The Role of WTO in the Regulation of Currency Manipulation

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ABSTRACT

Currency manipulation is widely recognized to impair international trade order as it grants price advantages to the exporting companies. Given that the current international laws are not sufficient to combat the issue, there are proposals that the World Trade Organization (WTO) should participate in the regulation process. This thesis examines the possible ways the WTO can be involved to regulate currency manipulation. The first way is to demonstrate that currency manipulation violates a WTO obligation. The most relevant provisions are Article I of the Agreement on Subsidies and Countervailing Measures and Article XV of the General Agreement on Tariffs and Trade. However, after interpretation, the thesis finds that none of the articles are satisfied. Another way is to conclude a new cooperation agreement between the WTO and the International Monetary Fund so that currency manipulation can be subject to the WTO dispute resolution mechanism. While this thesis finds that although a cooperation agreement is an ideal solution, it does not seem to be possible for it to obtain adequate support from the countries. Therefore, this thesis attempts to present a new solution, which is to amend the Anti-Dumping Agreement so that the price drop caused by currency devaluation can be eliminated by the anti-dumping duty. Compared with previous proposals, this indirect regulation mode has more advantages in terms of maintaining the integrity of the WTO legal system.

La manipulation des devises est largement reconnue comme biaisant pour le commerce international puisqu'elle avantage considérablement les exportateurs. Vu que le droit international ne remédie pas suffisamment à ce problème, les appels se multiplient pour que l'Organisation Mondiale du Commerce (OMC) participe au processus de réglementation. Cette thèse examine les diffèrent moyens par lesquelles l'OMC peut réguler la manipulation des devises. Dans un premier

temps, il importe de démontrer que la manipulation des devises constitue une violation des engagements pris auprès de l'OMC. Les textes les plus pertinentes sont L'Article I de L'Accord sur les subventions et les mesures compensatoires et L'Article XV de L'Accord général sur les tarifs douaniers et le commerce. Cette thèse ne révèle qu'aucun de ces articles adresse les besoins de réglementation de manière satisfaisante. Une solution envisageable consisterait à établir un accord de partenariat entre l'OMC et le Fond Monétaire Internationale (FMI) pour arbitrer les cas de manipulation de devises avec le mécanisme de résolution des disputes de l'OMC. Hormis le fait que cette thèse soutient qu'un accord de partenariat OMC-FMI pourrait être une solution idéale, il est envisageable qu'elle ne soit pas soutenue par les pays membres de ces organisations. Cette thèse propose donc une solution alternative. Il s'agit de modifier l'Accord antidumping de sorte que la chute des prix causé par la manipulation des devises serait éliminé par les pénalités antidumping. Comparé aux autres solutions envisagées, celle-ci semble plus avantageux pour le maintien de l'intégrité du système légale de l'OMC.

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INTRODUCTION

There is not a uniform definition of currency manipulation because the currency regulation activities in different countries are quite diversified and multi-targeted. As its name implies, currency manipulation can be understood as a series of interventions by governments or central banks in the exchange rate market. These interventions aim to deviate the value of a currency from normal level to a lower level and to help exporting companies gain advantages in international competition.[1] Besides, if a country has a fixed exchange rate currency regime, the government's deliberate inaction to adjust the value of currency from a fundamentally misaligned exchange rate can also constitute currency manipulation.[2]

Manipulated currency devaluation can grant unfair trade advantages to exporting companies because it makes the exporting prices lower. Like subsidy and dumping, it distorts trade and impairs the established international trade order. However, currently, there is not an effective international mechanism to regulate the issue. The International Monetary Fund (IMF) ascertains that it is the members' obligation to avoid exchange rate manipulation,[3] but there is not an effective sanction on the violation of the obligation. As a result, an increased attention has been placed on another international institution – the World Trade Organization (WTO), which has an effective dispute settlement and enforcement mechanism on international disputes, to participate in the

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[1] See e.g. Joseph E Gagnon, "Combating Widespread Currency Manipulation" (2012) Peterson Institute for International Economics Working Paper No PB 12-19 [*Gagnon*] ("[c]urrency manipulation occurs when a government buys or sells foreign currency to push the exchange rate of its currency away from its equilibrium value or to prevent the exchange rate from moving toward its equilibrium value" at 1); Morris Goldstein, "Currency Manipulation and Enforcing the Rules of the International Monetary System" in, Edwin M Truman, ed, *Reforming the IMF for the 21st Century* (Washington DC: Peterson Institute for International Economics, 2006) 141 ("large-scale, pro-longed, one-way intervention in exchange markets to limit or to preclude currency appreciation" at 141).
[2] A typical example is China. Before 2005, China's currency was pegged to U.S. dollar at an approximate rate of 8.28 and the government did not take measures to adjust the exchange rate. As a result, it was strongly criticized by countries like the US that the currency was severely undervalued and that China was manipulating its currency.
[3] *Articles of Agreement of the International Monetary Fund*, 22 July 1944, 2 UNTS 39 art IV (entered into force 27 December 1945) [*IMF Agreement*].

regulation of currency issues. The objective of this paper is to determine what role the WTO can play in this process. To be more specific, whether the WTO agreements are applicable to the issue and what developments the WTO can make in future negotiations.

Chapter I will give a comprehensive introduction to the background of currency manipulation problems. It will start with reviewing the change of paradigms of international currency regulation since the 1930s. And then, it will examine the existing multilateral regulatory framework on the issue. The analysis will show that the current regulatory framework is inadequate to prevent countries from manipulating currency. As such, the thesis will turn to the recommendations proposed in other research. According to the literature review, there are basically two ways for the WTO to participate in the regulation process: interpreting the existing WTO Agreement as covering currency manipulation issues, and concluding a new agreement to regulate the issue in future. Therefore, the following chapters will be unfolded based on these two dimensions. Chapter II will examine whether current WTO rules can be interpreted to cover currency manipulation. To be more specific, the chapter will focus on two issues: whether currency manipulation satisfies the definition of "subsidy" in the Agreement on Subsidies and Countervailing Measures (SCM Agreement) Article I; and whether it is covered by the General Agreement on Tariffs and Trade (GATT) Article XV paragraph 4. As Chapter II will conclude that both agreements cannot be interpreted to regulate the issue, Chapter III will move on to analyzing two possible developments the WTO is suggested to make in future. The first one is to conclude a cooperation regulation agreement with the IMF so that currency manipulation can be directly litigated to the WTO; and the second one is to amend the Anti-Dumping Agreement to calculate the influence of currency manipulation in anti-dumping investigations.

The dominant methodology in the research is doctrinal research. The main sources for analysis are texts of the WTO agreements and the IMF agreement, previous WTO cases, customary international law and relevant books and papers. Especially in Chapter II, the key terms in the SCM Agreement and GATT will be interpreted to examine whether they cover currency manipulation. The methodological framework for interpretation is established on the basis of Article 31 and Article 32 of the *Vienne Convention*. Previous findings by the WTO panels and Appellate Bodies will also be important sources for interpretation. Apart from treaties and cases, secondary materials such as books, periodical articles, working papers, news, and even blogs written by scholars and politicians are important sources. They contribute to the establishment of the entire thesis's analysis framework.

This thesis will attempt to make a significant contribution to the body of research on the relationship between currency issues and the WTO. Although there are already some papers discussing whether the WTO agreements can be applied to currency issues, few of them analyze with a strict treaty interpretation approach. By interpreting the provisions under customary international law framework, this research aims at providing a more accurate understanding of the role of the WTO in the regulation of currency manipulation. The research also contributes to the current literature by trying to propose a new way for the WTO to combat currency manipulation, which is to apply the surrogate-price approach in anti-dumping investigations to eliminate the unfair trade advantages. After explaining how this approach works, it will analyze the feasibility, advantages, and disadvantages of the approach, which can be expected to have practical value for future WTO negotiations.

I. PROBLEMS IN CONTEXT

The devaluation of a country's currency enables the exporting companies in that country to sell their products at a lower price, which helps them enlarge market share in foreign trade. However, at the same time, it impairs the exporting of like products from other countries and might impact related industries in the importing country. Therefore, the IMF explicitly prohibited export-oriented exchange rate manipulation.[4] Its regulatory framework on currency issues has changed remarkably in the last decades. Section 1 of this chapter will introduce how the laws have transformed with the change of IMF's role in the regulation of international monetary affairs. Section 2 will further explain the current rules against currency manipulation, including the obligation provisions in the IMF Agreement and their enforcement mechanism. Section 3 is a literature review section on how the WTO can be included in the regulation process. The objective of this chapter is to explain why the IMF's framework is not sufficient to combat currency manipulation, why the WTO is widely proposed by scholars and politicians to regulate the issue, and what are the possible ways for the WTO to address the issue.

1. History of International Currency Policy Regulation

The IMF Agreement established a multilateral regulatory framework on currency policies. However, the current rules are quite different from the first version of the IMF Agreement. This section will briefly review the evolution history of international law related to exchange rate issues. By looking back on the history, this section aims to provide a more holistic understanding of how the current regulatory framework is formed and why it lacks an effective enforcement mechanism.

[4] It will be explained further in Section 2 of this chapter.

1) Currency Regime Arrangement and Sovereignty

Before the establishment of the IMF, the accepted legal doctrine was that countries have an inherent right to determine the value of their currencies.[5] There were no international laws governing monetary affairs and the values of currencies were linked to gold or silver, entirely controlled by the individual countries.[6] As a result, the international exchange rate market and trade system fell into chaos between World War I and World War II.[7]

After World War II, a consensus was reached to build a stable international monetary system. The Bretten Wood Conference was held in 1944, during which the IMF Agreement was concluded and a multilateral currency regulation framework was formed. The members had to respect the par-value [8] of their currencies, which means that the exchange rate of the currency was fixed to the US dollar and gold.[9] Only under the circumstance that the par value of its currency had a fundamental disequilibrium from the normal value could a country change the exchange rate. The country must propose to, consult with, and get the permission from the IMF before it conducted the change.[10] Thus, under the par-value system, the members gave up the sovereignty of currency arrangement to a large extent and were subject to the uniform regulation by the IMF.

