be imported, for the purpose not of

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102 In his classic treatise, “World Trade and the Law of GATT,” supra note 70, at 483, John Jackson quoted the United States delegate at the 1946 drafting session in London in this regard.

[T]he basic provision with respect to exchange control is that exchange restrictions will not be imposed on imports from other members. That corresponds to the basic provision that quantitative restrictions will not be used, the one being regarded as an alternative to the other.

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introducing any additional element of discrimination in its import licensing system but of enforcing permissible exchange controls.\(^{103}\)

Article XV:4 of the GATT and its addendum must be read in conjunction with GATT Article XV:9 and GATT Article XV:2. Article XV:9 reads in part, “Nothing in this Agreement shall preclude: (a) the use by a contracting party of exchange controls or exchange restrictions in accordance with the Articles of Agreement of the International Monetary Fund or with that contracting party’s special exchange agreement with the CONTRACTING PARTIES...” Article XV:2 reads in part,

In all cases in which the CONTRACTING PARTIES are called upon to consider or deal with problems concerning monetary reserves, balances of payments or foreign exchange arrangements, they shall consult fully with the International Monetary Fund. In such consultations, the CONTRACTING PARTIES shall accept all findings of statistical and other facts presented by the Fund relating to foreign exchange, monetary reserves and balances of payments, and shall accept the determination of the Fund as to whether action by a contracting party in exchange matters is in accordance with the Articles of Agreement of the International Monetary Fund, or with the terms of a special exchange agreement between that contracting party and the CONTRACTING PARTIES.

3. Article XV’s Complexity and Applicability

As the paragraphs and addendum of Article XV suggest, Article XV of the GATT is not a model of clarity in important respects. Its overall purpose is evident – that the IMF and the WTO are to cooperate and coordinate with each other to achieve harmony between trade and exchange matters.\(^{104}\) As sensible as this goal of Article XV is, however, it is an ambitious one, and the framework and structure of Article XV leave unanswered a number of significant questions. Upon closer scrutiny, for instance, GATT Article XV:4 and GATT Ad Article XV, para. 4, do not really elucidate very well what sort of exchange action would properly be seen to “frustrate” the intent of one or more of the GATT’s other Articles. For that matter, ascertainment of whether a governmental measure is financial or trade in nature is not necessarily straightforward, and a given measure can be both.\(^{105}\) In addition, as between

\(^{103}\) GATT, supra note 4, at ad art. XV:4.

\(^{104}\) Along with GATT Article XV:2 just quoted, for example, Article XV:1 of the GATT instructs that the CONTRACTING PARTIES are to seek cooperation and a coordinated policy with the IMF concerning exchange questions falling within the IMF’s jurisdiction and questions of quantitative restrictions and other trade measures within the GATT’s jurisdiction.

\(^{105}\) See Report of the Special Sub-Group, Relations Between the GATT and the International Monetary Fund, 4-5, B.I.S.D. 35/170, 195, ¶ 2 (Mar. 2, 1955). This issue was also addressed, but ultimately not decided, in a dispute settlement in the early 1950s involving Greece. See Panel Report, Special Import Taxes Instituted by Greece, B.I.S.D. 15/48 (Nov. 1952) A charge levied by the Greek government on foreign exchange allocated for the importation of goods into Greece during a time when the drachma had depreciated in value vis-à-vis other countries’ currencies was described by Greece as the equivalent of a multiple currency practice. The panel considered the principal question raised to be whether the Greek tax was an internal tax under GATT Art. III:2 or a tax on foreign exchange allocated for payment of imports. In the latter event, if the Greek tax system were found by the IMF to be a multiple currency practice in conformity with the IMF’s Articles of Agreement,
Article XV:4 and Article XV:9(a), if exchange action causing protracted and significant undervaluation of a country’s currency were found by the IMF not to constitute manipulation of exchange rates under Article IV.1(iii) of the IMF’s Articles of Agreement, would that clearance by the IMF bar a finding in dispute settlement at the WTO that such undervalued misalignment violated one or more Articles of the GATT? Moreover, notwithstanding GATT Article XV:2, it is open to question in any given situation whether in practice the WTO and its member states will accept the IMF’s statistical and other factual findings relating to foreign exchange, monetary reserves, and balance of payments or a determination by the IMF as to whether exchange action by a member state is in accordance with the IMF’s Articles of Agreement.

As this recounting suggests, recourse to Article XV of the GATT to address the enforced, protracted, and fundamental undervaluation by a national government of its currency through means such as large-scale intervention in the exchange markets would likely precipitate extensive legal debate over a series of difficult and fascinating procedural and substantive issues. What jurisprudential and other guidance there has been under the GATT

the panel opined the tax would fall outside the scope of GATT Article III, but would in that situation prompt the further question under GATT Article XV:4 of whether the Greek government’s exchange action constituted frustration of the intent of GATT Article III. In 1953, the Government of Greece terminated the subject tax after devaluing the drachma in April of that year; See also ANALYTICAL INDEX: GUIDE TO GATT LAW AND PRACTICE 406-407 (6th ed. 1994).

One well-known scholar has commented upon the relationship between GATT Article XV:4 and GATT Article XV:9(a) as follows:

Exchange controls with effects equivalent to trade controls not permitted under the General Agreement frustrate the purposes of that Agreement. However, Article XV:4 has to be read in conjunction with Article XV:9(a) which exempts from all obligations under the General Agreement the use of exchange controls in accordance with the Fund Agreement. Whether the exemption of Fund-authorized exchange actions also relieves contracting parties of their obligation not to frustrate the General Agreement’s intent through exchange actions was discussed in 1954. The CONTRACTING PARTIES concluded that this question should be left “over for empirical consideration if and when particular points arose which had a bearing on it.” It is therefore still an open legal issue whether exchange controls frustrating the intent of the General Agreement, but imposed in conformity with the Fund Agreement, are at variance with the provisions of the General Agreement or not.
to this juncture would outline many of the conceptual difficulties and possibilities involved, but probably would not clearly lead to a conclusion one way or the other. On balance, however, it seems reasonable to say that a fundamentally undervalued currency that has been misaligned by its country's government seriously erodes the GATT's underpinnings, as has been described in this section. Whether the deterioration caused by that exchange action would be found to "frustrate" the intent of one or more of the GATT's Articles within the meaning of Article XV:4 of the GATT would be left for dispute settlement.

G. Summary

The foregoing survey of provisions in the GATT that interact with monetary measures and can readily be rendered ineffective by competitive currency depreciation is not comprehensive. Nor should this review be taken as a legal brief to demonstrate that, in dispute settlement against a country's enforced undervaluation of its currency, nullification or impairment of one or another of the GATT's Articles would or should be found. Instead, the limited and exclusive purpose of this section has been to take a selective look at several of the GATT's provisions that deal with non-discrimination, quantitative restrictions, and subsidies in international trade in goods - topics that also are germane, of course, to international trade in services under the General Agreement on Trade in Services - and to reflect briefly on how corrosive competitive currency depreciation is to these core values of the international trading system. Harry Dexter White was correct in his point made toward the end of the Second World War that the reduction of barriers to international trade is not possible without the assurance of orderly exchange rates and freedom in exchange transactions for trade purposes. That insightful observation and axiom are no less true today than back then. The question is whether the international community will rise to the occasion at this time - when the world is so much more interdependent and heavily populated than in White's time, and consequently is more vulnerable than in the 1930s and 1940s to the destructive repercussions that can flow from competitive currency depreciation - and act wisely and soundly to curtail this practice and contain its negative effects.

VI. COMPETITIVE CURRENCY DEPRECIATION UNDERMINES THE IMF'S ARTICLES

The drafters of both the IMF's Articles of Agreement and the GATT recognized that no international trading system can function and prosper without an orderly international exchange system. Keynes and White agreed that exchange rates were a matter of international concern and that they should be relatively stable and tempered by a certain flexibility when demanded by circumstances. Though the Bretton Woods system collapsed more than thirty years ago, the fundamental obligations of its members have not changed. Member

108 Law of GATT, supra note 70, at 492. Other GATT obligations regarding currency restrictions include Articles VII:4(a) and (c) on conversion of currencies and valuation of goods for customs purposes, Articles VIII:1 and VIII:4 on exchange controls and fees and formalities connected with the importation and exportation of goods, and Articles XII, XIII, XIV, and XVIII, Section B, on balance-of-payments exceptions.
109 See GATT, supra note 4, at art. XXIII.
110 H.D. White, supra note 46, at 195, 208.
111 TLAG, supra note 11, at 1.
states of the IMF must maintain reasonably valued currencies, altering or maintaining exchange rates only for legitimate ends with the concurrence of the IMF. Competitive currency depreciations debase the founding principles of the IMF, and the ongoing failure of the IMF to address the practice effectively erodes the IMF’s legitimacy.

A. Though the Bretton Woods System Collapsed in the 1970s, the IMF’s Articles Remain Antithetical to Competitive Currency Depreciation

Even though the Bretton Woods system continued the pre-war reliance on gold as the basis of its par-value system, it was a radical departure from the pre-war belief that every nation had an unlimited sovereign right to set its currency’s exchange rate. Article IV, Section 5 of the IMF’s original Articles of Agreement allowed a member state to change the par value of its currency only to correct “a fundamental disequilibrium,” a concept that has never been defined by the Articles of Agreement and that the IMF has never further elaborated upon. "The subject of how the IMF should treat proposals to revalue was very controversial, with the United States favoring exchange stability and the IMF’s authority over members and with Britain emphasizing elasticity and members’ rights against the IMF.” Changes in the par value of currencies were relatively infrequent in the period from the birth of the IMF through the 1950s.

Par value changes had not been frequent. The general devaluation of 1949, initiated by Britain and followed in varying degrees by other countries, was looked upon as exceptional, representing a one-shot adjustment to postwar conditions and, in fact, was strongly encouraged by the United States. After that, Canada decided in 1950 to let its currency float, and France devalued in two steps in 1957-58. No other industrial country changed its par value. Par value changes and multiple currency practices occurred much more often among developing countries, in cases where inflation was rapid or where the terms of trade moved adversely.

The Bretton Woods system, with its emphasis on exchange-rate stability, oversaw twenty-five years of economic growth while Japan, Germany, England, France, and other belligerents during the war gradually regained their economic strength. “[M]ultinational corporations made great strides, and restoration of currency convertibility and growth of domes-

112 Joseph Gold, supra note 48, at 28.
113 See China’s WTO Compliance and Industrial Subsidies, Hearing before the U.S.-China Economic and Security Review Commission (Apr. 4, 2006) (statement of Dr. C. Fred Bergsten, Peterson Institute for International Economics); ROBERT SOLOMON, THE INTERNATIONAL MONETARY SYSTEM, 1945-1976 13 (1977) [hereinafter "Robert Solomon"]. One other variation of the par-value system worth mentioning is the “scarce-currency” clause in Article VII of the IMF’s original Articles of Agreement. Under this provision, if a member ran excessive trade surpluses, the IMF could formally declare that member’s currency to be scarce, in which event other members were authorized, after consultation with the IMF, to impose temporary limitations on the freedom-of-exchange operations in the scarce currency. Article VII was borne of concern that the United States’ preeminent position as the world’s supplier and economic power in the early post-war period would lead to its accumulation of enormous amounts of foreign reserves and a shortage of U.S. dollars for other countries, but Article VII was not functional, was never invoked, and was abolished.
114 TLAG, supra note 11, at 14 (referencing Joseph Gold, supra note 48, at 30).
tic liquidity in industrialized countries increased the volume of funds that could be transferred internationally.\textsuperscript{116}

The Bretton Woods system began to unravel in the late 1960s when officials of the various major economic powers and members of the IMF recognized the need for greater flexibility in international monetary exchange rates. While the par-value system did not require strict rigidity, exchange-rate adjustments were a serious matter, and the IMF addressed members' short-term cyclical imbalances with policies other than exchange-rate adjustment, such as borrowing from the IMF.\textsuperscript{117} The situation had almost completely reversed from 1947. The United States ran a balance-of-payments deficit with rising inflation while Germany, Japan, and Italy had very large trade surpluses.\textsuperscript{118} "A widespread view was taking root that a way was needed for countries routinely and in a de-politicized procedure, without endangering the prestige of their governments, to be able to make 'small and frequent' changes in their exchange rates. As part of this process and as a first step toward the 'banalization' and dethroning of gold as the IMF’s ultimate standard of value, the IMF’s Articles of Agreement were amended in July 1969 (the “First Amendment”) to introduce the Special Drawing Right (‘SDR’) as the IMF’s unit of account and also as an unconditional line of credit for participating members."\textsuperscript{119} By 1971, the Bretton Woods’ par-value, gold-standard system had fallen apart. After years of currency speculation and gold flight from the United States, the U.S. suspended convertibility of the dollar into gold, thus terminating the Bretton Wood’s par-value system.\textsuperscript{120} Thereafter the IMF attempted to establish an orderly structure of stable exchange rates that did not rely upon a gold-based, par-value system.

After considerable diplomatic and legal work, the Interim Committee of the IMF’s Board of Governors agreed on the text of the amended Articles of Agreement (the “Second Amendment” or “Jamaica Agreement”).\textsuperscript{121} The so-called Jamaica Agreement accepted the fait accompli that had emerged after the 1971 par-value breakdown, permitting members to establish exchange arrangements of their choice while tasking the IMF with the “role of carrying out surveillance of members’ exchange-rate policies and adopting specific principles to guide members in regard to those policies.”\textsuperscript{122} Since the Second Amendment, which formally became effective as of April 1, 1978, the IMF’s members have chosen a variety of exchange arrangements from hard-peg to floating regimes.\textsuperscript{123} Though the IMF’s members were subsequently free to choose the exchange-rate regime they saw fit, they were still required to adopt a regime that complied with the IMF’s Articles, and the IMF still reserved the right to review members’ policies.

\textsuperscript{117} Robert Solomon, supra note 113, at 12.
\textsuperscript{118} TLAG, supra note 11, at 15.
\textsuperscript{119} Id. at 15 (internal citations omitted).
\textsuperscript{120} Id. at 16 (referencing Joseph Gold, supra note 48, at 62).
\textsuperscript{121} Robert Solomon, supra note 113, at 224.
\textsuperscript{122} TLAG, supra note 11, at 16 (referencing NORTH-SOUTH: A PROGRAM FOR SURVIVAL, THE REPORT OF THE INDEPENDENT COMMISSION ON INTERNATIONAL DEVELOPMENT ISSUES UNDER THE CHAIRMANSHIP OF WILLY BRANDT 205-206 (1980)).
\textsuperscript{123} Some IMF Members have chosen so-called Soft-Peg Regimes that include conventional fixed pegs, crawling pegs, and crawling bands.
B. Competitive Currency Depreciation and the Second Amendment

Article IV of the amended Articles of Agreement is particularly relevant to the discussion of competitive currency depreciation in the modern era. The amended Article IV no longer refers to “Obligations regarding exchange stability” but rather to “Obligations Regarding Exchange Arrangements.” Article IV’s Section 1 on “General obligations of members” and Section 3 on “Surveillance over exchange arrangements” are the heart of the current Article IV.124

Article IV. Obligations Regarding Exchange Arrangements.

Section 1. General obligations of members.

Recognizing that the essential purpose of the international monetary system is to provide a framework that facilitates the exchange of goods, services, and capital among countries, and that sustains sound economic growth, and that a principal objective is the continuing development of the orderly underlying conditions that are necessary for financial and economic stability, each member undertakes to collaborate with the Fund and other members to assure orderly exchange arrangements and to promote a stable system of exchange rates. In particular, each member shall:

(i) endeavor to direct its economic and financial policies toward the objective of fostering orderly economic growth with reasonable price stability, with due regard to its circumstances;

(ii) seek to promote stability by fostering orderly underlying economic and financial conditions and a monetary system that does not tend to produce erratic disruptions;

(iii) avoid manipulating exchange rates or the international monetary system in order to prevent effective balance of payments adjustment or to gain an unfair competitive advantage over other members; and

(iv) follow exchange policies compatible with the undertakings under this Section.

* * * *

Section 3. Surveillance over exchange arrangements.

(a) The Fund shall oversee the international monetary system in order to ensure its effective operation, and shall oversee the compliance

124 TLAG, supra note 11, at 17.
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of each member with its obligations under Section 1 of this Article.

(b) In order to fulfill its functions under (a) above, the Fund shall exercise firm surveillance over the exchange rate policies of members, and shall adopt specific principles for the guidance of all members with respect to those policies. Each member shall provide the Fund with the information necessary for such surveillance, and, when requested by the Fund, shall consult with it on the member’s exchange rate policies. The principles adopted by the Fund shall be consistent with cooperative arrangements by which members maintain the value of their currencies in relation to the value of the currency or currencies of other members, as well as with other exchange arrangements of a member’s choice consistent with the purposes of the Fund and Section 1 of this Article. These principles shall respect the domestic social and political policies of members, and in applying these principles the Fund shall pay due regard to the circumstances of the members.

Exchange-rate surveillance is a central pillar of the IMF’s responsibility to oversee the international monetary system. On April 29, 1977, the IMF issued specific principles and procedures for Article IV, Section 3, which were themselves later augmented by the 1979 Decision on Surveillance: Ad Hoc Consultations. The 1979 Decision essentially enabled “the IMF’s Managing Director to undertake ad hoc consultations with a member at anytime, in addition to the member’s regularly scheduled consultations, if the circumstances of the member’s exchange arrangement or exchange-rate policies warranted in the Managing Director’s judgment.”125 The 1988 Decision to Eliminate Annual Procedural Reviews subsequently amended the 1979 Decision and stipulated “that the IMF’s Executive Board shall review the general implementation of the IMF’s surveillance over members’ exchange-rate policies at intervals of two years and at such other times as consideration of it is placed on the Executive Board’s agenda.”126

The IMF’s 1977 Decision cited three main principles of guidance for members’ exchange-rate policies:

1. The avoidance of exchange-rate manipulation or manipulation of the international monetary system in order to prevent effective balance-of-payments adjustment or to gain an unfair competitive advantage over other members;

2. Reliance upon intervention in the exchange market by a member if necessary to counter disorderly conditions characterized by disruptive short-term movements in the exchange value of the member’s currency; and

125 TLAG, supra note 11, at 18.
126 Id. at 18 (referencing 1979 Decision on Surveillance: Ad Hoc Consultations, Decision No. 6026-(79/13) (IMF, Jan. 22, 1979); and 1988 Decision to Eliminate Annual Procedural Reviews, Decision No. 8856-(88/64) (IMF, Apr. 22, 1988)).
3. Consideration by a member, in the implementation of its intervention policies, of interests of other members, including those members in whose currencies the member intervenes.\textsuperscript{127}

The 1977 Decision also identified certain factors that might indicate the need for further discussion with members:

1. Protracted, large-scale intervention in one direction in the exchange market;

2. An unsustainable level of official or quasi-official borrowing, or excessive and prolonged short-term or quasi-official lending, for balance-of-payment purposes;

3. The introduction, substantial intensification, or prolonged maintenance, for balance-of-payment purposes, or restrictions on, or incentives for, current transactions or payments;

4. The introduction or substantial modification for balance-of-payments purposes or restrictions on, or incentives for, the inflow or outflow of capital;

5. The pursuit, for balance-of-payments purposes, of monetary and other domestic financial policies that provide abnormal encouragement or discouragement of capital flows;

6. Behavior of an exchange rate that appears to be unrelated to underlying economic and financial policies that provide abnormal encouragement or discouragement to capital flows; and

7. Unsustainable flows of private capital.\textsuperscript{128}

C. The Ongoing Obligations of the IMF’s Members Regarding Exchange Arrangements and Further Efforts by the IMF to Improve Surveillance

Despite the collapse of the Bretton Woods system and the drafting and approval of the Second Amendment of the IMF’s Articles in the 1970s, competitive currency depreciation remains an anathema to the IMF’s fundamental charter to monitor and regulate the international monetary order. As a matter of first principle, the end of the Bretton Woods system did not signify a return to the belief that each nation has an unfettered sovereign right to determine its own exchange rate. Even under the IMF’s amended Articles, nations must choose a currency exchange regime and submit to IMF surveillance and consultation to prevent abuse. As noted earlier, “The proposition of universal sovereign authority to determine a country’s exchange rate is a logical absurdity if the exchange rate at issue is that between different national currencies. For example, if China possesses the sovereign right to set the value of the yuan at,
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say, 8 yuan to the dollar, then the United States must symmetrically possess the absolute sovereign right to set the exchange rate of the dollar at 4 yuan per dollar.”

1. Article IV(1)

Section 1 of Article IV of the IMF’s amended Articles of Agreement clearly requires each of the IMF’s members to collaborate with the other members and with the IMF to “assure orderly exchange arrangements and to promote a stable system of exchange rates.” Rather than being hortatory in nature, this directed collaboration is the legal basis for “the Fund to call on members to take specific actions or to refrain from taking specific actions.” For example, Section 1 is what empowers the IMF’s Research Department to prepare its International Capital Markets Reports in overseeing the international monetary system. Under Section 1, “the Fund [can] call on its members’ general obligation to collaborate with it and with each other as required to remove any significant impairment or forestall any threatened impairment of the effective functioning of the international monetary system.”

2. Section IV(1)(iii)

Against the backdrop of the requirement that the IMF’s members must collaborate with the IMF on currency policy and thus do not have carte blanche to value their currencies, Article IV, Section 1(iii) is “the key specific obligation that relates to exchange rates.” Again, for emphasis, Article IV(1)(iii) provides positive duties for the IMF’s members to “avoid manipulating exchange rates or the international monetary system in order to prevent effective balance of payments adjustment or to gain unfair competitive advantage over other members.” Compliance with Article IV(1)(iii) thus hinges on (1) whether a member has deliberately manipulated its exchange rate and, in that event, (2) whether that member has done so in order to prevent effective balance-of-payments adjustment or to gain an unfair competitive advantage over other members.

Intent is a key consideration in Article IV(1)(iii). Not only must the IMF’s member actually manipulate its currency to run afoul of subsection (iii), it must do so with impermissible intent. On June 15, 2007, the IMF’s Executive Board adopted a “Decision on Bilateral Surveillance over Members’ Policies,” completing a year-long review of the 1977 Decision. Though the 2007 Decision repeals and replaces the 1977 Decision, it carries forward

129 Mussa, supra note 48, at 8. Even more succinctly, “Exchange rates, by their very nature, involve more than one side and are therefore a reflection of a multilateral system.” Liaquat Ahmed, Lords of Finance 268 (1st ed. 2009).
130 Id. at 9 (quoting IMF, supra note 3, at art. IV(1)).
132 Mussa, supra note 48, at 10.
133 Id. at 10 (bracketed language added).
134 Id. at 10.
135 IMF, supra note 3, at art. IV(1)(iii).
136 See International Lawyer, supra note 45, at 1278.

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the sum and substance of the 1977 Decision with a few key changes. For example, the 2007 Decision adds a fourth recommended (not obligatory) principle of guidance that the IMF’s members should avoid exchange-rate policies that result in external instability.138 The 2007 Decision also adds new principles and factors to be weighed by the IMF in its surveillance of exchange-rate regimes:

1. Fundamental exchange-rate misalignment;

2. Large and prolonged current-account deficits or surpluses; and

3. Large external-sector vulnerabilities, including liquidity risks, arising from private capital flows.139

With regard to currency manipulation, the 2007 Decision states:

(a) “Manipulation” of the exchange rate is only carried out through policies that are targeted at — and actually affect — the level of an exchange rate. Moreover, manipulation may cause the exchange rate to move or may prevent such movement.

(b) A member that is manipulating its exchange rate would only be acting inconsistently with Article IV, Section 1(iii) if the Fund were to determine that such manipulation was being undertaken “in order to prevent effective balance of payments adjustment or to gain an unfair competitive advantage over other members.” In that regard, a member will only be considered to be manipulating exchange rates in order to gain an unfair competitive advantage over other members if the Fund determines both that: (A) the member is engaged in these policies for the purpose of securing fundamental exchange rate misalignment in the form of an undervalued exchange rate and (B) the purpose of securing such misalignment is to increase net exports.140

Also very importantly, the 2007 Decision elaborates on how the IMF decides when a member’s intent is inconsistent with Article IV(1)(iii), observing that “. . . the Fund [must] make an objective assessment of whether a member is observing its obligations under Article IV, Section 1 (iii), based on all available evidence, including consultation with the member concerned.”141 Furthermore, “Any representation made by the member regarding the purpose of its policies will be given the benefit of any reasonable doubt.”142

Unfortunately, even this additional guidance from the IMF’s Executive Board does not entirely clarify the standard of intent under Article IV(1)(iii). It naturally begs the question of whether the IMF or a complainant must demonstrate through clear and convincing evidence that the exclusive purpose of the undervaluation was to obtain an unfair trade advan-

138 TLAG, supra note 11, at 20; quoting 2007 Decision, supra note 137, at 9, Part II, ¶14.
139 2007 Decision, supra note 137, at 9, Part II, ¶15.
140 Id. at 12-13, Annex, ¶ 2.
141 Id. at 13, Annex, ¶ 3 (bracketed language added).
142 Id. at 13, Annex, ¶ 3.
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tage. Or is it sufficient to argue that an unfair trade advantage is the obvious, natural, and actual consequence of the undervaluation and so intended?