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[5] See Joseph Gold, *Exchange Rates in International Law and Organization* (the USA: American Bar Association, 1988) at 2-3 [*Gold*].

[6] See Andreas F Lowenfeld, "The International Monetary System: A Look Back Over Seven Decades" in Thomas Cottier, John H Jackson & Rose M Lastra, eds, *International Law in Financial Regulation and Monetary Affairs* (Oxford: Oxford University Press, 2012) 52 at 52-53 [*Lowenfeld*].

[7] *Ibid.* During that period, many countries were suffering economic depression and unemployment problems, so they competed to increase export in order to increase their hold of gold and to recover the economy. They imposed measures such as subsidy, tariff and discriminatory exchange controls.

[8] This was mainly advocated by the US, who believed that it was not necessary for the governments to actively adjust the exchange rate and they should let the market to determine it. By that time, the US held around two thirds of the world's gold. Hence, it had the power to peg the value of US dollar to gold and made other parties peg their currencies to the US dollar. This formed a fixed exchange rates system among the IMF parties and consequently limited the parties' activities on exchange rate arrangement.

[9] Gold, *supra* note 5 at 7.

[10] *Ibid* at 41.

In August 1971, the par-value system collapsed as a result of the United State's (the US) unilateral suspension of the dollar's convertibility into gold, and consequently the members were free to choose the form of exchange rate arrangement again.[11] Accordingly, the IMF Agreement was amended to replace the previous fixed exchange rate obligation with less compulsory obligations. One example is Article IV 1(iii), which simply requires the members to avoid exchange rate manipulation.[12] The major role of the IMF also transformed from the core international monetary regulatory institution to a foreign aid agency.[13] Since then, the right to arrange currency regime went back to the member states again.

The discussion above shows that the pendulum of international currency regulation swung between absolute national sovereignty and uniform multilateral regulation during the last decades. It moved from the status of no multilateral rules to the status of strict and unified regulation. However, the history shows that both of them fails to maintain the international monetary order. And now, it goes back at a point where sovereignty plays a more significant role than multilateral regulation. It is not easy to find a balance point between the states' right to conduct currency arrangement and the stability of the international monetary system. The worldwide competitive currency devaluation prevalent in the past few years indicates that this pendulum is far from its balance point.

[11] IMF, "The End of the Bretton Woods System (1972–81)", online: IMF <https://www.imf.org/external/about/histend.htm>. The form of exchange rate agreement includes: allowing the currency to float freely, pegging it to another currency or a basket of currencies, adopting the currency of another country, participating in a currency bloc, or forming part of a monetary union.
[12] Article IV, Section 1(iii) of the IMF Agreement: "(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…".
[13] See Lowenfeld, *supra* note 6 at 62.

2) Competitive Currency Devaluation

Despite IMF's requirement to avoid exchange rate manipulation, the members are still keen on using currency arrangement as a tool to achieve domestic economic goals or to gain competitive advantages in international trade.[14]

The situation became worse after the 2008 global financial crisis. Since then the countries have developed the trend of devaluating their currencies competitively, also known as the "currency war", by means of direct interference in the exchange rate market or Quantitative Easing[15] (QE).[16] For example, China's currency, renminbi (RMB, also called *yuan*), is pegged to a basket of currencies. Since the government has a strong control of foreign currencies, it is easy for it to devaluate RMB by contracting the supply of foreign currencies and increasing the supply of RMB.[17] By contrast, the policy preferred by the US, QE, is normally not designed to devaluate the currency,[18] notwithstanding that it unavoidably leads to the devaluation result. This paper will only discuss the regulation of the first kind of manipulated currency devaluation because, as will be explained further in section 2 of this chapter, QE does not violate the IMF obligations.

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[14] IMF's study shows that a country's GDP tends to increase when its currency is depreciating. See IMF, *World Economic Outlook: Uneven Growth—Short- and Long-Term Factors* (Washington: IMF, 2015) at 9, online: IMF < www.imf.org/external/pubs/ft/weo/2015/01/>.

[15] It means "an unconventional form of monetary policy where a Central Bank creates new money electronically to buy financial assets, like government bonds". (Bank of England, "What is Quantitative Easing?", online: <www.bankofengland.co.uk/monetarypolicy/pages/qe/default.aspx>.) During this process, the real value of the currency will decrease because the amount of currency increases.

[16] During the "currency war", not only developing countries were intervening in the exchange market to keep the value of currency in a low level, the large developed economies such as the US and Japan were also devaluing their currency. See Ambrose Evans-Pritchard, "Capital controls eyed as global currency wars escalate" (2010), *The Telegraph* (blog), online: <www.telegraph.co.uk/finance/economics/8031203/Capital-controls-eyed-as-global-currency-wars-escalate.html>.

[17] See Nathan Fudge, "Walter Mitty and the Dragon: An Analysis of the Possibility for WTO or IMF Action against China's Manipulation of the Yuan" (2011) 45:2 J of World Trade 349 at 351[*Fudge*].

[18] QE is normally launched as an expansionary monetary policy to keep the inflation rate on an appropriate level and adjust interest rate. During this process, money supply increases, as a result of which the currency depreciates. See Bank of England, "Quantitative easing explained", online:<www.bankofengland.co.uk/monetarypolicy/Documents/pdf/qe-pamphlet.pdf>.

Empirical research indicates that total currency manipulation may be as high as $ 1.5 trillion per year and is responsible for millions of lost jobs in the US.[19] It is blamed to have caused the US's huge trade deficit and is criticized for being "the world's most protectionist international economic policy in the 21st century".[20] Besides, it severely disturbs the normal order of global trade by artificially influencing the price of goods, service, and investment in cross-border transactions.[21] Apart from the global economy, competitive currency undervaluation also undermines some fundamental international principles such as the Most Favored Nation (MFN) principle, National Treatment principle and tariff bindings in WTO laws.[22] Therefore, international institutions and governments attach great importance to the issue. The IMF makes assessments on the members' currency policies periodically to examine whether their currency policy is consistent with the IMF Agreement Article IV.[23] For example, in 2014, it criticized South Korea for intervening in the exchange market which caused a devaluation of its currency, *won*.[24] The US Department of the Treasury also publishes semi-annual reports on foreign exchange rate policies of its major trade partners.[25] While the measures taken by the institutions and the countries

[19] Gagnon, *supra* note 1 at 4. Unemployment usually happens as a result of a country's increasing reliance on import of goods and services instead of producing domestically, which decreases the demand for domestic labors.
[20] C Fred Bergsten, "Currency Manipulation: Why Something Must Be Done" (25 February 2015) *Forbes* (blog) online:<www.forbes.com/sites/realspin/2015/02/25/currency-manipulation-why-something-must-be-done/#6d3c1ff331c8 >. Mr. Bergsten is a senior fellow and director emeritus at the Peterson Institute for International Economics.
[21] Jeffrey S Beckington & Matthew R Amon, "Competitive Currency Depreciation: The Need for a More Effective International Legal Regime" (2011)10 J Int'l Bus & L 209 at 244 [*Beckington & Amon*].
[22] *Ibid*. According to *Beckington & Amon,* if country A devalues its currency relatively to country B's currency, while maintain the normal exchange rate to country C's currency, country C is conferred with advantage compared to country B in trade because the relative import price of country B increases as a result of A's devaluation. Thus it undermines the principle of MFN. It is similar to the National Treatment principle. As to the tariff binding obligation, it will be explained in detail later in the analysis of the SCM Agreement.
[23] *IMF Agreement,* art IV.
[24] IMF, Press Release, No. 14/20, "IMF Executive Board Concludes 2013 Article IV Consultation with the Republic of Korea" (22 January 2014), online: IMF< www.imf.org/external/np/sec/pr/2014/pr1420.htm>.
[25] See US Department of the Treasury, Resource Center, online:< https://www.treasury.gov/resource-center/international/exchange-rate-policies/Pages/index.aspx>.

incline to be political measures, international laws have played little role in combating currency manipulation yet.

2. Existing International Legal Framework

Up to now, only Article IV1(iii) of the IMF Agreement explicitly forbids currency manipulation. It requires the member states to "avoid manipulating exchange rates or the international monetary system in order to prevent effective balance of payments (BOP) adjustment or to gain an unfair competitive advantage over other members".[26]

The *Bilateral and Multilateral Surveillance Executive Board Decision* (the 2012 Decision) published by the IMF further explains the meaning of "manipulating exchange rates". It identifies two criteria to examine whether a policy violates Article IV: 1) the existence of manipulating activities, and 2) the existence of BOP adjustment preventing or trade boosting purpose.[27] As to the first criteria, the activities must be "carried out through policies that are targeted at—and actually affect—the level of an exchange rate" in order to be considered as "manipulation".[28] As to the second criteria, the IMF will determine whether the policy is carried out for one of the two purposes listed in Article IV (i.e. "to prevent effective balance of payments adjustment or to gain an unfair competitive advantage over other members"). Especially, when determining whether the purpose is to gain an unfair competitive advantage, the IMF will consider whether the exchange

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[26] *Ibid*.
[27] IMF, *Bilateral and Multilateral Surveillance Executive Board Decision*, 18 July 2012, Public Information Notice [2012] OJ, L 12/89, online: IMF < https://www.imf.org/external/np/sec/pn/2012/pn1289.htm> at ANNEX [*2012 Decision*]. The decision is a result of the *Executive Board discussions of Article IV consultations* with member countries to enhance bilateral and multilateral surveillance on exchange rate issues. It's the second multilateral consultation on the article. The first one was held in 2007.
[28] *Ibid*.

rate misalignment is in the form of the undervalued exchange rate as well as whether the purpose of misalignment is to increase export.[29]

The standard adopted by the IMF is a combination of objective and subjective standards. By requiring both the objective existence of manipulation and subjective purpose of gaining competitive advantage, it narrows the scope of activities prohibited by Article IV. For example, QE does not violate the article because normally its purpose is not to promote export,[30] although it leads to the currency devaluation consequence. Another example is the circumstance of currency overvaluation. Even though there exist manipulation activities, the member will not be found to violate Article IV because overvaluation makes the export price higher, which cannot help the member gain competitive advantage.[31] Besides, the article excludes the possibility for other members to participate and demonstrate evidence in the process of examining a member's currency regime as only the IMF has this authority.[32] The scope of regulation is further narrowed by the requirement of the exchange rate misalignment result ("actually affect the level of an exchange rate"). That is to say, a member does not violate Article IV if it implemented export-oriented currency policy but the policy fails to influence the exchange rate.

According to the IMF Agreement, the mechanism by which Article IV is enforced is the IMF's surveillance over the members' exchange arrangement.[33] During the process, the members have the obligation to provide information and consult with the IMF if necessary.[34] Besides, according to Article XXVI of the IMF Agreement, "[i]f a member fails to fulfill any of its

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[29] *Ibid*.
[30] See *supra* note 18.
[31] Annamaria Viterbo, *International Economic Law and Monetary Measures: Limitations to States' Sovereignty and Dispute Settlement* (UK: Edward Elgar Publishing Limited, 2012) at 296 [*Viterbo*].
[32] See Elizabeth L Pettis, "Is China's Manipulation of Its Currency an Actionable Violation of the IMF and/or the WTO Agreements?" (2011) 10:2 J Int'l Bus & L 28 at 287 [*Pettis*].
[33] *IMF Agreement,* art. IV3.
[34] *Ibid*.

obligations under this Agreement, the Fund may declare the member ineligible to use the general resources of the Fund"[35]; if after a reasonable period the member still fails to fulfill the obligation, its voting power is at the risk of being suspended[36]; and if the member insists on violating its obligation after a reasonable period of voting power suspension, it might be subject to the severest sanction – being required to withdraw its membership from IMF.[37]

However, the sanctions do not seem to be effective because there are no clear, transparent and binding procedures for the IMF to make investigations, which makes it difficult to prove the existence of a violation.[38] Besides, the decision-making process of IMF's Board of Governors is power-based rather than rule-based, which means that countries with higher voting quota[39] have a stronger influence on the final result. Thus, it is difficult for the IMF to take a collective measure against a state's currency undervaluation, especially when the targeted member has a large voting quota.[40] Hence, it is not surprising that since the adoption of the article, the IMF has never officially found that any member is violating this obligation on currency manipulation.[41]

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[35] *IMF Agreement*, art XXVI 2(a).

[36] *Ibid* art XXVI 2(b). The subparagraph states: "[i]f, after the expiration of a reasonable period following a declaration of ineligibility under (a) above, the member persists in its failure to fulfill any of its obligations under this Agreement, the Fund may, by a seventy percent majority of the total voting power, suspend the voting rights of the member. During the period of the suspension, the provisions of Schedule L shall apply. The Fund may, by a seventy percent majority of the total voting power, terminate the suspension at any time".

[37] *Ibid* art XXVI 2(c). The subparagraph states: "[i]f, after the expiration of a reasonable period following a decision of suspension under (b) above, the member persists in its failure to fulfill any of its obligations under this Agreement, that member may be required to withdraw from membership in the Fund by a decision of the Board of Governors carried by a majority of the Governors having eighty-five percent of the total voting power".

[38] Ernst Baltensperger & Thomas Cottier, "The Role of International Law in Monetary Affairs" (2010) 13:3 J Intl Econ L 911at 935 [*Baltensperger & Cottier*].

[39] Members have different voting quota which is based on a holistic consideration of the member's GDP, openness, economic variability and international reserves. The US has the largest quota (16.7%). For more information on IMF's decision making process, see IMF, "How the IMF Makes Decisions" (27 January 2016), online: <www.imf.org/external/np/exr/facts/govern.htm>.

[40] Haneul Jung, "Tackling Currency Manipulation with International Law: Why and How Currency Manipulation should be Adjudicated?" (2012) 9:2 Manchester Journal of International Economic Law184 at 195[*Jung*].

[41] Laurence Howard, "Chinese Currency Manipulation: Are There Any Solutions?" (2013) 27:2 Emory Intl L Rev 1215 at 1225 [*Howard*].

Lacking an effective enforcement mechanism makes Article IV non-binding in practice. It is suggested that, in order to enhance the surveillance of currency policies, the IMF should concern itself more with the following issues: 1) potential currency manipulation practices and potential risks arising from it; 2) the use of the Financial Sector Assessment Program (FSAP)[42] to conduct more bilateral consultations with the members and assess their currency policy frequently; 3) in addition to a member's domestic finance stability, the external impacts of a member's currency policy on other members; 4) the development of the IMF's own surveillance policies.[43] However, no matter how much the IMF enhances its surveillance power, surveillance, as an enforcement measure on its own, is hardly adequate to prevent or regulate currency manipulation activities. A more powerful mechanism is required to enforce the IMF's findings. Hence, some scholars are seeking for the possibility of IMF's cooperation with other international institutions [44] or subjecting the issue totally to another institution.

3. Proposed Regulatory Framework

It seems that there could be two patterns to regulate a state's currency manipulation behaviors with mechanisms outside IMF. The first one is to find an effective enforcement mechanism to implement Article IV of the IMF Agreement, which, in other words, is to directly challenge currency manipulation *per se* as a violation of international obligations. Since the standards of

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[42] The FSAP is a periodical program conducted by the IMF which "analyzes the extent to which a member's financial sector regulatory framework is consistent with international best practice in key areas". Sean Hagan, "Enhancing the IMF's Regulatory Authority" in Thomas Cottier, John H Jackson & Rose M Lastra, eds, *International Law in Financial Regulation and Monetary Affairs* (Oxford: Oxford University Press, 2012) 397 at 401 [*Hagan*].

[43] See Morris Goldstein, "Currency Manipulation and Enforcing the Rules of the International Monetary System" in Edwin M Truman, ed. *Reforming the IMF for the 21st Century* (Washington DC, USA: Peterson Institute for International Economics, 2006) 141 at 153- 4. See also Nadia Rendak, "Monitoring and Surveillance of the International Monetary System: What Can Be Learnt from the Trade Field?" in Thomas Cottier et al, eds, *The Rule of Law in Monetary Affairs: World Trade Forum* (Cambridge: Cambridge University Press, 2014) 204 at 229-30 [*Rendak*]; Hagan, *ibid* at 401-4.

[44] See e.g. Rendak, *ibid* at 230.

currency manipulation identified in Article IV and the *2012 Decision* are not quite controversial, the main problem of the IMF Agreement is that IMF's consultation as an enforcement measure is not adequate to bind the members. One solution is to find a linkage between currency manipulation and agreements in other areas such as anti-subsidy and anti-dumping laws so that the sanctions in the agreements can be applied to regulate manipulation activities. In this scenario, the members are not accused because they violate the obligation of avoiding currency manipulation, but because the consequence of manipulation resembles a violation of other international trade rules. The second solution is to cooperate with an institution who has effective dispute settlement and enforcement mechanism to fill this gap. Despite the variety of the proposals, there is one common point among them: to make sure that there are enforceable legal sanctions for the violation of IMF's rules.

1) The WTO Agreements

As discussed above, the first pattern to regulate currency manipulation is to connect it with other international agreements so that it can be subject to the regulation of that agreement. Up to now, the most discussed agreements are the SCM Agreement; GATT Article XV and the Anti-Dumping Agreement.

a. The SCM Agreement

There are many similarities between currency undervaluation and subsidy. To start with, both of them are governmental activities. The former is a result of the governments or central banks' intervention in the exchange rate market and the latter is a result of the government or public body's financial contribution to exporting goods. Besides, both of them lead to a decrease of export price and aim at boosting export. And both of them have negative impacts on other countries and hinder international trade order. According to the SCM Agreement, a subsidy exists if there is a 1)

financial contribution by a government or any public body, 2) *benefit* is thereby conferred and 3) the subsidy is *specific* to an enterprise or industry or group of enterprises or industries.[45] If the measure is defined as prohibited export subsidy under Article III[46], it is considered to meet the specificity requirement.[47] It is widely acknowledged that the benefit granted by advantaged exchange rate fails to meet the requirement of specificity because the benefit is open to everyone who is involved in foreign trade using non-local currency.[48] Therefore, the debate concentrates on whether currency devaluation constitutes "export subsidy".

Magnus and Brightbill strongly suggest that the US Commerce Department should directly litigate China's currency regime in the WTO or launch countervailing duty (CVD)[49] investigations according to domestic petitions. This is because they believe that China's currency regime meets all the requirements in the SCM Agreement, although they cannot guarantee the result of the case.[50] Caryl compares the two kinds of actions the US can take against China's currency devaluation. The first is to directly complain China's currency regime to the WTO and the second is to conduct CVD investigation unilaterally. He concludes that although the former approach is better to avoid

[45] See Agreement on Subsidies and Countervailing Measures, 15 April 1994, 1867 UNTS 14 arts I –II (entered into force 1 January 1995) [*SCM Agreement*].
[46] Article III states that "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 (5)" shall be prohibited.
[47] The interpretation of these articles will be elaborated in the next chapter.
[48] See e.g. Matthew R Leviton, "Is It a Subsidy? An Evaluation of China's Currency Regime and Its Compliance with the WTO" (2005) 23 UCLA Pac Basin L J 243 at 259 [*Leviton*]; Catharina E. Koops, "Manipulating the WTO? The possibilities for challenging undervalued currencies under WTO rules" (2010) Amsterdam Center for International Law Research Papers 2010 at 4 [*Koops*].
[49] According to the SCM Agreement, if a member feels its domestic industry is harmed as a result of another member's subsidy, there are two kinds of actions it can take: it can "use the WTO's dispute settlement procedure to seek the withdrawal of the subsidy or the removal of its adverse effects". Or it can "launch its own investigation and ultimately charge extra duty (known as 'countervailing duty') on subsidized imports that are found to be hurting domestic producers". WTO, "Understanding the WTO: The Agreements - Anti-dumping, Subsidies, Safeguards: Contingencies, etc", online :<www.wto.org/english/thewto_e/whatis_e/tif_e/agrm8_e.htm>. If the member chooses to impose CVD according to its domestic law, it may face the risk to be complained by the other country in WTO.
[50] John R Magnus & Timothy C Brightbill, "China's Currency Regime Is Legitimately Challengeable as a Subsidy under ASCM Rules" (16 April 2010) *VOX* (blog), online:<www.voxeu.org/article/china-s-currency-regime-legitimately-challengeable-subsidy >. John R. Magnus is the president of TradeWins LLC and Timothy C. Brightbill is a Partner of Wiley Rein LLP.