As discussed earlier, the 2007 Decision continues the practice of ad hoc consultation between the IMF’s Managing Director and the member in question outside the normal surveillance schedule if the Managing Director concludes that step is necessary to ensure adequate compliance with the IMF’s Articles of Agreement. Paragraph 20(a) of the 2007 Decision permits the Managing Director to initiate confidential and informal discussions with members maintaining exchange-rate policies that are likely to be affected by important economic or financial developments. Since 2007, however, the IMF appears to have had some difficulty in applying the 2007 Decision either in general or with regard to specific allegations of competitive currency depreciation. In an announcement on August 12, 2008, the IMF attempted to clarify how exchange-rate regimes would be monitored under the 2007 Decision, but also observed that efforts had thus far been hampered by “technical difficulties in evaluating exchange-rate [equilibriums] and that frankness called for in some discussions of exchange rates has been a sensitive matter.”

D. The IMF Has No Greater Responsibility Than the Curbing of Competitive Currency Depreciation, Yet the Question is Whether the IMF Can Fulfill that Role

As the drafters of the IMF’s Articles of Agreement recognized in the 1940s, a government’s artificial depreciation of its currency threatens to impair the effective functioning of the international monetary and trading systems. “Contemporary economic theory has built upon the global community’s painfully gained experience in the 20th century to arrive at a solid, and generally-agreed upon, foundation for defining currency misalignment using the concept of an equilibrium exchange rate.” Competitive currency depreciation rejects a century’s worth of economic experience and instead favors a beggar-thy-neighbor approach. Though such undervaluation can lead to incredible short-term growth for a government that adopts this practice, over the longer term even that government will pay a heavy price at the

143 TLAG, supra note 11, at 22.
144 Id. at 22-23.
145 Id. at 23; see also Report to Congress on Implementation of the International Monetary Fund’s 2007 Decision on Bilateral Surveillance over Members’ Policies, U.S. DEP’T OF TREASURY (Aug. 28, 2008), available at www.treas.gov/press/releases/hpl122.htm. Using less diplomatic language, the U.S. Department of Treasury issued a “Report to Congress on Implementation of the International Monetary Fund’s 2007 Decision on Bilateral Surveillance Over Members’ Policies,” which took a dim view of the IMF’s record of “firm surveillance” over the international monetary system. The report expressed frustration with the IMF’s implementation, describing results as “mixed” and remarking that “...difficult cases have been repeatedly and unnecessarily delayed for considerable periods due to debates about the meaning of the 2007 Decision.” Furthermore, “While the consensus-based nature of the IMF is critical for its cooperative character, when the Fund’s powers of persuasion and candor have not resulted in meaningful change after a prolonged period, it is imperative that the Fund speak out forcefully and publicly about harmful country exchange rate policies.”
146 TLAG, supra note 11, at 37, “An equilibrium exchange rate is a calculable benchmark rate under which trade by a nation with its trading partners and domestic growth within that nation are sustainable. While the level of the equilibrium exchange rate for any given currency with other currencies changes over time in response to dynamic conditions, a long-term departure from an equilibrium exchange rate can lead to macroeconomic instability both for a nation whose currency diverges from that equilibrium and for its trading partners as well.”
expense of its country's institutions and market infrastructure.\footnote{TAG, \textit{supra} note 11, at 38.} Competitive currency depreciation by a country, in other words, impinges not only upon the interests of that nation's trading partners, but also poses grave risks and costs to the country that engages in the practice.\footnote{Id. \textit{See also}, \textit{China Currency Under Pressure} \textit{Wash. Post}, May 3, 2011, at A-16 [hereinafter "\textit{China Currency Under Pressure}"]\textmd{. The Chinese government's policy of setting a low exchange rate contrary to market forces is increasingly being recognized in China as exacerbating inflation of prices for important items such as imported fuel and food, restricting domestic consumption, and limiting international use of the renminbi.}.\footnote{TAG, \textit{supra} note 11, at 40.}

From every vantage, competitive currency depreciation destabilizes and undercuts the global economic balance by affecting – in ways contrary to the market's normal workings and fundamentals of supply and demand – the prices of goods, services, and investments in transactions across national boundaries:

1. The aggregate effect of competitive currency depreciation is a shift in investment away from domestic industries and banking and toward export-oriented businesses, which are the principal beneficiaries of an artificially undervalued currency.\footnote{Id. \textit{(referencing Dani Rodrick, \textit{The Real Exchange Rate and Growth: Theory and Practice} 33 (July 2007)).}} Producers in countries that do not undervalue their currencies are put at a competitive disadvantage compared to their counterparts in countries that undervalue.

2. Competitive currency depreciation increases domestic political pressure in the non-depreciating trading partners to adopt protective policies like tariffs and countervailing duties.

3. The citizens living in the depreciating economies have an artificially handicapped buying power for foreign-produced products.

4. Protracted currency depreciation by one country may cause trade deficits in countries that trade with that country, which deficits over time pressure trading partners to issue debt. Should the debt markets become tight, trading partners may be forced to pay higher rates of interest on their debt and increase the likelihood of default.\footnote{Id. \textit{(referencing Aguirre, Alvaro, and Cesar Calderon, \textit{Real Exchange Rate Misalignments and Economic Performance, 5 Central Bank of Chile} (Economic Research Division, Apr. 2005)).}}

5. Currency depreciation distorts the free-market allocation of goods.\footnote{Id.} Consequently, export-oriented industries benefit from an artificial competitive advantage that has nothing to do with the efficient allocation of goods and production. Likewise, exporting industries in trading-partner countries suffer from an artificial competitive disadvantage. As a result, consumers in both nations make purchases based on distorted market signals.\footnote{Id.}
The IMF's Articles as they exist today already provide sufficient legal basis to challenge competitive currency depreciation. As previously discussed above, Article IV(1) makes clear that IMF members cannot do whatever they like with respect to their exchange arrangements or exchange-rate policies. They are subject to Article IV(1)'s general obligation "... to collaborate with the Fund and other members to assure orderly exchange arrangements and to promote a stable system of exchange rates." Collaboration is not mere precatory language, but rather is "... a basis for the Fund to call on members to take specific actions or to refrain from taking specific actions." The IMF is affirmatively charged with overseeing the international monetary system and empowered to call on its members to collaborate actively to make policy changes where necessary.

Furthermore, under Article IV(1), "... each member shall... (iii) avoid manipulating exchange rates or the international monetary system in order to prevent effective balance of payments adjustment or to gain an unfair competitive advantage over other members. ..." What can be said about the requisite intent for manipulation and the IMF's policing authority? The element of intent should be viewed in Article IV's broader context and in the context of the Fund's surveillance guidelines.

First, Article IV, Section 3(a) states that "[t]he Fund shall oversee the international monetary system in order to ensure its effective operation, and shall oversee the compliance of each member with its obligations under Section 1 of this Article." Under Article IV, Section 1, each member also undertakes to collaborate with the Fund and other members to assure orderly exchange arrangements and to promote a stable system of exchange rates. When these provisions are taken together, it can be seen that the IMF has broad authority to request that a member modify an exchange-rate policy that the IMF reasonably finds threatens to impair or is actually impairing the effective functioning of the international monetary system.

Second, the IMF can weigh carefully just how much deference it should show to members with obvious and serious undervaluation policies manifested, for instance, in large and persistent foreign-exchange reserves and trade and investment surpluses. If a nation's competitive currency undervaluation has the clear effect of conferring upon its exporting industries a competitive advantage, any attempt by that country to argue that such was not its intent should be open to skepticism. Put another way, if X is the obvious and actual result of Y, is an assumption warranted that a member pursued Y without intending X? In addition, if the undervaluing member asserts that its policy is meant legitimately to stabilize its domestic economy, it is only reasonable that the IMF should exercise its authority by examining with the member whether some other means would accomplish that purpose without having

153 IMF Legal Department Paper, supra note 131, at 9, ¶ 20 (Article IV(1)'s general obligation includes more than just the four specific obligations set forth with particularity in subsections (i) through (iv), otherwise the general obligation in Article IV(1) would be redundant).
154 IMF Legal Department Paper, supra note 131, at 9, ¶ 22.
155 IMF, supra note 3, at art. IV(1)(iii).
156 Id. at art. IV(3).
157 See, e.g., Mussa, supra note 48, at 14.
158 Id.
159 Mussa, supra note 48, at 75, In the case of China, Mussa poses this question: "If the purpose of China's policy is not actively to pursue unfair competitive disadvantage to boost domestic employment, one might well ask, why have the Chinese authorities engaged for so long in such massive, largely sterilized, intervention to resist appreciation of the yuan?"
the impact of giving an unfair competitive advantage to that member over other members and without preventing effective adjustment to the balance of payments.

In an evaluation of the IMF, it is important not to lose sight of the fact that there is still an international monetary system dating from the Second World War and to keep in mind that this system was meant to anchor and facilitate a sustainably balanced international trading system, by an agreed curtailment of national sovereignty for the greater good, so that standards of living in all countries around the globe can peacefully improve. Fundamental misalignment of exchange rates can reasonably be seen as an improper reassertion of sovereignty by the undervaluing country and is a severe impediment to the realization of the monetary and trading systems' shared goal. The longer this practice is tolerated and allowed to fester, the worse the repercussions and lack of progress can be expected to be and the greater the weakening of each system likely will be.160

Unfortunately, without its own dispute settlement mechanism like that of the World Trade Organization, the IMF ultimately has little leverage other than moral suasion, especially over a member that is awash in foreign reserves gained from competitive currency depreciation. The international monetary system needs to be reinvigorated, and national sovereignty needs to give way sufficiently to effect that purpose. The relevant text of the IMF's Articles of Agreement on exchange arrangements is only sufficient if the members' political consensus for meaningful enforcement is present. Whether such a political consensus can emerge remains to be seen, even as the strength and effectiveness of the system have continued to be tested by a rash of competitive currency depreciation over the last decade or so, most prominently by China.161

160 Id. at 37-38, "Payments imbalances can grow too large and go on too long, and exchange rates can become seriously misaligned. This may reflect either errant government policies or market forces that have gone wrong, or a combination of the two. The correction of such disequilibria can be damaging and disruptive for individual countries and their trading partners, for regions, and even for the world as a whole."

161 In regard to the political front, two points are worth making. First, whether apocryphal or not, an unnamed finance minister of a large developing country some years ago is said to have summarized the situation at the IMF, "cynically but not entirely inaccurately," as follows: "When the Fund consults with a poor and weak country, the country gets in line. When it consults with a big and strong country, the Fund gets in line. When the big countries are in conflict, the Fund gets out of the line of fire." (Paul Volcker & Toyoo Gyohten, Changing Fortunes, 143 (1992)) (cited in International Economic Law 2003, supra note 13, at 506 n.28.

Second, the Group of 20, comprised of countries having the largest economies in the world, was established in 1999 after the Asian Financial Crisis of 1997-1998 and meets periodically to discuss measures to promote global financial stability and sustainable growth and development. After its most recent meeting of finance ministers and central bank governors on April 14-15, 2011, in Washington, D.C., the G-20 issued a communiqué that reported, in part, agreement to strengthen the international monetary system by focusing, "... in the short term, on assessing developments in global liquidity, a country specific analysis regarding drivers of reserve accumulation, [and] a strengthened coordination to avoid disorderly movements and persistent exchange rate misalignments. We also agreed on the need to strengthen further the effectiveness and coherence of bilateral and multilateral IMF surveillance, particularly on financial sector coverage, fiscal, monetary and exchange rate policies." Communiqué – Meeting of Finance Ministers and Central Bank Governors, Washington, DC, 14-15 April 2011, ¶ 4, G-20, available at www.g20.org/index.aspx (bracketed language added).

It is difficult to predict how the political dynamics of exchange-rate misalignment and competitive currency depreciation will unfold and whether the IMF will be able to have more influence in the future in this area than it has thus far, particularly as the United States and a number of other countries - such as the members of the European Union, Japan, and Brazil - have been at odds with China over China's enforced undervaluation of the renminbi.
VII. COMPETITIVE CURRENCY DEPRECIATION, FOREMOST BY CHINA, STILL PLAGUES THE INTERNATIONAL MONETARY AND TRADING SYSTEMS AND CALLS FOR ENHANCED COLLABORATION BY THE INTERNATIONAL MONETARY FUND AND THE WORLD TRADE ORGANIZATION

“When the Fund consults with a poor and weak country, the country gets in line. When it consults with a big and strong country, the Fund gets in line. When the big countries are in conflict, the Fund gets out of the line of fire.” Anonymous

A. Background

Despite the history recounted in this article, competitive currency depreciation remains a serious problem. China’s persistent undervaluation of the renminbi – most pronouncedly since China joined the WTO on December 1, 2001 – highlights the need for greater cooperation between the IMF and the WTO to rein in destructive, competitive currency depreciation. As one of the two largest economies in the world, China’s significant undervaluation of its currency has been contributing substantially to national and international imbalances in employment, trade in goods and services, and investment. Though the U.S. Department of Treasury has noted that other nations also tightly manage their currencies, China remains the most egregious and influential abuser of undervalued exchange-rate misalignment and probably has led some other national governments to adopt this approach as well in order to keep pace with China economically, the essence of competitive currency depreciation.