harming bilateral trade,[51] for the US, the latter approach is less difficult and has a larger chance to be supported by the DSB.[52] De Lima-Campos and Gaviria's article also focuses on CVD and comes to the same conclusion.[53] While Pettis's article focuses on the former scenario, it is also quite optimistic that China's currency regime constitutes export subsidy in the SCM Agreement.[54] Both Caryl and Pettis think that undervalued exchange rate constitutes a "direct transfer of funds" from the government to companies when the companies exchange *yuan* to dollar, which is one of the five approaches to examine whether there is "financial contribution" under SCM Agreement Article I.[55] Both of them believe that it is not hard to convince the DSB that undervalued exchange rate is in fact export contingent.[56] For Caryl, an important concern is the benchmark to be compared with when deciding whether there exists a "benefit" under Article I – if the DSB chooses Chinese market or global foreign exchange markets as the benchmark[57] instead of an "equilibrium real effective exchange rate"[58], there will be no "benefit".[59]

In fact, the above-discussed scholars are only the minorities - most scholars believe that currency manipulation cannot be regulated by the SCM Agreement. Waibel thinks that it is difficult to meet all of the financial contribution, benefit, and export contingent requirements,

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[51] In this scenario, the member being challenged (China), will have to stop the manipulation activities. Consequently, trade distortion is eliminated. By contrast, if the US imposes CVD on China, currency manipulation activities still continue and the US's import tariff increases, which harms trade between the two countries.
[52] Benjamin Blase Caryl, "Is China's Currency Regime A Countervailable Subsidy? A Legal Analysis Under the World Trade Organization's SCM Agreement" (2011) 45:1 J World Trade 187 at 191–2 [*Caryl*].
[53] Aluisio de Lima-Campos & Juan Antonio Gaviria, "A Case for Misaligned Currencies as Countervailable Subsidies" (2012) 46:5 J World Trade 1017 at 1040 [*Lima-Campos & Gaviria*].
[54] Pettis, *supra* note 32 at 292-5.
[55] *Ibid* at 293; Caryl, *supra* note 52 at 200.
[56] Pettis, *supra* note 32 at 295; Caryl, *supra* note 52 at 208-213.
[57] When deciding whether there is benefit, the DSB has to find a "benchmark" as a standard to be compared with. Usually this benchmark is the market price of the goods. However, if a country is suspected to have manipulated the exchange rate, the global "market price" of its currency is supposed to be influenced by that manipulation. Thus it is difficult to prove that there exists benefit. It will be further explained in Chapter II.
[58] "Equilibrium real effective exchange rate" can be understood as the exchange rate which is estimated by economic model and is believed to represent the real exchange rate of a currency.
[59] Caryl, *supra* note 52 at 205.

given that 1) "Article 1 of the SCM Agreement contains a closed list of financial contributions"; 2) the benefit is ambiguous, and 3) exchange rate applies to various kind of transactions which are not limited to export.[60] Viterbo,[61] Koops,[62] Jung,[63] Marcus,[64] Leviton,[65] Fudge,[66] Mercurio and Leung,[67] and Staiger and Sykes,[68] although for different reasons, come to the same conclusion. For most of them, currency manipulation fails to meet all the three requirements. Howard even comments it to be as difficult as creating a new international law and change the rules of WTO.[69] Apart from the technical difficulties to prove that currency manipulation meets the three requirements, Viterbo points out that there is a large chance that countries like China will invoke exceptions for developing countries, which makes the litigation even more difficult.[70] The above-mentioned scholars' arguments will be further referred to in the second chapter's discussion.

b. GATT Article XV

Literally, GATT Article XV has a close relationship with exchange rate regulation – it stipulates trade-related currency arrangement issues. Especially, Article XV (4)[71] seems to be

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[60] Michael Waibel, "Retaliating against Exchange-Rate Manipulation under WTO Rules" (16 April 2010), *VoxEU.org* (blog), online: <www.voxeu.org/index.php?q=node/4881>. Michael Waibel is the British Academy Postdoctoral Fellow at the Lauterpacht Centre for International Law and Downing College, University of Cambridge.
[61] Viterbo, *supra* note 31 at 313.
[62] Koops, *supra* note 48 at 2 -6.
[63] Jung, *supra* note 40 at 188-192.
[64] Sohlberg Marcus, "The China Currency Issue: Why the World Trade Organization Would Fail to Provide the United States with an Effective Remedy" (Paper delivered at the Cornell Law School Inter-University Graduate Student Conference, 4 January 2011) Cornell Law School Inter-University Graduate Student Papers 43 at 11-14[*Marcus*].
[65] Leviton, *supra* note 48 at 256 - 65.
[66] Fudge, *supra* note 17 at 352 - 8.
[67] Bryan Mercurio & Celine Sze Ning Leung, "Is China a 'Currency Manipulator'?:The Legitimacy of China's Exchange Regime Under the Current International Legal Framework" (2009) 43:3 The International Lawyer 1257 at 1293 - 8 [*Mercurio & Leung*].
[68] Robert W Staiger & Alan O Sykes, "'Currency manipulation' and world trade" (2010) 9:04 World Trade Review 583 at 609 – 11[*Staiger & Sykes*].
[69] Howard, *supra* note 41 at 1229.
[70] Viterbo, *supra* note 31 at 313.
[71] GATT Article XV (4) stipulates 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".

litigable for the members to bring currency manipulation issues to the WTO. However, it is controversial on how to interpret texts such as "exchange action" in the article. Thorstensen, Muler and Ramos notice that "[a]n exchange action could be understood both as a governmental measure that affects the availability or use of foreign exchange, or as an intervention on the exchange rate".[72] The authors prefer to interpret the word broadly to include both circumstances because both of them influence international trade.[73] Pettis, whose interpretation relies largely on the ordinary meaning of "exchange action" and "frustrate", comes to the same conclusion.[74] Fudge considers elements such as the history and purpose of GATT: although the elements indicate an interpretation excluding exchange rate manipulation, he believes that an up-to-date interpretation of Article XV should cover a broad scope.[75]

Mercurio and Leung emphasize the strict correspondence between the two actions and two intents: in order to violate the article, if the measure is identified as "exchange action", it must frustrate the intent of the provisions of GATT; if it is identified as "trade action", it must frustrate the intent of the provisions of the IMF Agreement.[76] Zimmermann has a different thinking of the interpretation of the article: can XV (4) be an independent basis for a WTO claim?[77] The author considers intrinsic context of Article XV (4), such as Article XV paragraph (5), (6), (7) and *Ad* note of paragraph (4), drawing a conclusion that Article XV (4) must be alleged together with the

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[72] Vera Thorstensen, Carolina Muler & Daniel Ramos, "Exchange Rate Measures: Who Judges The Issue—IMF or WTO?" (2015) 18:1 J Intl Econ L 117 at 128 [*Thorstensen et al.*].
[73] *Ibid* at 129.
[74] Pettis, *supra* note 32 at 288 – 90. For the interpretation of "exchange action", the author mainly relies upon the dictionary meaning of "exchange". For "frustrate", the author analyzes the plain meaning of the *Ad* Note to Article XV(4).
[75] Fudge, *supra* note 17 at 359. His mean reason is that the article is concluded during Bretton Wood System time, when there was little room for the members to manipulate exchange rate. While, since Bretton Wood System has collapsed now, the article should be interpreted consistent with the present context.
[76] Mercurio & Leung, *supra* note 67 at 1285.
[77] Claus D Zimmermann, "Exchange Rate Misalignment and International Law" (2011) 105 Am J Int'l L 423 at 469 – 72[*Zimmermann*].

violation of the intention of other GATT Articles, instead of a violation of the article alone.[78] There is also argument that Article XV (9), which precludes the application of GATT if the exchange rate activities concerned are in accordance with the IMF Agreement,[79] is "an important limitation to the scope of Article XV (4)".[80]

Despite the different understanding of the article, most of the above-mentioned authors feel that it is difficult or impossible to invoke GATT Article XV (4) to regulate currency manipulation given the ambiguity of the articles and the lack of precedents.[81] These arguments will be analyzed further in Chapter II section 3.

c. GATT Article VI and Anti-Dumping Agreement

There are also a few discussions on the possibility of regulating currency manipulation under WTO's anti-dumping mechanism.[82] Like subsidy, dumping shares some similarities with currency devaluation: both of them cause the actual export price to be lower than normal price. Feinberg's economic analysis indicates that under-valued currency is an important cause of dumping to the US.[83] Although agreed with this result, Koops worries that considering exchange rate in a dumping context is inconsistent with the purpose of the Anti-Dumping Agreement because the subject of

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[78] *Ibid*. See also Viterbo, *supra* note 31 at 310.
[79] See *GATT* art XV (9)(a).
[80] Gabrielle Z Marceau & Jone J Maughan, " The WTO Dispute Settlement Mechanism in Matters Involving Exchange Rate and Trade" in Thomas Cottier et al, eds, *The Rule of Law in Monetary Affairs: World Trade Forum* (Cambridge: Cambridge University Press, 2014) 358 at 366 – 7 [*Marceau & Maughan*].
[81] *Contra* Pettis, *supra* note 32 at 290-1. When discussing China's currency regime, the author argues that "the United States could make a strong argument that China's currency manipulation is an exchange action" and that "these exchange actions are frustrating the intent of the tariff schedule China agreed to when it acceded to the WTO in 2001".
[82] GATT Article VI regulates dumping measures in international trade and stipulates actions which the members can take against dumping. During Uruguay Round negotiation, *Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994* was concluded to further explain Article VI. See *GATT* art VI; *Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994*, 15 April 1994, 1868 UNTS 201(entered into force 1 January 1995) [*Anti-Dumping Agreement*].
[83] See generally Robert M Feinberg, "U.S. Antidumping Enforcement and Macroeconomic Indicators: What Do Petitioners Expect, and Are They Correct?" (2004) American University Department of Economics Working Paper Series No 2004-17.

the agreement should be companies which compete unfairly with a lower export price, not governments whose policies lead to unfair competition in trade. [84] This may explain why there are more discussions on the SCM Agreement than on the Anti-Dumping Agreement: to most scholars, currency manipulation is a state action rather than a private entity's action, which makes them believe that Anti-Dumping Agreement is irrelevant to the issue.[85] The Anti-Dumping Agreement will also be discussed in detail in the third chapter.