Whether or not China is a “currency manipulator” with the requisite intent under Article IV(1)(iii) of the IMF’s Articles of Agreement is not the focus here. Instead, as the sections above have outlined, by its nature competitive currency depreciation has the effect of taking a terrible toll both on the efficient functioning of the global economy and on the integrity and efficacy of the agreements and institutions of the IMF and the WTO. In order to address this practice successfully, the IMF and the WTO need to coordinate to magnify their respective strengths and to minimize their respective weaknesses. In fact, both institutions have an obligation to consult and cooperate with each other in the discharge of their respective and complementary mandates with a view to achieving greater coherence and success in global economic policymaking. Seen from this perspective, the competitive currency depreciation exhibited by China and other countries stands as a rigorous challenge to the IMF and the WTO.


163 Thus, for example, the IMF itself has no procedures for dispute settlement to enforce its mandate of surveillance, while the WTO has a dispute-resolution mechanism, but thus far has been reluctant to link trade issues and undervaluation of currencies. JONATHAN E. SANFORD, CONG. RESEARCH SERV., CURRENCY MANIPULATION: THE IMF AND WTO 4 (Jan. 26, 2010) [hereinafter “CRS Report”].

B. China Deliberately and Significantly Undervalues the Renminbi

There is a nearly universal consensus that China has long pursued a policy of intervening in currency markets to keep the value of the renminbi artificially low and has been committing tremendous amounts of capital, time, and political resources to that end. In the eyes of China’s leaders who have authored this strategy, all the effort involved apparently has been worthwhile from their perspective. How, to what extent, and why China has been undervaluing its currency for so long a time are questions worth exploring to obtain a better understanding of China’s policy and its ramifications.

1. China’s Enforcement of the Renminbi’s Undervaluation

Various countries in recent years have been suspected or accused of manipulating the value of their currencies for the purpose of gaining an unfair advantage in trade and accumulating foreign reserves by enhancing exports and reducing imports. The George W. Bush administration frequently urged China to revalue its currency, but never outright accused China of “manipulating” its currency. In contrast, during his confirmation hearing on January 23, 2009, then Treasury Secretary-designate Timothy Geithner reported that “President Obama, backed by the conclusions of a broad range of economists, believes that China is manipulating its currency.” Most recently in February 2011, in its semi-annual Treasury Report, the Obama Administration nevertheless once more declined to label China a currency manipulator, but again cited the People’s Republic of China for substantially undervaluing the renminbi. The Treasury Report noted official Chinese assurances that China would relax restrictions on the renminbi and allow it to appreciate more rapidly against other currencies, including the dollar. The Treasury Report also remarked upon an emerging belief in China that the world’s second largest economy cannot depend on an export-led growth strategy indefinitely and that future growth will likely require currency flexibility.

The failure to label China a currency “manipulator” disappointed American trade and labor groups that have long maintained that China has deliberately undervalued its currency with the results of making Chinese exports to the United States and third-country markets less costly and U.S. and third-country exports to the Chinese market more expensive than they would otherwise be absent massive Chinese governmental intervention in the exchange markets. However, the Report did stress that Chinese progress on revaluing the renminbi

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165 See CRS Report, supra note 163, at 3.
166 Id. In addition, both then-Senator Barack Obama (D-IL) and then-Senator Hillary Clinton (D-NY) were co-sponsors of S. 796, the Fair Currency Act of 2007, introduced by Senator Jim Bunning (R-KY). This legislation, which was not acted upon, included clarification that exchange-rate misalignment can be treated as a countervailable subsidy under U.S. law consistently with the WTO’s relevant provisions and agreements on subsidies.
168 Id. at 12.
169 Id. at 14.
170 Sewell Chan, supra note 167; see also Treasury Report, supra note 162, at 2. “The Omnibus Trade and Competitiveness Act of 1988 [sic] requires the Secretary of the Treasury to provide semi-annual reports on international economic and exchange rate policies of the major trading partners of the United States. Under Section 3004 of the Act [22 U.S.C. § 5304], the Report must consider whether countries manipulate the rate of exchange between their currency and the United States dollar for the purpose of preventing effective balance of
so far was insufficient in light of the Administration’s belief that the renminbi is undervalued despite assurances from Chinese President Hu Jintao that China would allow greater exchange-rate flexibility.\textsuperscript{171} Though the renminbi at that time had appreciated by about 3.6 percent nominally against the dollar since Summer 2010 – or 5-6 percent after adjustment for China’s greater inflation than the rate of inflation in the United States – many American economists and politicians maintain that the movement is inadequate.\textsuperscript{172} Senator Max Baucus, Chairman of the Senate Finance Committee, expressed his continuing disappointment on the Chinese currency issue, stating, “China has been given a free pass on its currency practices for far too long. We need to hold China and our other trading partners accountable for their actions, and we must acknowledge – and take steps to remedy – those actions that harm the competitiveness of American businesses and workers.”\textsuperscript{173}

How does China maintain a substantially undervalued currency? Some historical analysis is helpful to provide context. China has gone through several exchange-rate phases since the country began to turn away from Mao Zedong’s policies of economic isolation at the end of the 1970s. From that juncture to the late 1980s, China gradually rejected rigid Maoist economic thought and embraced a new economic model of “reform and opening.”\textsuperscript{174} One reform was the creation of the first “swap centers” for foreign-exchange dealings.\textsuperscript{175} Though the Chinese government maintained an official exchange rate, the “swap centers” offered extremely advantageous rates as part of reforms aimed at economic development through increased exports.\textsuperscript{176} First opened in 1985-86, these “swap centers” (known more formally as Foreign Exchange Adjustment Centers) were for use by Foreign Invested Enterprises (“FIEs”) and for the first time allowed FIEs to obtain Chinese domestic currency at rates dramatically more favorable than the official exchange rate.\textsuperscript{177}

The “swap centers” became an increasingly important part of China’s early economic rise, growing in number, size, and scope between 1987 and 1993.\textsuperscript{178} During this period, China operated a dual exchange-rate system whereby the government maintained an official exchange rate (used mostly for non-trade transactions), while the “swap centers” pro-

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\textsuperscript{171} Sewell Chan, supra note 167.

\textsuperscript{172} Id.

\textsuperscript{173} Sewell Chan, supra note 167. In September 2010, “The House overwhelmingly approved a bill seeking to add pressure on China to allow its currency to rise in value.” A sense of this matter’s political and legal intensity can be seen from the report and additional views issued by the Committee on Ways and Means of the U.S. House of Representatives in September 2010 in conjunction with H.R. 2378, the Currency Reform for Fair Trade Act. See H.R. Rep. No. 646, 111th Cong., 2d Sess. (2010). This bill passed the House on September 29, 2010, by a vote of 348 – 79, but died in the 111th Congress when no vote was taken in the Senate before adjournment sine die, supra.


\textsuperscript{175} Id. at 438-39.

\textsuperscript{176} Id. at 438-39.

\textsuperscript{177} Id. at 440-441.

\textsuperscript{178} Id.
vided a substantially better exchange rate for international trade transactions.179 “By increasing the price competitiveness of Chinese exporters, the devaluation of the yuan almost certainly was a major factor in China’s rapid export growth during this period. The devalued exchange rate also helped China attract more foreign investors looking for a cheap base for goods sold globally.”180 China eliminated its dual exchange-rate system in 1994 in preparation for accession to the WTO.181 This system was widely viewed as a “non-tariff trade barrier by many of China’s trading partners and had become a significant obstacle to China’s WTO accession.”182 In 1994, China established a single unified exchange rate of 8.7 renminbi per U.S. dollar, which was the prevailing exchange rate in the “swap centers” at the time.183 This formal peg of the renminbi with the dollar remained in place until mid-2005, going to 8.30 renminbi per U.S. dollar for several years and then from 1997 to 8.28 renminbi per U.S. dollar.184

In July 2005, China announced that it had terminated its peg to the U.S. dollar and that the renminbi’s value would henceforth reflect a weighted basket of currencies, the exact composition and relative weights of which were known only to the Chinese government.185 Following maintenance of dual exchange rates at “swap centers” in the 1980s and 1990s and the Asian Financial Crisis that erupted in 1997, China has stressed the stability of the renminbi and its steadfastness in not depreciating its currency.186 The principal concern of the leadership in Beijing has been inflation caused by sudden spikes and influxes into China of foreign speculators’ capital (“hot money”) to purchase renminbi in anticipation that the Chinese government will permit a large, one-time revaluation of the renminbi against the U.S. dollar. In ostensibly de-pegging the renminbi from the U.S. dollar in July 2005, China at first restricted the daily appreciation or depreciation of the renminbi to a narrow band of no more than 0.3 percent relative to the U.S. dollar.187 Thereafter, between 2005 and July 2008, China permitted the renminbi to appreciate nominally against the U.S. dollar by about 21 percent. After holding the renminbi steady at the rate of about 6.83 renminbi to the dollar during the Global

180 Hall, supra note 174, at 442-443.
181 Id. at 444.
182 Id. at 444; Chris Brown, China’s GATT Bid: Why All the Fuss About Currency Controls? 3 Pac. Rim L. & Pol’y J. 57, 71-75 (1994).
183 Hall, supra note 174, at 444.
184 TLAG, supra note 11, at 49.
185 Id. at 50; Paul V. Sharobeem, Biting the Hand that Feeds Us: A Critical Analysis of U.S. Policy Trends Concerning Chinese Currency Manipulation, 19 Fla. Int’l L. 697, 700-701 (2007) “While the exact composition of the currency basket is only known to Chinese authorities, it is widely speculated that the basket includes the euro, the yen, the U.S. dollar, as well as other Asian currencies.” (footnote omitted) [hereinafter “Sharobeem”].
186 Hall, supra note 174, at 448 “Beijing more recently has moved cautiously with further reforms, emphasizing stability and focusing primarily on incremental and ad hoc improvements to the regulatory and administrative regime.”; H.D. White, supra note 46, at 195, 199. Given the inflexible peg and undervaluation of the renminbi to the U.S. dollar, China’s claim of stability brings to mind Harry Dexter White’s admonition that “[s]tability of exchange rates is not, however, identical with rigidly fixed rates that cannot be changed under any circumstances. The difference between stability and rigidity in exchange rates is the difference between strength and brittleness. It is the difference between an orderly adjustment, if the conditions warrant it, and eventual breakdown and painful readjustment.”
187 TLAG, supra note 11, at 51.
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Financial Crisis from July 2008 to June 2010, the Bank of China on June 20, 2010, announced a second time that China would delink the renminbi and the U.S. dollar and that China would improve foreign-exchange management and keep the renminbi’s exchange rate at a reasonable and balanced level. Most recently, in large part apparently due to concerns about social unrest due to inflation in the prices of food and fuel that directly affect hundreds of millions of Chinese, the Chinese government has permitted the renminbi to inch up further to about 6.49 – 6.50 renminbi per U.S. dollar as of mid-May 2011.

Though China officially ended its peg to the U.S. dollar in 2005, it still closely manages the renminbi’s exchange rate by persistently and heavily intervening in foreign-exchange markets and through capital controls on capital movements and currency holdings. The direct interventions in the exchange markets and the sterilizations that follow entail considerable effort, requiring the Chinese government to print enormous amounts of renminbi to buy the huge quantities of U.S. dollars and other foreign currencies that are obtained from China’s exports and foreign direct investment in China. “China relies on two methods for maintaining the RMB exchange rate within the set target. First, the [People’s Bank of China (‘PBC’)] employs both domestic and international monetary measures – such as through increasing the RMB supply by issuing RMB and decreasing foreign exchange supply by purchasing foreign currency – in order to accumulate a large amount of foreign reserves and at the same time counter the appreciative pressure on the RMB. Second, China employs strict capital controls to ensure that the adjustment of RMB supply effectively maintains a specified level of RMB exchange.” According to the Treasury Report, cumulatively over the last ten years China has made $2.3 trillion in net purchases of foreign exchange. In 2010 alone, China’s foreign exchange reserves grew by $443 billion. China’s intervention in foreign-exchange markets is tremendous and necessary to maintain the government’s policy of currency “stability.”