2) WTO as the Dispute Settlement and Enforcement Body

It does not seem to be surprising that the WTO is the most proposed international institution to cooperate with the IMF.[86] There are mainly three reasons why WTO is widely recognized to be the suitable institution. The fist reason is that the fluctuation of exchange rates is closely trade-related because it has a significant influence on world trade. When a country devaluates its currency, the export price of a product in foreign currencies will be lower than that of countries who do not devaluate their currencies, which grants unfair trade advantage to the devaluation country.[87] Mattoo and Subramanian go further by asserting that the legal consequences of currency undervaluation are similar to those of export subsidy and import tariff, which are "compelling

[84] Koops, *supra* note 48 at 6 – 8.
[85] See e.g. Zimmermann, *supra* note 77 ("Dumping is a matter of companies' product-pricing decisions, which have nothing to do with the macro-level governmental measures that lead to exchange rate misalignment" at 457). Viterbo agrees with the argument. See Viterbo, *supra* note 31 at 314. See also Staiger & Sykes, *supra* note 68 at 615.
[86] See e.g. Jung, *supra* note 40 at 194-200; Aaditya Mattoo & Arvind Subramanian, "Currency Undervaluation and Sovereign Wealth Funds: A New Role for the World Trade Organization" (2008) Peterson Institute for International Economics Working Paper No WP 08-2 [*Mattoo & Subramanian*]; Gary Clyde Hufbauer & Jeffrey J Schott, "Will the World Trade Organization Enjoy a Bright Future?" (2012) Peterson Institute for International Economics Working Paper No PB 12-11 at 12 [*Hufbauer & Schott*]; Gagnon, *supra* note 1 at 8; Baltensperger & Cottier, *supra* note 38 at 930; Vera Thorstensen, Emerson Marcal & Lucas Ferraz, "Exchange Rate Misalignments and International Trade Policy: Impacts on Tariffs" (2012) 46:3 J of World Trade 597; Beckington & Amon, *supra* note 21 at 247-58.
[87] For example, simply presume that both country A (with currency *a*) and country B (with currency *b*)'s normal exchange rate to country C's currency *c* is 5 *a* : 1 *c*; 5 b : 1 *c*. When A and B produce the same product which sells at a price of 10 in their domestic currency, both countries' export prices of the product are 2 in currency *c*. However, when A devaluate its currency so that *a* is only half the value compared with before, i.e. 10 *a* = 1 *c*, while B keeps its exchange rate unchanged, A's export price of the product will decrease to 1 *c*, but B's export price is still 2 *c*. During these process, A gains price advantage in transnational trade and consequently its export is promoted.

reasons" for the WTO to address the issue.[88] The second reason is that the WTO has a complete and efficient dispute settlement and enforcement mechanism with respect to the regulation of governmental activities,[89] which is exactly what IMF lacks. The third reason concerns the WTO's obligation of cooperating with the IMF in existing agreements. Article XV of The General Agreement on Tariffs and Trade (GATT) requires the WTO to consult the IMF with regard to exchange rate issues in its decision-making process.[90] Plus, there are also documents such as *the IMF/WTO Cooperation Agreement* and *the Declaration on the Relationship of the World Trade Organization with the International Monetary Fund*, which establish principles on the cooperation between the two organizations.[91] To sum up, to many scholars, the WTO has to, is capable of and has the obligation to be involved in international currency regulation issues.

It is argued that a new plurilateral agreement on currency regulation must be concluded to fill the "gap" between the IMF and the WTO in order to realize the effective cooperation between the two organizations.[92] Hufbauer and Schott specially design the regulatory procedure for the agreement. The basic idea is that one member challenges the other for violating the obligation of avoiding currency manipulation in the WTO, and then a panel constituted by IMF experts will thereby be established to review the challenged currency policy.[93] If the panel finds a violation of that obligation, the member being challenged is bound to implement the findings within a given

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[88] Mattoo & Subramanian, *supra* note 86 at 5.
[89] Under the WTO mechanism, a member can complain another member's legal documents or the application of law to the WTO DSB and a panel will thereby be established to resolve the dispute. The members can appeal to the Appellate Body (AB) if they are not satisfied with the panel's findings. The decision of the panel or AB must be implemented within a period of time. And if the members fail to implement the decisions or fail to adequately implement the decisions, the complaining party is allowed to take punitive measures, such as imposing a countervailing import duty, against that member.
[90] See General Agreement on Tariffs and Trade, 30 October 1947, 58 UNTS 187 art XV (2) (3) (entered into force 1 January 1948) [*GATT*]. The article will be further analyzed in the next chapter.
[91] See Marceau & Maughan, *supra* note 80 at 380 - 1.
[92] Hufbauer & Schott, *supra* note 86 at 12.
[93] *Ibid.*

period, otherwise, the complaint party is allowed to impose countervailing import duty against the undervalued exchange rate.[94] Mattoo and Subramanian propose similar roles for the WTO and IMF: the former is responsible for resolving disputes and the latter makes an assessment on whether the value of the currency is misaligned.[95] They also identify two standards for the panel to examine whether a policy violates WTO rules – "a clear finding of undervaluation and its demonstrable attribution to government action", and the IMF plays the dominant role in assessing the first standard.[96] On the basis of GATT Article XV (2)[97], Jung also agrees that on technical issues like the misalignment of exchange rate, the IMF should get fully involved in WTO's decision-making process and their findings are binding for the WTO DSB[98]; while for Beckington and Amon, the advice of the IMF is inclined to be a "guidance" for the DSB rather than binding.[99] Although the extent to which the IMF is involved is various in different proposals, the framework is the same: IMF deals with the technical analysis of the member's currency policy since it has more experts in the area, and the findings are enforced through the WTO dispute settlement mechanism.

However, as Gagnon points out, a big question is how to get the members, especially the members who have been criticized for manipulating their currencies, to conclude such an agreement, since changes in the WTO agreements require consensus and changes in the IMF articles require eighty-five percent of voting shares.[100] Howard believes that even countries who

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[94] *Ibid*. The process is generally the same as that of the WTO dispute settlement procedure, except that the panel in this case is constituted by experts from the IMF rather than from the WTO.
[95] Mattoo & Subramanian, *supra* note 86 at 11.
[96] *Ibid* at 10. Mattoo & Subramanianm believe that the process will work because there were similar precedents in several WTO cases in which the WTO and IMF cooperated and supervise on the members' balance of payment (BOP) issues.
[97] The article stipulates the role of IMF when a member's currency arrange issues are concerned during WTO DSB's decision making process. The Article will be further discussed in the next chapter.
[98] Jung, *supra* note 40 at 196.
[99] Beckington & Amon, *supra* note 21 at 266.
[100] Gagnon, *supra* note 1 at 8.

claim to be victims of currency manipulation, such as the US and EU, will not be willing to conclude such agreement because they worry that vesting too much regulatory power in IMF would hinder their own currency arrangement sovereignty.[101] For Baltensperger and Cottier, the difficulty of concluding such an agreement not only exists in the negotiating period but also in maintaining the credibility and stability of the system during the enforcement period because countries tend to "deviate from agreed upon behavior" on monetary affairs.[102]

There are also discussions on whether the WTO is suitable to undertake the responsibility of enforcing IMF rules. Koops argues that the WTO rules should not be changed in order to regulate currency manipulation and the responsibility lies totally in the IMF.[103] The two organizations were designed with different functions and regulatory scope, and the fact that IMF lacks rule-enforcement mechanism should not be the excuse to transfer this responsibility to WTO.[104] Viterbo finds that exchange rate misalignment also closely relates to global trade imbalances and distortive capital flows, which is beyond the WTO's ability and makes the organization not suitable to discussing the issue.[105]

To briefly sum up, concluding an agreement to build a bridge between the IMF and the WTO is desirable in theory – the WTO's strength, i.e., an effective enforcement mechanism, can complement IMF's weakness. However, it is questionable whether it is feasible to launch such an

[101] Howard, *supra* note 41 at 1230.
[102] Baltensperger & Cottier, *supra* note 38 at 924.
[103] Koops, *supra* note 48 at 16.
[104] *Ibid.* While Vera Thorstensen, Emerson Marcal and Lucas Ferraz hold the opposite opinion by arguing that "[t]he WTO cannot continue to ignore the effects that exchange rates have on the trade system and its rules, at the risk of losing touch with reality and transforming the organization into merely a sophisticated juridical fiction!". Thorstensen et al*, supra* note 40 at 599.
[105] Viterbo, *supra* note 31 at 315. The author cites the former AB chair James Bacchus's comments, which states that "WTO's litigation over China's exchange rate undervaluation is 'disastrous for the global trading system' as it would undermine the reliability of a rule-based global trading system, straining the political limits of the WTO".

agreement in practice, as it is questionable whether the proposal will obtain adequate support from the countries.

3) Other Proposals

Chaisse and Matsushita mention that the WTO's Trade Policy Review Mechanism (TPRM)[106] can be extended and refined to cover more key areas related to world trade, including currency manipulation.[107] While Kende feels that TPRM's work on monetary affairs is inhibited by its periodicity and its trade-concentrated nature.[108]

There are also proposals beyond the realm of international laws. For example, Howard suggests that the countries which are harmed by currency manipulation can establish an international currency monitoring agency and take unilateral and corrective measures when they find themselves suffering from an undervalued currency.[109] However, this proposal ignores the fact that unilateral actions are strongly discouraged under current international law framework because it will severely hinder the normal international trade order.[110] Leviton notices that the diplomatic pressure by the US on China has produced desirable results. Hence, the US can continue this work to push forward China's currency policy liberalization.[111] Hufbauer and Cimino-Isaacs believe that only regional trade agreements such as TPP and TTIP have the possibility to solve the problem rather than multilateral negotiations.[112] On the contrary, Archie holds the opinion that

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[106] TPRM is WTO's surveillance mechanism over the members' trade policies. For more information on TPRM, see WTO's website online :< www.wto.org/english/tratop_e/tpr_e/tpr_e.htm>.
[107] Julien Chaisse & Mitsuo Matsushita, "Maintaining the WTO's Supremacy in the International Trade Order: A Proposal to Refine and Revise the Role of the Trade Policy Review Mechanism" (2013) 16:1 J Intl Econ L 9 at 35. The authors merely mentioned the issue in the paper, without further explaining.
[108] Mathis Kende, "Monetary Affairs in the WTO Trade Policy Review" in Thomas Cottier et al, eds, *The Rule of Law in Monetary Affairs: World Trade Forum* (Cambridge: Cambridge University Press, 2014) 384 at 407.
[109] Howard, *supra* note 41 at 1238 – 9.
[110] See e.g. WTO, "Introduction to the WTO dispute settlement system" online:<www.wto.org/english/tratop_e/dispu_e/disp_settlement_cbt_e/c1s3p3_e.htm> at paras 5 – 8.
[111] Leviton, *supra* note 48 at 267.
[112] Gary Clyde Hufbauer & Cathleen Cimino-Isaacs, "How will TPP and TTIP Change the WTO System?" (2015) 18:3 J Intl Econ L 679 at 693 – 4.

multilateral negotiations provide “a flexibility of approach and strength in numbers” to affect the currency reform in some countries.[113]

It is necessary to emphasize before the next chapter again that the kind of currency manipulation discussed in this thesis is limited to 1) a government’s direct or indirect intervention into exchange rate market 2) which aims at boosting export. Monetary policies which lead to an undervaluation result but are not designed to influence cross-border trade are not included in the scope of “currency manipulation” in this paper.

[113] Charles V Archie, “China Cannot Have Its Cake and Eat It Too: Coercing the PRC to Reform its Currency Exchange Policy to Conform to its WTO Obligations” (2011) 37:1 NCJ Intl L & Com Reg 247 at 297.

II. EXISTING WTO MECHANISMS RELATING TO CURRENCY MANIPULATION

As discussed in the first chapter, up to now, there are two ways in which the WTO can be involved in the regulation of currency manipulation. The first one is to subject currency manipulation to the regulation of existing WTO agreements, such as GATT and the SCM Agreement so that trade sanctions can be imposed to the manipulators; the second one is to conclude a new cooperation agreement between the IMF and the WTO to make IMF Agreement Article IV justiciable. This chapter will focus on the first way and discuss: whether currency manipulation can be identified as "export subsidy" under the SCM Agreement and whether GATT Article XV is applicable on this issue.

1. Analytical Framework

The main methodology applied in this chapter is treaty interpretation. Since both treaties concerned are WTO Agreements, it is necessary to respect the provision on interpretation in the *Understanding on Rules and Procedures Governing the Settlement of Disputes* (DSU), which requires the DSB to "clarify the existing provisions of those agreements in accordance with *customary rules of interpretation* of public international law".[114] And it is ascertained by the DSBs that Article 31 and Article 32 of the *Vienna Convention* are qualified as "customary rules of interpretation".[115] Therefore, in this chapter, the provisions will be interpreted in conformity with

[114] *Understanding on Rules and Procedures Governing the Settlement of Disputes*, 15 April 1994, 1869 UNTS 401 art 3.2.2 (entered into force 1 January 1995) [*DSU*].

[115] See *United States - Standards for Reformulated and Conventional Gasoline (Complaint by Bolivarian Republic of Venezuela)* (1996), WTO Doc WT/DS 2/AB/R ("[t]hat general rule of interpretation has attained the status of a rule of customary or general international law.(60) As such, it forms part of the 'customary rules of interpretation of public international law' which the Appellate Body has been directed, by Article 3(2) of the DSU…" at 17) (Appellate Body Report), online: WTO <www.wto.org/english/tratop_e/dispu_e/cases_e/ds2_e.htm >; *Japan - Taxes on Alcoholic Beverages (Complaint by European Communities)* (1996), WTO Doc WT/DS 8/AB/R ("[t]here can be no doubt that Article 32 of the Vienna Convention, dealing with the role of supplementary means of

Article 31 and 32 of the *Vienna Convention*.[116] And the ultimate goal of interpretation is to "determine the intentions of the parties".[117]

The AB in *US - Continued Zeroing* addressed that a logical progression of interpretation starts from the ordinary meaning of the terms, and then shall "have recourse to context and object and purpose to elucidate the relevant meaning of the word or term".[118] Ordinary meaning is mainly ascertained via dictionaries, sometimes including French and Spanish versions of the word. For the DSB, dictionaries are important but not dispositive tools.[119] Dictionary meanings are important

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interpretation, has also attained the same status." at 10) (Appellate Body Report), online: WTO <www.wto.org/english/tratop_e/dispu_e/cases_e/ds8_e.htm >.

[116] *Vienna Convention on the Law of Treaties*, 23 May 1969, 1155 UNTS 331 arts 31-32 (entered into force 27 January 1980) [*Vienna Convention*]. Article 31 and Article 32 states that:

> Article 31. GENERAL RULE OF INTERPRETATION
> 1. A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.
> 2. The context for the purpose of the interpretation of a treaty shall comprise, in addition to the text, including its preamble and annexes:
> (a) Any agreement relating to the treaty which was made between all the parties in connexion with the conclusion of the treaty;
> (b) Any instrument which was made by one or more parties in connexion with the conclusion of the treaty and accepted by the other parties as an instrument related to the treaty.
> 3. There shall be taken into account, together with the context:
> (a) Any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions;
> (b) Any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation;
> (c) Any relevant rules of international law applicable in the relations between the parties.
> 4. A special meaning shall be given to a term if it is established that the parties so intended.
>
> Article 32. SUPPLEMENTARY MEANS OF INTERPRETATION
> Recourse may be had to supplementary means of interpretation, including the preparatory work of the treaty and the circumstances of its conclusion, in order to confirm the meaning resulting from the application of article 31, or to determine the meaning when the interpretation according to article 31 :
> (a) Leaves the meaning ambiguous or obscure; or
> (b) Leads to a result which is manifestly absurd or unreasonable.

[117] *India - Patent Protection for Pharmaceutical and Agricultural Chemical Products (Complaint by United States)* (1997) WTO Doc WT/DS50/AB/R at para 45 (Appellate Body Report), online: WTO <https://www.wto.org/english/tratop_e/dispu_e/cases_e/ds50_e.htm>.

[118] *United States - Continued Existence and Application of Zeroing Methodology (Complaint by European Communities)* (2008), WTO Doc WT/DS350/AB/R at para 268 (Appellate Body Report), online: WTO<docs.wto.org/dol2fe/Pages/FE_Search/FE_S_S009DP.aspx?language=E&CatalogueIdList=67294&CurrentCatalogueIdIndex=0&FullTextHash=> [*US – Continued Zeroing*].

[119] This doctrine has been repeated in many WTO reports. One example is the Appellate Body report of *EC -Chicken Cuts* which says "dictionaries are a 'useful starting point' for the analysis of 'ordinary meaning' of a treaty term, but

because they ascertain the scope of meanings which are subject to interpretation. However, as addressed in DSB reports repeatedly, ordinary meanings must be examined together with context and object and purpose, and sometimes with factual context.[120] The context includes immediate context such as preamble and annex of the agreement and other supplementary agreements or instruments relating to the conclusion of that agreement.[121] The role of objects and purposes will be controversial if there seem to be conflicts between the purpose of a specific provision and the purpose of the entire agreement. The attitude of AB is that "[we] caution against interpreting WTO law in the light of the purported 'object and purpose' of specific provisions … in isolation from the object and purpose of the treaty on the whole".[122]

Besides, subsequent agreements, practice and any relevant international laws applicable to the parties should also be considered.[123] This triggers the question of, since the IMF Agreement Article IV directly regulates currency manipulation, whether it can act as "relevant international laws" and influence the interpretation of the SCM Agreement and GATT. The key word in this provision is "relevant". The AB in *US - Anti-Dumping and Countervailing Duties (China)* has ascertained that, in order for an international rule to be relevant, it must "concern the same subject matter as the treaty terms being interpreted".[124] For example, in that case, both the articles in the *Statute of the International Court of Justice* and the article in the SCM Agreement are talking about the

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they are not necessarily dispositive". *European Communities - Customs Classification of Frozen Boneless Chicken Cuts (Complaint by Brazil)* (2005) WTO Doc WT/DS269/AB/R at para 175 (Appellate Body Report), online: WTO <www.wto.org/english/tratop_e/dispu_e/cases_e/ds269_e.htm> [*EC – Chicken Cuts*].

[120] See e.g. *ibid*.

[121] See *Vienna Convention* art 31.2.

[122] *EC – Chicken Cuts*, *supra* note 119 at para 239.

[123] *Ibid* art 31.3.

[124] *United States - Definitive Anti-Dumping and Countervailing Duties on Certain Products from China (Complaint by China)* (2011) WTO Doc WT/DS379/ AB/R at para 308 (Appellate Body Report), online: WTO <docs.wto.org/dol2fe/Pages/FE_Search/FE_S_S009-DP.aspx?language=E&CatalogueIdList=129338&CurrentCatalogueIdIndex=0&FullTextHash=> [*US – AD/CVD (China)*].

attribution of governmental and non-governmental activities. Therefore, the AB found them relevant.[125] However, the circumstance is different in this case. Article 1 of the SCM Agreement concerns the definition of subsidy and GATT Article XV concerns the member's exchange rate arrangements. While the IMF Agreement Article IV stipulates the obligations of the IMF members, which is not relevant to the two articles. Therefore, it cannot influence the interpretation of them in this chapter.