China’s basic regulations on foreign-exchange (“FOREX”) controls date back to 1996 and have since then been amended twice. The PBC and the State Administration for Foreign Exchange administer these sweeping foreign-exchange regulations, which lay down the framework and essential guidelines for China to monitor and control the flow of currency into, out of, and within the country. “In practice, this oversight means that the Chinese central government can insulate the renminbi to a great degree from the market’s pressures and undervalue the renminbi relative to the values of the currencies of China’s trading partners.” Included in these regulations are the following provisions:

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188 Saving the Global Financial System: International Financial Reform and United States Financial Reform, Will They Do the Job? 43 No. 1 UCC L.J. 9; Beijing vows slow pace for rise of its currency, INT’L HERALD TRIBUNE (June 21, 2010), 1 (internal citations deleted).
189 See TLAG supra note 11; “China Currency Under Pressure,” supra note 148.
190 TLAG, supra note 11, at 53, n.159.
191 Id. at 53, n.160.
192 International Lawyer, supra note 45, at 1262 (bracketed material added).
193 Treasury Report, supra note 162, at 15.
195 TLAG, supra note 11, at 52.

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Article 5 – International payment and transfer in foreign exchange for current account transactions shall not be subject to government restrictions. 196

Article 7 - Financial institutions in China authorized to conduct foreign-exchange operations shall report all foreign-exchange transactions or changes in foreign-exchange accounts to the Chinese government’s foreign-exchange administration.

Article 8 - All foreign currencies are prohibited from circulating within China and shall not be quoted for pricing or settlement in China unless the government states otherwise.

Article 9 - The Chinese government holds the power to decide when and how foreign-exchange receipts of domestic entities and domestic individuals may be repatriated into or placed outside China. 197

Article 11 - In the event or the possible event of a “serious disequilibrium” in China’s balance of payments with China’s trading partners or a “severe crisis” of the national economy, the government may impose currency safeguards, controls, or other necessary measures.

Article 12 - Financial institutions authorized to engage in foreign-exchange transactions must examine foreign-exchange receipts and expenditures against import and export licenses or against the customs declarations for imports and exports in order to ensure that receipts and payments in foreign exchange for current account transactions have bona fide and legitimate transaction backgrounds. 198

Article 19 - All bonds or guarantees issued outside China must be approved by the government.

196 See Hall, supra note 174, at 461 (footnote omitted). Article 5’s previous version had stated that China did not restrict the current international payment and transfer of foreign exchange. “In other words, individuals and enterprises are, in principle, free to receive foreign currency as payment for international sales that fall under the current account as well as to procure and use foreign currency for similar international purchases. . .. Though technically not restricted, buying and selling foreign currency for current account transactions remains heavily regulated. In order to prevent current account convertibility from threatening China’s supply of foreign currency, the regulatory regime for current account transactions is designed primarily to: 1) ensure that all current account earnings are repatriated, and 2) protect against the use of false records of current account transactions to illegally remit foreign currency out of the country.” Even though Article 5’s current language has been changed somewhat from its earlier version, the situation of the Chinese government’s extensive controls over foreign currency as just described is understood to remain largely and effectively the same.

197 Hall, supra note 174, at 461-462 (footnotes omitted). The most fundamental restriction on current account earnings is the repatriation requirement. Article 9 of the Forex Regulations requires the repatriation of all foreign exchange receipts of domestic institutions and prohibits their deposit abroad without specified authorization. Without this provision, China could possibly face a currency crisis even while enjoying a substantial current account surplus. * * * * Upon repatriation, current account receipts must either be converted into renminbi or deposited in a current account foreign exchange bank account, both to be done at one of the designated foreign exchange banks.”

198 Article 12 seeks to discourage the entry into China of “hot money” that would increase inflation in China.
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Article 20 - Lending by Chinese non-banking institutions to institutions or individuals outside China must be approved by the Chinese government.

Article 32 - The foreign-exchange administration may intervene in the Chinese foreign-exchange market to reduce the volatility of this market.

Article 33 - The foreign-exchange administration may inspect the records of any foreign-exchange operation in China or any operation suspected of illegal foreign-exchange operations in China.

Article 39 – The foreign-exchange administration is authorized to penalize foreign-exchange evasion schemes, such as transferring exchange abroad in violation of the regulations or transferring domestic capital abroad by fraudulent means, and to order the foreign exchange in question to be repatriated.

China's massive intervention in foreign-exchange markets generates a correspondingly large influx of renminbi into China's domestic economy for circulation and spending. Importantly, too, this conversion of U.S. dollars requires more renminbi than would otherwise be the case to the extent of the renminbi's undervaluation. This infusion of renminbi into the Chinese domestic market, without a commensurate increase of goods and investment domestically, builds inflationary pressure. To keep inflation in check, China "sterilizes" the renminbi it has just printed and issued to purchase the U.S. dollars and other foreign currencies realized from Chinese exports and foreign direct investment in China. This "sterilization" is accomplished by (1) the Chinese government's issuance of renminbi-denominated debt in the form of bonds, (2) higher reserve requirements for Chinese banks, and (3) so-called "window guidance" by the Chinese government to domestic banks to keep domestic lending low. The renminbi-denominated debt is especially critical to China's ability to limit inflation.

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199 TLAG, supra note 11, at 54; Treasury Report, supra note 162, at 28. The U.S. Department of Treasury defines sterilization as "[a]n action taken by the central bank to offset the effect of intervention on the domestic money supply. Intervention in which the central bank sells domestic currency increases the domestic money supply, in essence expansionary monetary policy. To neutralize the effect of the intervention on the money supply the central bank will sell domestic government securities, taking an equivalent amount of domestic currency out of circulation. If the intervention involved the purchase of domestic currency, the central bank will buy government securities, placing an amount of domestic currency equivalent to the size of the intervention back into circulation. An intervention is partially sterilized if the action by the central bank does not fully offset the effect on the domestic money supply."

200 TLAG, supra note 11, at 54.

201 Id. (footnotes omitted). "When these bonds are purchased by banks and private investors in China, the newly printed renminbi are taken out of circulation. China's cost to issue 'sterilization' bonds continues to rise. In its efforts to limit inflation, the Chinese government must ensure that there is a domestic market in China for its bonds to support the 'sterilization' process. However, sustaining the market for 'sterilization' bonds becomes a delicate and more expensive balancing act over time. As the Chinese government issues more bonds to Chinese banks and to private Chinese investors in order to 'sterilize' the Chinese government's purchases of foreign currencies, the increase in the supply of bonds forces the Chinese government to pay greater yields to the Chinese investors. Increasing the return on the bonds increases the cost of 'sterilization' in renminbi, because more renminbi are needed for future payments by the Chinese government to the investors."
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2. Measurement of the Renminbi’s Undervaluation

By means of its FOREX rules and system of capital controls, China is able to set the value of its currency relative to other countries’ currencies, particularly the U.S. dollar. By having intervened for years in the exchange markets and having bought on a very large scale U.S. dollars and other foreign currencies in exchange for renminbi, the Chinese government has prevented the renminbi from reaching its equilibrium level on a trade-weighted basis. In its surveillances of China’s monetary system and exchange-rate regime over the last decade under Article IV of the IMF’s Articles of Agreement, the IMF’s staff regularly – but without much headway – has spoken to the Chinese authorities in favor of significant appreciation of the renminbi and greater exchange-rate flexibility as advisable ways for China to pursue an independent monetary policy and adjust to shocks.202

Even as the IMF’s staff has expressed its concern that the renminbi has been substantially undervalued, however, it has not made a quantitative assessment of that undervaluation. In conjunction with a press teleconference call in July 2009, for example, the IMF’s Mission Chief for China, Mr. Nigel Chalk, remarked that the IMF’s 2009 staff report found there was “substantial undervaluation” of the renminbi, but that the staff felt that “... given the current climate, it’s very difficult to put any particular point estimate on how large undervaluation is, but we do see a stronger RMB, as I said, as an important part of the broader policy package. I think whether China has been moving enough, that’s a difficult question. If you look since 2005, we’ve seen around a 20 percent increase in the real exchange rate, which is a substantial increase in the exchange rate, in effective terms that is. So I think how you assess what’s enough depends on the horizon you look over, but obviously, if we see the exchange rate is undervalued, we do see further need for appreciation.”203 In the 2010 sur-

202 See, e.g., INT’L MONETARY FUND, People’s Republic of China: 2004 Article IV Consultation – Staff Report; Staff Statement; and Public Information Notice on the Executive Board Discussion, IMF Country Report No. 04/351, at ¶ 19, 12 (Nov. 2004); INT’L MONETARY FUND, People’s Republic of China: 2005 Article IV Consultation – Staff Report; Staff Supplement; and Public Information Notice on the Executive Board Discussion, IMF Country Report No. 05/411, at ¶ 21, 14 (Nov. 2005); INT’L MONETARY FUND, People’s Republic of China: 2006 Article IV Consultation – Staff Report; Staff Statement; and Public Information Notice on the Executive Board Discussion, IMF Country Report No. 06/394, at ¶ 28, 18-19 (Oct. 2006), “Increased flexibility would provide much needed space to exercise greater monetary policy control. With limited nominal exchange rate flexibility, the expansionary impulse of reserve accumulation on domestic monetary conditions is being contained to a substantial extent by financial repression. This works at cross purposes with the banking sector reforms since it directly conflicts with the government’s aim to create a banking sector operating on a sound commercial basis. From a near-term perspective, greater flexibility would create more room to enable the central bank to use open market operations to help tighten liquidity without triggering a renewal of speculative inflows. That said, the staff emphasized that exchange rate flexibility, not just appreciation, is what is needed for China’s economy going forward. The authorities acknowledged that limited flexibility of the exchange rate creates a conflict in monetary policy, but they were confident that they could manage the situation. The staff said it could not be done without creating distortions through further repression of the banking system, and noted that it would be better to eliminate the source of the conflict by allowing more flexibility in the exchange rate.”

203 INT’L MONETARY FUND, Transcript of a Press Teleconference Call with International Monetary Fund Officials on China’s 2009 Article IV Consultation, 3-4, 9, 10 (July 23, 2009), available at http://www.imf.org/external/np/pr/2009/tr072309.htm. On the same occasion, Mr. Chalk also remarked that the IMF in 2007 and 2008 did not have consultations with China that were discussed by the IMF’s Executive Board due to “internal discussion of how best to move forward with the consultation” and not due to blocking in any way or a veto by the Chinese authorities. In response to a question about whether the 2009 report of the IMF’s staff, which
veillance of China, once more without releasing a quantitative assessment, the IMF’s staff reiterated its view that the renminbi was “substantially below the level that is consistent with medium-term fundamentals” and based that assessment upon three broad arguments – first, that China’s pace of accumulating international reserves remained rapid; second, that the renminbi’s level of the real exchange rate was close to its level in the late 1990s, even though, in the interim, China’s productivity had become significantly higher than that of its trading partners; and, third, that China’s current account was set to return to a position of sizable surplus in the coming years.204

While the IMF’s staff has not publicly calculated the degree of the renminbi’s undervaluation (and, for that matter, does not appear to have addressed publicly whether China’s intent has been manipulative under Article IV(3)(iii) of the IMF’s Articles of Agreement), computations by William Cline and John Williamson with the Peterson Institute for International Economics confirm that the renminbi, as well as a number of other Asian countries’ currencies, are substantially undervalued.205 Although not everyone agrees on whether the renminbi is undervalued, on the best methodology(ies) to employ in carrying out the calculations, or on the extent of the renminbi’s undervaluation,206 Cline and Williamson are highly respected economists and experts in comparing the levels of effective exchange rates with fundamental equilibrium exchange rates (“FEERs”) and determining whether a country’s currency is overvalued or undervalued. Their latest figures – relying upon data from the IMF’s “World Economic Outlook” issued in April 2010, an actual exchange rate of 6.67 RMB/U.S. $1 in October 2010, and an inflation-adjusted, FEER-consistent rate of 5.57 RMB/U.S. $1 – estimate that the renminbi is undervalued relative to the U.S. dollar by 19.7 percent.207 This approximation, which is solidly within the range of percentages that one typically sees, gives a reasonable sense of how considerable an advantage Chinese exporters receive from the renminbi’s undervaluation. The situation is not unlike that in a 100-yard dash, in which one runner is positioned at the starting line while a second runner begins the race at the 20-yard line. The circumstances become even bleaker for the runner at the starting line in the United States when it is recognized that the runner in China is often the beneficiary of a number of other Chinese governmental subsidies as well and so could be starting even further ahead at the 30- or 40-yard line.