As to broader context such as the treaty's preparatory work and the circumstances of its conclusion, according to the *Vienna Convention* Article 32, they should be taken into account only when the meaning of the term or provision is still ambiguous or leading to absurd results after the application of Article 31.[126] Generally, treaty interpretation in the WTO inclines to be more pragmatic, as Van Damme commented, "[t]he pattern in the Appellate Body's jurisprudence has been to stress contextualism and effectiveness".[127]

Apart from the above basic procedures of treaty interpretation in the WTO, there are two more principles which are worth noting in this chapter's discussion. The first one is that Article 31 is a whole set of rules, which means that the elements must be considered and applied holistically rather than individually.[128] This principle was confirmed by the AB in *US - Continued Zeroing* by emphasizing that "treaty interpretation is an integrated operation, where interpretative rules or principles must be understood and applied as connected and mutually reinforcing components of a holistic exercise".[129] The second one is that the AB has developed a criterion of necessity in interpreting silence in treaties. It means that they do not categorically ignore silence of the

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[125] *Ibid,*
[126] *Vienna Convention* art 32.
[127] Isabelle Van Damme, *Treaty Interpretation by the Appellate Body* (New York: Oxford University Press, 2009) at 379 [*Van Damme*].
[128] Richard K Gardiner, *Treaty Interpretation* (New York: Oxford University Press, 2008) at 141 - 2.
[129] Van Damme, *supra* note 127.

provisions or find it necessary to interpret every silence, but depending on the context of that silence.[130] And in this chapter, it means that although some provisions concerned do not explicitly refer to currency devaluation, it should not exclude the necessity to interpret them, as the AB in *US – Carbon Steel* said, "[s]uch silence does not exclude the possibility that the requirement was intended to be included by implication".[131]

Apart from the *Vienna Convention*, the chapter will also refer to previous WTO cases. Although there have not been a case relating to currency manipulation, there are a large number of cases relating to subsidies, and consequently, there are interpretations of Article I of the SCM Agreement. Although in the WTO legal system, the precedents do not bind the panels and AB in later cases, they are still important guidelines to this chapter's interpretation, especially the findings that have been cited repeatedly in the DSB reports.[132]

2. The SCM Agreement

The argument that currency manipulation should be regulated by the WTO as a subsidy was asserted in 2004 by an organization called "the China Currency Coalition" in the US, which claimed that China devaluated its currency, renminbi (RMB), by pegging to the U.S. dollar and gained unfair trade advantage.[133] The petition was supported by another US organization, the National Council of Textile Organisations (NCTO), which attributed China's dramatic increasing

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[130] Van Damme, *supra* note 127 at 156.
[131] *United States - Countervailing Duties on Certain Corrosion-Resistant Carbon Steel Flat Products from Germany (Complaint by European Communities)* (2002) WTO Doc WT/DS213/AB/ R at para 65 (Appellate Body Report) online:
<docs.wto.org/dol2fe/Pages/FE_Search/FE_S_S006.aspx?Query=(@Symbol=%20wt/ds213/ab/r*%20not%20rw*)&Language=ENGLISH&Context=FomerScriptedSearch&languageUIChanged=true#>.
[132] Although the DSB is not obligated to follow previous findings, to maintain the certainty and predictability of the system, later panels and ABs usually repeat previous findings if they find them persuasive. See WTO, "Legal effect of panel and appellate body reports and DSB recommendations and rulings", online:
<www.wto.org/english/tratop_e/dispu_e/disp_settlement_cbt_e/c7s2p1_e.htm>.
[133] See "USTR Rejects Section 301 'Currency Manipulation' Petition", *HKTDC* (23 September 2014), online:
<info.hktdc.com/alert/us0418a.htm> [*HKTDC*]. The original petition is not available online now.

of shares of global textile and apparel goods market to its devalued currency.[134] However, it was rejected by the Office of the US Trade Representative (USTR) immediately.[135] But the debate on whether currency manipulation is a subsidy under the SCM Agreement did not end.

As mentioned in the last chapter, currency devaluation resembles subsidy in many aspects: they have the same conductors, similar goals and similar economic influence on trade. To give a better illustration of why they have similar influences on trade, it is helpful to explain with some numbers. Assuming that there is a company in country EX exporting textile products to country IM at a price of 10 EX Dollars per kilo and that the exchange rate between EX and IM's currency is 1 EX Dollar: 5 IM Dollars. That is to say, the importers in country IM pay 50 IM Dollars for the textile from EX. Presuming that the government of EX subsidizes 2 EX dollars per kilo to the export of textile, it will make the company's cost of textile production lower. And consequently, the company can sell it at a lower price in the world market, normally higher than 8 EX Dollars (equals to 40 IM Dollars) and lower than 10 EX Dollars (equals to 50 IM Dollars).[136] Apparently, for import companies in IM, it is cheaper to purchase textiles from companies in EX compared with companies in other countries. This grants EX's exporting companies competitive advantage compared with companies from other countries.

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[134] *Ibid*. The president of NCTO believed that "China used its currency as a lethal weapon, dropping its prices by an average of 53%" and "in just 30 months' time, China went from 9% of the market to 72% and continues to grow".
[135] *Ibid*. In response, the USTR comment the petition as "reckless" because the trade remedies it sought would also hurt US exports. Instead, the Bush administration insisted its strategy to impose political pressure on Beijing. On July 1, 2005, China gave up RMB's peg to U.S. dollar and moved into a managed floating exchange rate regime based on market supply and demand with reference of a basket of currencies. See CCTV.com, news release, "China decides to further reform RMB exchange rate regime" (20 June 2010), online: Xinhua < english.cntv.cn/20100620/100044.shtml>.
[136] The exact amount depends on the elasticity of supply and demand in textile market. The economic logic behind this is acknowledged in many international economic text books. See e.g. Paul R Krugman, Maurice Obstfeld & Marc J Melitz, *International Economics, Theory and Policy*, 9th ed (Boston: Addison-Wesley, 2011) at 203. Paul R Krugman was awarded the Nobel Prize in economics in 2008.

What will happen if the government of EX intervenes into exchange rate market to devaluate its currency instead of implementing export subsidy? Assuming that after the intervention, the exchange rate between EX and IM's currencies drops from 1 EX Dollar: 5 IM Dollars to 1 EX Dollar: 4 IM Dollars. As a result, for import companies in IM, they only need to spend 40 IM Dollars on per kilo textile after the devaluation if they purchase from EX's companies. This price is cheaper than textile from companies in other countries. Again, export companies in EX are granted with competitive advantages on export price by the government's currency devaluation.

In both cases, EX's export companies benefit from the government's policies because they expand export volume without cutting down profit;[137] IM's import companies also benefit because they pay less IM Dollars for one kilo textile; and the benefit of export companies from other countries and domestic companies in IM producing the same products is harmed as a result of a drop in market share. This explains why it is widely believed that currency undervaluation "meets at least the lay definition of a 'subsidy'".[138] However, the SCM Agreement has a much narrower definition of subsidy, which makes it controversial whether currency undervaluation can be identified as a subsidy in a legal sense.

Article I, Article II and Article III in the SCM Agreement are articles relating to the definition of subsidy. SCM Agreement Article I stipulates that:

> 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:

[137] In the case of subsidy, although the export companies sell at a lower price, they receive funding from the government. Therefore, they do not need to cut down their profit. In the case of currency undervaluation, the amount of money they earned for one kilo textile is still 10 EX Dollars, the same as the circumstance before currency devaluation.

[138] Magnus & C Brightbill, *supra* note 65 at para 3.

(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);
(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

(b) a *benefit is thereby conferred*.

1.2 A subsidy as defined in paragraph 1 shall be subject to the provisions of Part II or shall be subject to the provisions of Part III or V only if such a subsidy is *specific* in accordance with the provisions of Article 2.

The provisions clarify three elements that must be satisfied at the same time in order to find a measure to be a subsidy, namely "financial contribution", "benefit" and "specific". Article 1.1(a)(1) and (a)(2) list four categories of financial contribution and a kind of transaction called "income or price support". As to the concept of "benefit" in Article 1.1(b), there is not an explanation in the SCM Agreement. With respect to the last requirement, "specific", Article 2 has detailed explanation. It is widely accepted that, since exchange rate intervention has broad influence on all exporting companies, which is not "specific to an enterprise or industry or group of enterprises or industries",[139] it fails to meet the "specific" requirement in Article 2.1.[140] However, Article 2.3

[139] *SCM Agreement* art 2.1 preamble.
[140] See e.g. Leviton, *supra* note 48 at 259.

stipulates that "[a]ny subsidy falling under the provisions of Article 3 shall be deemed to be specific". Article 3 is the provision identifying "prohibited subsidy", which is also called "export subsidy":

> 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 I5;
>
> (b) subsidies contingent, whether solely or as one of several other conditions, upon the use of domestic over imported goods.

Taking both Article 2.3 and Article 3 of the SCM Agreement into consideration, if a subsidy is identified as an *export subsidy* in Article 3.1, it is deemed to be specific even if it is not targeting at particular companies or industries.

The next section will examine whether currency manipulation by the government's intervention into exchange rate market is a subsidy under the legal framework of SCM Agreement Article I - III.