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206 International Lawyer, supra note 45, at 1265-66; Sharobeem, supra note 185, at 705, Depending upon when and the way in which the calculations have been performed, the renminbi’s undervaluation against the U.S. dollar has been ranged as being anywhere from 10 percent to 60 percent or more.
207 Cline and Williamson, supra note 205, at 2, 11.
3. The Benefits Gained by China from the Renminbi’s Undervaluation Diminish the Possibility of a Meaningful Revaluation by China in the Foreseeable Future

In a world in which most people spend many incremental portions of every day considering the monetary values of practically anything and everything, China (and any other country so inclined) with the single stroke of undervaluing its currency affects the costs and prices of whatever goods and services are sold in trade or investment across its national boundaries. With such a sweeping measure, it is to be expected that the results for the undervaluing country are somewhat mixed, positive for the undervaluing country in some respects and negative in other respects. In the latter regard, for instance, reference has been made earlier that the relative inflexibility of the renminbi curtails the Chinese government’s control over monetary policy, risks inflation in China generally and for imports of such basic needs as food and fuel for China’s population of 1.3 billion persons, represses modernization and reform of China’s banking system, and helps to keep in business both efficient and inefficient, export-oriented, state-owned enterprises and other companies located in China.208 The list of difficulties that stem from the renminbi’s enforced undervaluation by the Chinese government is obviously a lengthy one.209 It is no wonder that China’s Premier Wen Jiabao several years ago expressed concern that China’s policy of misaligning its currency has left its economy unstable, unbalanced, uncoordinated, and unsustainable.210

208 See, e.g., INT’L MONETARY FUND, People’s Republic of China: 2006 Article IV Consultation – Staff Report; Staff Statement; and Public Information Notice on the Executive Board Discussion, IMF Country Report No. 06/394, at ¶ 28, 18-19 (Oct. 2006); Chinese S&ED Head Warns Against Politicization of Currency Issue in U.S., WTO NEWSSTAND.COM (May 10, 2011) available at http://chinatradextra.com/Inside-US-China-Trade/Inside-US-China-Trade-05/11/2011/chinese-saamped-, [hereinafter “Chinese S&ED Head”] Reporting comments by Chinese Vice Premier Wang Qishan that China needs to shift from export-dependence in light of a threateningly unsustainable lack of balance and coordination in China’s development and that appreciation of the renminbi will perhaps be needed to fight inflation in China, (“S&ED” refers to the Strategic and Economic Dialogue that the United States and China have been having during the Obama administration). The emphasis on exportation of goods from China has led to excess manufacturing capacity, decreased domestic purchasing power and suppressed domestic consumption, as well as environmental pollution attributable to the spate of industrialization; see, e.g., TLAG, supra note 11, at 64-67; see also Treasury Report, supra note 162, at 15-16.

209 See, e.g., Treasury Report, supra note 162, at 16. As another example, different aspects of the process of “sterilization” are quite problematic. The low interest rates offered with “sterilization” mean that Chinese households realize very little return on their savings, which can be destroyed by inflation. Moreover, to the degree that not all of the renminbi printed and distributed are actually being “sterilized,” the excessive liquidity that results has undoubtedly been contributing to bubbles in China’s housing and stock markets.

210 Risks and Reforms: The Role of Currency in the U.S.-China Relationship: Hearing Before the S. Comm. On Finance, 110th Cong. (Mar. 28, 2007) (statement of Stephen S. Roach); Bernanke, supra note 14, at 11, Even more broadly with reference to recovery from the Global Financial Crisis, Federal Reserve Chairman Ben Bernanke has observed that large-scale currency undervaluation inhibits “necessary macroeconomic adjustments and creates challenges for policymakers in both advanced and emerging market economies. Globally, both growth and trade are unbalanced and unstable.”; Speech by Treasury Secretary Timothy F. Geithner, The United States and China, Cooperating for Recovery and Growth 6 (June 1, 2009), available at http://www.treasury.gov/press-center/press-releases/Pages/tg152.aspx, Along the same lines, Treasury Secretary Geithner has remarked, “China and the United States individually, and together, are so important in the global economy and financial system that what we do has a direct impact on the stability and strength of the international economic system. Other nations have a legitimate interest in our policies and the ways in which we work together, and we each have an obligation to ensure that our policies and actions promote the health and stability of the global economy and financial system.”


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Notwithstanding all of these serious shortcomings and complexities, however, the Chinese government has seen fit to persist in its undervaluation of the renminbi for roughly the last decade especially. Its evident reasons for doing so suggest that an effective appreciation of the renminbi might well take China much longer to accomplish in the future than is palatable to other countries or desirable for the global economic recovery.

- China’s trade balances with the United States and the world have been heavily in surplus. In the last decade through 2010, the United States has run a cumulative current account deficit with China in excess of $2 trillion.211

- China’s foreign-exchange reserves have reached extraordinary levels. From mid-2005, when these reserves were approximately $750 - $800 billion, by the end of 2010, these reserves had grown to about $3 - $3.5 trillion. As striking as these figures are, these sums are all the more exceptional given that the renminbi was nominally appreciating during this period of nearly six years,212 and also given that China has accumulated these foreign-exchange reserves even as the Chinese government has been spending large sums in investments around the world to secure raw materials and other assets, to build a blue-water navy, and for other major undertakings.

- China’s economy has been generating 20-25 million new jobs annually to provide sufficient employment opportunities for new entrants, the unemployed, and migrants from rural to urban areas.213

- China’s state-owned enterprises with their export-orientation have flourished. These companies play a key role in the accomplishment of the Chinese government’s economic strategy.214

213 See, e.g., INT’L MONETARY FUND, People’s Republic of China: 2004 Article IV Consultation – Staff Report; Staff Statement; and Public Information Notice on the Executive Board Discussion, IMF Country Report No. 04/351, at ¶21, 12-13 (Nov. 2004). When Chinese authorities have raised concerns that a large change in the value of the renminbi might have an adverse impact on employment in China, the IMF’s staff has responded by urging instead that increased flexibility of the exchange rate would contribute to balanced and sustainable growth that would provide the best conditions to stimulate growth in employment; Cline and Williamson, supra note 205, at 8-9. In their study in November 2010, Cline and Williamson urged that replacement of foreign with domestic demand in China could be expected to increase, not reduce, domestic employment. In rejecting the position that defense of employment is a valid reason for China not to permit an appreciation of the renminbi’s value, they comment that “[t]hat argument is based on the fallacy of assuming that revaluation would occur in isolation, rather than being undertaken in conjunction with an expenditure-increasing policy.”
214 See, e.g., Key Targets of China’s 12th Five-Year Plan, Gov.cn (Mar. 5, 2011) available at http://english.gov.cn/2011-03/05/content_1816822.htm, announcing, inter alia, the Chinese government’s program for 2011 - 2015 to “nurture and develop seven new industries with favorable policies during the next five years.” These...
Foreign direct investment in China has burgeoned, bringing technology, intellectual property, and research and development across the spectrum of manufacturing.

Over time, therefore, as the foregoing incomplete list indicates, the renminbi's chronic undervaluation has become an integral element of China's governance politically, economically, and militarily. For strong, vested interests in China, the renminbi's artificially low value vis-à-vis the U.S. dollar and other currencies has been serving as the means of securing what at times has likely seemed an endless stream of funds for China. The prospect of revaluation of the renminbi consequently must not be appealing to China's leaders, not only because this policy to date has been so remunerative, but also because a shift to a stronger renminbi will certainly bring changes and risks, some of which are predictable and some of which are not. Although Vice Premier Wang Qishan recently admonished the United States not to "politicize" the issue of the renminbi's exchange rate with the U.S. dollar, this question as a practical matter is unavoidably political in nature, because the relative value of the renminbi and the U.S. dollar powerfully affects, directly and indirectly, the administration of the internal and external affairs of both countries as well as of third countries. The real test is whether a mutually acceptable, timely resolution of this situation can be accomplished in a lasting way in this politically charged atmosphere and economically vulnerable time. A recapturing of the spirit of international cooperation that prevailed at Bretton Woods in 1944 and that was so instrumental in the shaping of the GATT in 1946 and 1947 could assist in gaining this goal.

C. Whether or Not China Acts on Its Own to Value the Renminbi According to Supply and Demand in the Market, Concerted Efforts are Warranted by the International Monetary Fund and the World Trade Organization Jointly to Clarify and Improve International Discipline Over Competitive Currency Depreciation

1. Taking Stock of the Efforts to Date by the International Monetary Fund and the World Trade Organization to Address the Relationship Between Exchange Rates and International Trade

The events of the Great Depression, sandwiched between the two World Wars, are a cautionary tale. The steps taken by the international community thereafter to put in place rules for international monetary and trade affairs were very positive ones. These events and measures are worth studying and debating to glean from those experiences what lessons remain germane for the purpose of addressing as wisely as possible the very complex subject of how exchange rates and international trade relate to one another and should be addressed in

"pillar" or "strategic" industries are next-generation information technology, energy-saving and environmental protection, new energy, biotechnology, high-end equipment manufacturing, new-energy automobiles, and new materials.

215 Chinese S&ED Head, supra note 208, Vice Premier Wang's complete statement: "It seems to me that somehow the Americans have the view of believing that China's trade surplus is all caused by the manipulation of its exchange rate, and China became a big trading country in the world simply by manipulating its currency. Actually, this is a very politicized argument, and for all those people who really understand what the exchange rate is really about, they would not say so."
the present period. Consideration of what factors were essential to the successful launching and establishing of the IMF and the GATT leads to several central conclusions.

- Most critically, the persons who were the agents of these international institutions’ creation in the mid- and latter 1940s seem understandably to have been appalled at the horrific, widespread damage done economically and militarily in the two generations after 1914 and, despite being exhausted by all that had occurred, admirably resolved to avert such happenings from occurring again to the best of their ability.

- Also underlying the deliberations that took place was a widespread recognition that competitive currency depreciation along with high tariffs had contributed greatly to countries’ economic woes and the Great Depression. There was more comprehension than before that national currencies that are reasonably and realistically valued in relation to one another are a vital component of healthy transnational commerce and investment. It was understood that fundamentally undervalued misalignment of a currency by its national government is a hybrid, a monetary measure that can have severe repercussions for international trade and investment.

- This analytical evaluation prompted a consensus in three fundamental respects. First, the countries that helped to found the IMF and to draft the GATT concluded that, for the sake of the global welfare, there must be a relinquishment by each nation of some measure of sovereignty adequate to administer effective international rules over exchange rates and international trade in goods. Second, on the monetary side, the IMF’s members went so far in attempting to block competitive currency depreciation as to accept a system of gold-based, par-value exchange rates whereby the IMF’s approval was required before a member was permitted to modify its exchange rate. Third, the intertwining of exchange rates and international trade was acknowledged in different provisions of the GATT, most prominently in GATT Article XV, although exactly how the IMF’s Articles of Agreement and the GATT were to be administered together was left somewhat unclear.

These conceptual advances – on sovereignty, competitive currency depreciation, and the many ties there are between exchange rates and international trade – were profound at the time and remain so today. In the interim, there have been two major changes, one at the IMF and the other at the WTO, which also should be considered for their relevance.

- The shift at the IMF, mentioned earlier, was the replacement in the 1970s of the gold-based, par-value system of exchange rates. That system – ironically in light of the emphasis by Keynes and White on flexible exchange rates – proved to be too rigid. Likewise contrary to the tenets of Keynes and White, the much greater leeway each member of the IMF now has to choose its currency’s exchange rate, albeit with surveillance under the IMF’s Article IV, apparently has been viewed by at least some
of the IMF’s members, including China, as an opportunity to reclaim full sovereignty over national exchange rates. This regression, combined with the IMF’s lack of dispute-settlement powers, has impaired the IMF’s effectiveness.

- The notable modification at the WTO has been the strengthening of the GATT’s dispute-settlement function, beginning when the WTO commenced operations at the start of 1995. Since then, a member that has not prevailed in dispute settlement has not been able to block the result and instead has been expected to bring into compliance its measures that have been deemed to be in violation of its obligations at the WTO. Compensation and suspension of concessions for the member that has been vindicated in dispute settlement can be authorized by the WTO if the losing member does not correct the problem. This revision, while controversial on occasion and in some respects, has seen a sharp increase in resort to dispute settlement and compliance by the WTO’s members.

Against this backdrop, a couple of over-all impressions emerge. First, until recent years with the case of China, competitive currency depreciation has not been so prevalent as to receive much political attention. For its part, as discussed further below, the WTO has done very little on this subject, and what political energy has been expended by the IMF and its members on this issue has been thwarted by the resurgence of members’ assertions of sovereignty in this area. Thus, after promulgating the initial surveillance guidelines in 1977, it was not until 2007 and 2008 that the IMF updated those guidelines, and at no point does it appear that the IMF has ever formally and publicly declared that a member has exhibited the intent necessary under Article IV(1)(iii) for a finding of manipulation. Further, in crafting its current guidelines on surveillance, the IMF stressed that members should avoid exchange-rate policies, undertaken for whatever reason, that result in “external instability” and that an important indicator of “external instability” is fundamental exchange-rate misalignment, whether caused by exchange-rate policies, unsustainable domestic policies, or market imperfections. While the IMF is correct to inveigh against “external instability,” the status of the

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216 Cline and Williamson, supra note 205, at 2. This reversion and its general impact have been explained very well by Cline and Williamson: “The Bretton Woods system collapsed when the United States accepted that it could no longer maintain the gold convertibility of the dollar in August 1971. Shortly after that the then-major powers all started to float, but many of the emerging economies continued to peg to the dollar. But they did this without effective surveillance by the IMF, which had formerly been responsible for approving any administered change in exchange rate but which now had to operate under a set of rules that said that any exchange rate regime was permissible except pegging to gold (which no country was foolish enough to consider anyway). True, the United States insisted on inserting a requirement in the guidelines for floating that countries with floating currencies consider the interests of the country whose currency they planned to use when intervening, but it was not clear that this applied to currencies that pegged. In any event it has not prevented the proprietors of those currencies from viewing the value of their peg as a sovereign decision in which other countries, including the issuers of their reserve currencies, are not entitled to interfere.”

217 2007 Decision, supra note 137. Two interesting aspects of this new notion of “external instability” are (1) its expanded reach in comparison with manipulation’s more confined and confining scope and, also in contrast to manipulation, (2) its focus upon the effects of “external instability” rather than any intent by the member’s government. The IMF’s emphasis on “external instability” and its features perhaps manifests an implicit assessment by the IMF that any finding of manipulation is too politically daunting to make with its requisite element of governmental intent.
IMF’s statements on this concern is that of a recommendation rather than an obligation like that against manipulation, and so it is doubtful how influential the IMF’s monitoring of “external instability” will be in checking irresponsible exchange-rate policies by members. The point is that the IMF and the WTO appear for many years largely to have neglected, and made little real progress on, the prickly but consequential subject of competitive currency depreciation, and the resultant vacuum has emboldened China – among others – to test and expose the limits of the international rules on this topic.

A second impression that is left from the history just summarized is what might inelegantly be called, an unevenness in two related respects in the evolution of the IMF and the WTO as international institutions. In brief, (1) the reassertion by the IMF’s members of controlling sovereignty over exchange rates is a serious restraint on the IMF’s performance, whereas the WTO’s members – virtually the very same countries that comprise the IMF’s membership – have been amenable to imposing upon themselves considerable obligations under public international law in the arena of trade in goods and services and in doing so have conveyed a good portion of their sovereignty to the WTO as a practical matter, thereby empowering the WTO in many important ways; and (2) as an extension of their members’ respective positions on sovereignty, the IMF has no dispute-settlement authority, while the WTO has in place what can fairly be said to be one of the most extensive dispute-settlement mechanisms that there are at the international level.

Why these differences between the IMF and the WTO exist is a question of practical significance that is not necessarily easy to answer. As suggested earlier, one plausible explanation is an ingrained disposition of national governments to keep as much sway over their financial affairs as possible, but a willingness to accept more authoritative international regulation of trade in the interest of prospering and avoiding trade wars. The complication posed for this neat dichotomy, however, as observed above, is that fundamentally undervalued misalignment of a currency is a hybrid, a monetary measure that adversely affects international trade and investment. Indeed, as Section V touched on earlier, the overlapping of exchange-rate valuation with the GATT’s bedrock axioms that are designed to propel expanded international trade flows is so extensive as to be difficult to overstate. Recognition of this reality should steer the members of the IMF and the WTO to deepen their partnership. In this setting, each institution should respect the other’s jurisdiction and expertise, and the two bodies in combination should work to reduce and ideally to eradicate fundamental currency misalignment and its debilitating effects on vibrant and balanced international trade. It is, after all, this sort of relationship that the drafters of the IMF’s Articles of Agreement and the authors of the GATT envisioned in the first place. Moreover, the IMF and the WTO have often interacted with each other in years past in dealing with different issues, and this experience should

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218 Id.
219 The importance of this working bond has been reiterated over the years, including in Article III.5 of the Agreement Establishing the World Trade Organization, which states, “With a view to achieving greater coherence in global economic policy-making, the WTO shall cooperate, as appropriate, with the International Monetary Fund and with the International Bank for Reconstruction and Development and its affiliated agencies.” Marrakesh Agreement Establishing the World Trade Organization, Apr. 15, 1994; THE LEGAL TEXTS: THE RESULTS OF THE URUGUAY ROUND OF MULTILATERAL NEGOTIATIONS 4 (1999), 1867 U.N.T.S. 154, 33 I.L.M. 1144 (1994). Orderly exchange arrangements are integral to the coherence of the global economy and undeniably merit cooperation by the WTO and the IMF.
stand these two international institutions in good stead in the years ahead in dealing with fundamental currency misalignment.  

2. How the International Monetary Fund and the World Trade Organization Might Proceed from This Point Forward in Dealing With the Rudimentary Issue of the Relationship Between Exchange Rates and International Trade

The renminbi’s fundamentally undervalued misalignment particularly has put the IMF and the WTO on their mettle. It will surely take both institutions, with their interrelated skills, to devise the best way to tackle the intersections of international monetary and trade affairs. Clarification is needed to improve the international regulatory structure that is already in place and that has not previously been brought into play very much at all on exchange rates. That framework can be built upon and hopefully will be strengthened. Just as there was a watershed when the international monetary and trading systems were originally constructed in the mid- and latter 1940s, it seems that the present time quite possibly could be viewed in hindsight as a watershed when those systems were brought forward and adapted to mesh as well as possible with global conditions now and in the foreseeable future. Fundamental currency misalignment is as knotty a stumbling block today as it has ever been, if not more so. The factors that contributed to the affirmative launching and establishing of the IMF and the GATT more than six decades ago hopefully can serve well for enlivening the rules on the relationship between exchange rates and international trade at this time.

An excellent article on the historical interaction between the IMF and the WTO has been written by Deborah E. Siegel, Legal Aspects of the IMF/WTO Relationship: The Fund’s Articles of Agreement and the WTO Agreements, 96 A.J.L. 561 (1996), describing the IMF and the WTO as asymmetrical organizations, despite their complementary objectives, and as interacting in the areas of (1) WTO obligations and conditions imposed by the IMF – such as import surcharges – in return for financing by the IMF to a member, (2) the role of the IMF in cases of balance-of-payments (“BOP”) exceptions under the GATT, and (3) avoiding inconsistent rights and obligations in situations involving exchange restrictions, multiple-currency practices, and exchange controls.

On the need for clarification and improvement, the terms of China’s accession to the WTO on exchange rates are instructive. At the end of the negotiations, China made a number of representations and commitments, among them that (1) with the unification of its dual exchange rates at the start of 1994, it had adopted “a single and managed floating exchange rate regime based upon supply and demand,” (2) “depending upon its macro-economic objectives, the PBC could intervene in the forex open market in order to regulate market supply and demand, and maintain the stability of the RMB exchange rate,” (3) “. . . China would implement its obligations with respect to forex matters in accordance with the provisions of the WTO Agreement and related declarations and decisions of the WTO that concerned the IMF,” (4) “. . . to encourage foreign direct investment, China had granted national treatment to FIEs in exchange administration,” and (5) “. . . unless otherwise provided for in the IMF’s Articles of Agreement, China would not resort to any laws, regulations or other measures, including any requirements with respect to contractual terms, that would restrict the availability to any individual or enterprise of forex for current international transactions within its customs territory to an amount related to the forex inflows attributable to that individual or enterprise.” Report of the Working Party, on the Accession of China, WT/ACC/CHN/49, 6-7, ¶¶ 31, 32, 33, 35 (Oct. 1 2001); While these commitments are solid evidence that China and the WTO’s members considered orderly exchange rates by China to be a prerequisite for China’s admission to the WTO, the substance of these commitments reasonably construed is hard to reconcile with much of China’s behavior since its accession in late 2001. The promise of “a single and managed floating exchange rate regime based upon supply and demand,” for instance, surely did not signify to the WTO’s members that China had been granted license to undervalue the renminbi as it has through the protracted, large-scale interventions in the exchange markets that the Chinese government has undertaken for the nearly ten years since China’s accession to the WTO.
As remarked above, what carried the day in the 1940s was the sense of urgency and consensus after two World Wars and the Great Depression that an orderly exchange system and a fair and efficient trading system were imperative to global prosperity and peace and that toward this end national sovereignty over these areas should be reduced. That judgment is equally true in the present day, but the slowness with which countries have reacted over the last decade to the undervaluation of the renminbi and other currencies indicates that the same sense of urgency and consensus is lacking at this stage. There is, however, no cause for complacency, and there is really no justification for distortive exchange rates that have unilaterally been put in place by a national government in its narrow self-interest as an exercise of purported sovereignty. In the short term, competitive currency depreciation could still upend the global recovery thus far from the recession of the last several years. In the longer term, competitive currency appreciation also could become a threat. The demographic pressure of billions more people in the world today and in the time ahead than in the 1940s already has raised the possibility of more and more acute shortages in the future of arable land and food, fresh water, clean air, and raw materials for energy and basic goods. These dangers do not seem to be overstated. Albeit that situation would present many other difficulties, it is not far-fetched to imagine that in that setting the government of a country might be tempted to appreciate its currency in an attempt to guard against such shortages in its territory. In theory, an artificially strong currency of one country could buy needed items from other countries while protecting the first country's resources from being easily affordable for other countries, but that tactic—as unflattering and morally repugnant as it is—would almost certainly be copied by other countries out of desperation and in self-defense and accordingly could be expected quickly to become self-defeating for all countries. One would hope that this prospect would be adequate incentive for members of the IMF and the WTO to reach consensus on exchange-rate measures that would prevent this scenario from occurring. One would further hope that this incentive would be a catalyst for sober thinking that would accept the wisdom of limiting national sovereignty for this purpose, much as was done at Bretton Woods in 1944 and with the GATT in 1947 and at the WTO since 1995. The realization of these hopes might not be politically realistic, but waiting until an emergency occurs before grappling with the relationship between exchange rates and international trade seems shortsighted.

Another part of any review of the current monetary and trade systems should enumerate and stress the many linkages there are between exchange rates and international trade. Those linkages, which the GATT and the IMF’s Articles of Agreement have always recognized, naturally prompt questions about which linkages under what circumstances should be actionable. It is in these latter regards and with respect to how the IMF and the WTO would proceed in fashioning an analysis and a response in any given situation that might arise that the GATT and the IMF’s Articles are not as defined as could be wished and have not been invoked enough to flesh out their meanings from experience.

In this last connection, the WTO’s Working Group on Trade, Debt and Finance should be mentioned. This Working Group’s mandate comes from the Doha Round’s Minis-

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222 See, e.g., GATT, supra note 3, at art. XV sec. V(F).
223 For example, there are times when intervention or capital controls by a country in the exchange markets can be warranted to prevent the exchange rate from being pushed further away from its equilibrium level. See Cline and Williamson, supra note 205, at 5, 9 “It would be very wrong for the G-20 to condemn all countries that are trying to prevent their exchange rates from appreciating. One needs to ask which currencies are undervalued and concentrate on preventing their intervening and tightening currency controls.”
terial Declaration in November 2001. While this Working Group has focused since 2008 mostly on initiatives to support trade finance, a submission by Brazil in April 2011 has proposed that the Working Group explore the relationship between exchange rates and international trade. In introducing its proposal, Brazil stated in part that "... the more specific macroeconomic dynamics between exchange rate [sic] and foreign trade is an issue that is yet to be better understood and addressed in international forums, against the background of the international crisis triggered in 2008. The time has come to do so in an institutional and structured way." Proposing what it described as "essentially a debate with a view to better understanding the issues involved and their implications for members of the WTO" and not negotiations, Brazil cited the Working Group’s mandate to strengthen the coherence of international trade and financial policies and to safeguard the multilateral trading system from the effects of financial and monetary instability and then advanced two “pillars” for consideration and action by the Working Group: (1) an economic approach based upon theory and real case studies of the relationship between exchange rates and international trade; and (2) an institutional approach looking into global coherence of international trade and financial policies and related global governance matters. As since reported in the press, the Working Group has accepted going forward with the first pillar, but not with the second pillar. Both the United States and China objected to the second pillar, the United States on the ground that macroeconomic policies and exchange rates are the jurisdiction of the IMF, and China on the ground that suggestions that trade balances and exchange rates should be linked should be dismissed according to an extensive study of the world’s 46 leading economies carried out by Chinese researchers. At the request of the Working Group’s chairman, Brazil is reported to be reformulating the second pillar in response to members’ concerns. If the Working Group’s deliberations thus far are taken as a barometer, the relationship between exchange rates and international trade is a subject that is recognized as important, in need of some attention, and controversial. Brazil appears for thoughtful reasons to be intent on a study of this topic being made, and, at least as far as the first pillar is concerned, the Working Group has endorsed Brazil’s request.

224 World Trade Organization, Ministerial Declaration of 14 November 2001, WT/MIN(01)/DEC/1, 41 I.L.M. 746 (2002), ¶ 36, “We agree to an examination, in a Working Group under the auspices of the General Council, of the relationship between trade, debt and finance, and of any possible recommendations on steps that might be taken within the mandate and competence of the WTO to enhance the capacity of the multilateral trading system to contribute to a durable solution to the problem of external indebtedness of developing and least-developed countries, and to strengthen the coherence of international trade and financial policies, with a view to safeguarding the multilateral trading system from the effects of financial and monetary instability.” (emphasis added).


226 Id. at 1 (bracketed material added).

227 Id. at 1-3.


229 Id.

230 Submission by Brazil, supra note 225, at 1. In Brazil’s words, “The international debate on the relationship between exchange rates and international trade is not a new one. It was a key component, for example, in the design of the Bretton Woods architecture of international institutions. The issue has gained momentum again lately. Responses to the financial and economic crisis of 2008/09 have included the adoption, by a vast number
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IMF and the WTO now, while there is time to explore strengthening the coherence of international trade and financial policies, would be prudent and might save much turmoil down the road. The reasoning of the United States not to look at the second pillar’s institutional approach out of jurisdictional worries consequently is not persuasive. China’s reaction not to pursue the second pillar also is misplaced, because exchange rates and trade balances are linked. If the members of the WTO were to take the time at this juncture, in conjunction with the IMF, to do a careful, reflective review of the relationship between exchange rates and international trade, that effort would almost surely pay good dividends down the road.

While there is no assurance that the efforts of the WTO’s Working Group on Trade, Debt and Finance will be fruitful, the Brazilian government’s submission is constructive simply by pointing out that the relationship between exchange rates and international trade is a subject that is ripe for scrutiny and that involvement by the IMF and the WTO (and possibly even the World Bank) for this purpose is warranted. These two elements – the timeliness of the issue and the institutional collaboration – are important to advance and can be advanced by other means as well. As one example, there does not seem to be any reason why the IMF and the WTO could not engage in writing together a report on fundamental currency misalignment. This kind of undertaking has been done before on other subjects, such as in 2009, when the WTO and the United Nations Environment Programme produced a report on trade and climate change.\(^{231}\) In a forward to the WTO-UNEP Report, Pascal Lamy, the WTO’s Director General, and Achim Steiner, the UNEP’s Executive Director, observed that climate change is “one of the greatest challenges facing the international community” and that “{w}ith a challenge of this magnitude, multilateral cooperation is crucial . . . .”\(^{232}\) In that report, the WTO and the UNEP compiled a thoughtful and thorough précis of climate change from each international institution’s vantage historically, scientifically, technologically, and – without prejudging how dispute settlement at the WTO might conclude – legally. Fundamental currency misalignment in the form of competitive currency depreciation is likewise a great challenge of a magnitude that requires multilateral cooperation, and a similarly insightful précis of the technical, historical, and legal aspects of fundamental currency misalignment from the viewpoints of the IMF and the WTO could be quite worthwhile. Carrying out such a project would entail coordination by the IMF and the WTO with each other, would put the global community on notice that the IMF and the WTO consider fundamental currency misalignment to be a serious international problem, and could add significantly to the comprehension of how a government’s enforced, protracted undervaluation or overvaluation of its country’s currency weakens the legal underpinnings of the international monetary and trading systems. This suggestion is not to understate the political sensitivities that are present both nationally and internationally or the intricacies and subtleties that spring from fundamental currency misalignment and its relationship with international trade, but these difficulties counsel determined and persistent effort by the IMF and the WTO to guard against this practice.


\(^{232}\) Id. at v.
Finally, dispute settlement at the WTO should be weighed as another way in which the WTO and the IMF might be called upon to address fundamental currency misalignment. While the WTO’s Dispute Settlement Understanding does not provide for advisory opinions, in one scenario a member of the WTO could conceivably invoke dispute settlement to contest whether another member’s currency was fundamentally undervalued. In another scenario, dispute settlement at the WTO might instead be precipitated by a country with a currency that another member had found in its municipal legal system was undervalued and in violation of one or another of its domestic trade laws and rights at the WTO. In either situation, as indicated in Section V, supra, in the absence of much jurisprudence at all on this subject under the GATT, the breaking of new legal ground substantively and probably procedurally could be expected. China’s undervaluation of the renminbi would presumably be the prime candidate for dispute settlement at the WTO. Whatever the legal gravamen of a complaint (for example, that the alleged fundamental undervaluation constituted a prohibited, countervailable export subsidy under the WTO’s ASCM or, contrary to GATT Article XV:4, was exchange action that frustrated the intent of one or more provisions of the GATT), two key aspects of such a dispute settlement, among others, would almost certainly be (1) whether a violation of rights and obligations at the WTO could be determined, even if there was no manipulation with the intent proscribed by Article IV(1)(iii) of the IMF’s Articles of Agreement, and (2) how in dispute settlement at the WTO would a panel and the Appellate Body go about determining whether the subject currency was, in fact, fundamentally undervalued. On the first score, it is submitted that the WTO’s provisions against subsidies and generally otherwise focus upon a measure’s effect and do not require a showing of intent by the member whose measure is under attack, so that a violation of rights and obligations at the WTO could be established even if no manipulative intent could be demonstrated under the IMF’s standards. On the second score, under GATT Article XV:2, which calls for the WTO to consult fully with the IMF on problems concerning monetary reserves, balances of payments, or foreign exchange arrangements and to accept all findings of statistical and other facts presented by the IMF relating to foreign exchange, monetary reserves, and balances of payments, it would seem that a panel and the Appellate Body would be expected to seek and adopt the IMF’s computations on whether a member’s currency were fundamentally undervalued. At least in these two respects, it is possible to envision the IMF and the WTO collaborating in a manner that would offset the unevenness referred to in section VII(C)(1), supra, in the two international institutions’ evolution. That is, (1) the strength of the WTO’s dispute-settlement mechanism would handily compensate for the IMF’s not having one, (2) there is a credible basis to conclude that with their emphasis on the impact caused by a measure rather than the intent of the member’s government – the WTO’s provisions could properly sidestep the quagmire of whether a member intentionally was at fault under Article IV(1)(iii) of the IMF’s Articles of Agreement, and (3) the IMF’s expertise with exchange rates would give guidance to the WTO in dispute settlement.

In summary, while there no doubt are other measures by which the IMF and the WTO can act in tandem to clarify and improve international discipline over competitive currency depreciation, the ones just discussed are among those steps that appear to be feasible


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and constructive. Fundamental misalignment of currencies is so potentially disruptive as to demand these two international institutions’ best collective teamwork.

VIII. CONCLUSION

“If, with substantial justification, people and businesses in other countries see themselves as the victims of substantial and prolonged competitive depreciation practiced by the Chinese authorities, and if the Fund does not even acknowledge the problem, then the disaffected will seek redress through other channels — and will be justified in doing so. The result could ultimately be that — disgusted with the Fund’s failure reasonably to fulfill its assigned responsibilities — others will be given the job.” — Michael Mussa

“In June 1933, a thousand representatives from 66 countries gathered in London for the World Economic Conference — the grandest collection of world leaders since the Paris Peace Conference of 1919. Among those attending were a king, eight prime ministers, 20 foreign ministers, and 80 other cabinet ministers and heads of central banks.” At the time, the world economy was mired in the Great Depression; unemployment topped 30 percent in some countries; exchange-rate arrangements were in disarray; and nations were poised to adopt the beggar-thy-neighbor policies that would come to define the era. Though much of the world sought some form of cooperation on trade and exchange policy, President Roosevelt “made it clear that his first priority was to get the U.S. economy back on its feet; international considerations would have to take second place.”

Even when it seemed there was a consensus forming around a plan to stabilize exchange rates, President Roosevelt dismissed currency stabilization as one of the “old fetishes of so-called international bankers” and instead put the United States on its own path to recovery. The 1930s and the inter-war period will forever be recalled negatively as a time of high tariff barriers, import controls, and draconian restrictions on capital flows.

Though there are many parallels to be drawn between the interwar period and today, it is important to note the differences, too. The entire world is not presently in a Great Depression. Unemployment is high, but not close to 30 percent. Some nations are again undervaluing their currencies and are deriving a competitive advantage as a result, but the practice is relatively isolated compared to the interwar period. Finally, thanks to visionaries like John Maynard Keynes, Harry Dexter White, and many others, there are international institutions like the WTO and the IMF to oversee the system and police the worst abuses. Through hard experience starting with the First World War and carrying through the Second World War, the leaders of that time came to realize that, without decisive international regulation, nations once more would themselves seek redress in the form of protectionist measures, such as competitive currency depreciation, and instability for all again could ensue.

To reiterate, complacency in the current circumstances would be a mistake. Past is often prologue. “At the root of many of the problems of the interwar years was a malfunction-

234 Mussa, supra note 48, at 75.
235 Liaquat Ahamed, Currency Wars, Then and Now: How Policymakers Can Avoid the Perils of the 1930s, FOREIGN AFFAIRS, 92 (March/April 2011) [hereinafter “Ahamed”].
236 Id. at 92-94.
237 Id. at 92.
238 Id. at 93.
239 Id. at 94.
ing global financial system. Policymakers then had to contend with misaligned exchange rates, apparently intractable current account imbalances, and the growing threat of protectionism. As the Seoul G-20 meeting so vividly illustrated, their counterparts of today are struggling with very similar challenges.”

Though post-war policymakers in the 1940s clearly understood the dangers posed by widespread currency misalignment, it is worrisome that the memory of all that transpired between 1914 and 1945 is seemingly being discounted by many and even ignored by some today. “Like France in the 1920s, China has an undervalued exchange rate and to sustain its peg is forced to accumulate enormous quantities of dollar reserves. The country must then neutralize these reserves by limiting credit growth in order to prevent domestic inflation from undermining its competitive advantage. As a result, not only is the dollar prevented from falling against the [RMB], but manufactured goods from China continue to remain unusually cheap, disabling two critical mechanisms for reducing the trade imbalance between China and the United States.”

This article has sought to give an overview of the problem of competitive currency depreciation and in the process to put in some historical context what has happened in the past so as possibly to shed light on what might most productively be done from this juncture forward to control this practice. Fundamental misalignment of currencies, whether through depreciation or appreciation, is complex, and the instability that it generates monetarily, commercially, and politically can be overwhelming. “Having so successfully averted the mistakes that made the slump of the 1930s so deep, it would be truly tragic if policymakers were now to repeat the beggar-thy-neighbor policies that made the 1930s a time of the worst sort of populism and nationalism.” History need not repeat itself, but the risk that it might will continue and probably become more pronounced with time absent a firm, international determination to stem this irresponsible sovereign behavior. Without orderly exchange arrangements, the global economy cannot operate in a balanced, sustainable fashion. Within the existing international framework, the WTO and the IMF have means to hold to account countries like China that do not allow their currencies to reach their equilibrium values. The time has come for the international community to reaffirm its commitment against so-called currency wars and in favor of stable growth and better standards of living for all.

240 Id. at 94.
241 Id. (bracketed material added). In his speech on June 1, 2009, at Peking University, Treasury Secretary Geithner tactfully, respectfully, and accurately echoed how the renminbi’s relative inflexibility jeopardizes the rebalancing process for the United States, for China, and globally. In his words, “Our common challenge is to recognize that a more balanced and sustainable global recovery will require changes in the composition of growth in our two economies. Because of this, our policies have to be directed at very different outcomes. In the United States, saving rates will have to increase, and the purchases of U.S. consumers cannot be as dominant a driver of growth as they have been in the past. In China, as your leadership has recognized, growth that is sustainable growth will require a very substantial shift from external to domestic demand, from an investment and export intensive driven growth, to growth led by consumption. Strengthening domestic demand will also strengthen China’s ability to weather fluctuations in global supply and demand. * * * * An important part of this strategy is the [Chinese] government’s commitment to continue progress toward a more flexible exchange rate regime. Greater exchange rate flexibility will help reinforce the shift in the composition of growth, encourage resource shifts to support domestic demand, and provide greater ability for monetary policy to achieve sustained growth with low inflation in the future.” Speech by Treasury Secretary Timothy F. Geithner, The United States and China, Cooperating for Recovery and Growth 3, 4-5 (June 1, 2009), available at http://www.treasury.gov/press-center/press-releases/Pages/tg152.aspx (bracketed material added).
242 Ahamed, supra note 235, at 103.