1) Financial Contribution

Article 1.1 (a) (1) lists four types of transactions conducted by a government which should be considered to be a financial contribution: direct transfer of funds, foregoing of government revenue, providing goods or services, and making payments to a funding mechanism or by entrusting or directing a private body.[141]

To start with, an important question is whether Article 1.1(a)(1)'s list of activities is exhaustive. In *US — Export Restraints*, the Panel considered the negotiating history of the article and concluded that including "financial contribution" requirement in addition to the "benefit"

[141] *SCM Agreement* art 1.1 (a)(1).

requirement in the article reflected that the parties' intention was to "prevent the countervailing of benefits from any sort of (formal, enforceable) government measures, by restricting to a finite list the kinds of government measures that would, if they conferred benefits, constitute subsidies".[142] This interpretation was confirmed by the Panel in *US — Large Civil Aircraft (2nd complaint)*, which stated that "Article 1.1(a)(1) is a definitional provision that sets forth an *exhaustive*, *closed* list ("… i.e. where …") of the types of transactions that constitute financial contributions under the SCM Agreement".[143] It excludes the possibility of transactions beyond the four listed types to be identified as a financial contribution. Since this finding has been confirmed repeatedly in the WTO reports and has not been challenged by the DSB or any scholars, discussion in this subsection will be unfolded on the basis of it. In other words, even if a government's intervention into exchange rate market does confer benefit to the companies, it is not a subsidy if it does not fall within the four categories of activities listed in Article 1.1(a)(1) or satisfies "income or price support" in Article 1.1(a)(2).

Another important issue is, what the object and purpose of the SCM Agreement is and to what extent should it be considered in the interpretation of a term. Unlike GATT, there is no word in the SCM Agreement explicitly indicating the object and purpose of the agreement. It is addressed in previous cases that the purpose of the SCM Agreement is to enhance the GATT's disciplines on both the application of subsidies and the application of countervailing measures and at the same

[142] *United States - Measures Treating Exports Restraints as Subsidies (Complaint by Canada)*(2001), WTO Doc WT/DS194/R at para 8.73 (Panel Report), online: WTO <docs.wto.org/dol2fe/Pages/FE_Search/FE_S_S006.aspx?Query=(%40Symbol%3d+wt%2fds194%2f*)&Language=ENGLISH&Context=FomerScriptedSearch&languageUIChanged=true >.
[143] *United States - Measures Affecting Trade in Large Civil Aircraft - Second Complaint (Complaint by European Communities)* (2011), WTO Doc WT/DS353/R at para 7.955 (Panel Report), online: WTO <docs.wto.org/dol2fe/Pages/FE_Search/FE_S_S006.aspx?Query=(%40Symbol%3d+wt%2fds353%2f*)&Language=ENGLISH&Context=FomerScriptedSearch&languageUIChanged=true> [*US - Large Civil Aircraft (2nd complaint)*].

time, respecting the members' right to apply the measures.[144] It means that the object and purpose of the agreement favors neither a broad nor a narrow interpretation of the scope of subsidy, but seeks to balance the regulation of subsidy and the regulation of countervailing measures. Therefore, it does not have a clear instruction on whether currency manipulation inclines to be included into the scope of financial contributions or not. Besides, in the *Vienna Convention*, the role of object and purpose itself is limited to shed light on ordinary meanings rather than being an independent indicator as important as ordinary meaning.[145] Not to mention that the object and purpose is not concluded from the preamble and legal text of the treaty but is speculated by the Panels and AB. Therefore, the object and purpose of the SCM Agreement does not help to interpret Article 1.1 (a)(1) and the chapter will not refer to it in its interpretation.[146] However, object and purpose of specific provisions will still be considered.

1.1 a. Direct Transfer of Funds

Among the four types of transactions, the first one, "direct transfer of funds" is considered to be most relevant to exchange rate manipulation by many scholars.[147] According to the AB's finding in *Japan - DRAMs (Korea)*, "the term 'funds' encompasses not only 'money' but also financial resources and other financial claims more generally".[148] If a government devaluates its

[144] See e.g. *United States - Countervailing Duty Measures on Certain Products from China (Complaint by China)* (2014), WTO Doc WT/DS437/AB/R at para 301 (Appellate Body Report), online: WTO <docs.wto.org/dol2fe/Pages/FE_Search/FE_S_S009-DP.aspx?language=E&CatalogueIdList=129338&CurrentCatalogueIdIndex=0&FullTextHash= >.

[145] Richard K Gardiner, *Treaty interpretation,* ed 1 (New York: Oxford University Press, 2008) at 190.

[146] According to the literature review in Chapter I, none of previous research considered the object and purpose in interpreting whether currency manipulation is a subsidy.

[147] See Caryl, *supra* note 52 at 195; Pettis, *supra* note 32 at 293; Lima-Campos & Gaviria, *supra* note 53 at 1024; Fudge, *supra* note 17 at 354; Staiger & Sykes, *supra* note 68 at 610. Some of them believe that exchange rate manipulation can be defined to be a direct transfer of funds; while others, although disagree with the conclusion, agrees that exchange rate manipulation is related to "direct transfer of funds".

[148] *Japan - Countervailing Duties on Dynamic Random Access Memories from Korea (Complaint by Korea)* (2007), WTO Doc WT/DS336/AB/R at para 250 (Appellate Body Report), online: WTO <docs.wto.org/dol2fe/Pages/FE_Search/FE_S_S006.aspx?Query=(%40Symbol%3d+wt%2fds336%2f*)&Language=ENGLISH&Context=FomerScriptedSearch&languageUIChanged=true>.

currency by selling its domestic currency and buying foreign currency, there is, without a doubt, a transaction of money. While the key question is whether this transaction is a "*direct* transfer of funds".[149] The plain meaning of "direct" indicates that there should not be a medium agency or medium mechanism between the conducting entity and the receiving entity,[150] i.e., in this case, between the currency manipulator and the companies. This close relationship is confirmed by the meaning of "transfer": "a conveyance from one person to another".[151] Taking both terms into consideration, "direct transfer of funds" in this text should mean that the fund is conveyed directly from the government to the companies, without a significant help or intervention from other mechanisms. By contrast, Article 1.1(a)(1)(iv), which describes the circumstance of "a government mak[ing] 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", shows that an "indirect" contribution is made by means of a medium funding mechanism or a private entity. This contrast further confirms that the meaning of "direct" in Article 1.1(a)(1)(i) excludes a significant involvement of a medium mechanism. The examples listed in the provision ("e.g. grants, loans, and equity infusion") also suggest that the purpose of Article 1.1(a)(1)(i) is to prohibit the government's direct transfer of money to the companies. The common character of grants, loans, and equity is that the money finally reaches the companies and increases the asset of that entity. If the money flows to another entity and the activities of that entity influences the companies, it does not fall into the same category as them.

[149] In previous cases, the controversial point is how to interpret "fund" in the article. For example, in *Korea - Commercial Vessels*, one matter at issue was whether debt-for-equity swaps and interest reductions and deferrals are "transfer of funds". Since the transaction was between government and the companies, there was not debate on whether this transfer is direct. However, in this case, it is essential to clarify the meaning of "direct" in the article.
[150] See e.g. *Black's Law Dictionary,* 10th ed*, sub verbo* "direct" ("free from extraneous influence").
[151] *US - Large Civil Aircraft (2nd complaint), supra* note 143 at para 7.954 (Panel Report), citing *Shorter Oxford English Dictionary* (2002) Vol. II at 3367.

This interpretation means that the government's exchange rate intervention fails to meet the requirement of "direct transfer of funds". When a government or a central bank intends to devaluate its currency, it influences the exchange rate by controlling the supply of its own currency and foreign currency in the exchange rate market.[152] After the intervention makes an effect on the exchange rate market and the value of currency decreases, the export companies are affected.[153] During this process, it is obvious that the money is transferred to the market and the fluctuation of the exchange rate in the market influences the real price of export products.[154] The exchange rate market is the destination of the fund and plays a significant role as an intermedium mechanism. Therefore, the process of manipulating currency value does not constitute a *direct* transfer of funds.

This interpretation is in accordance with the object and purpose of Article 1.1 (a) (1). As discussed at the beginning of this section, the negotiators intended to narrow the scope of financial contribution by making a finite list of activities. What's more, the provision explicitly lists some examples of transfer of funds ("e.g. grants, loans, and equity infusion"), which further reflects the negotiators' concern that the scope of the term would be enlarged in future interpretation. If "direct transfer of funds" is interpreted broadly to include exchange rate arrangement, it will certainly deviate from that purpose.

There are arguments that when an exporting company sells its products to a foreign company, it obtains a larger amount of local currency after the currency devaluates compared with before,[155]

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[152] It can be realised by buying a great amount of foreign currency with its own currency, which makes the supply of its own currency suddenly increases and the value decreases. Releasing money into the market has similar effect. Usually the former approach is more typical and is frequently used by countries like China.

[153] Actually sometimes export companies are not influenced by the fluctuation of exchange rates if they use financial tools such as foreign exchange forward contracts.

[154] See Fudge, *supra* note 17 at 353; see also Staiger and Sykes. *supra* note 97 at 610; Zimmermann, *supra* note 77 at 448.

[155] Taking the example of country IM and EX in the last section, if the exporting company prices textile in IM's currency, i.e. 40 IM Dollars per kilo, when the exchange rate changes from 1 EX Dollar: 5 IM Dollar to 1 EX Dollar: 4 IM Dollar, they money it earns increases from 8 EX Dollars to 10 EX Dollars.

therefore, a direct transfer of funds occurs as soon as the company sells the product.[156] Leaving alone the question of how the company finally prices the product in reality,[157] even if it does earn extra money as a result of currency devaluation, the money is not transferred directly from the government to the export companies.

1.1 b. Foregoing Government Revenue

This category does not seem to be relevant to currency issues because when the government sells its own currency and buys a foreign currency, it does not give up any of its revenues. Besides, the example illustrated in this subparagraph ("e.g. fiscal incentives such as tax credits") and its footnote[158] indicate that "government revenue that is otherwise due is foregone or not collected" particularly refers to a member's *fiscal* regime,[159] for example, tax regime.[160] And the previous WTO cases invoking this subparagraph also concern with the member's tax or tariff arrangement.[161] Besides, economic analysis suggests that, in both the short run and the long run, currency devaluation does not reduce the exporting country's tariff revenue.[162] Thus, it is not likely that a monetary issue is covered by the provision.

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[156] See Lima-Campos & Gaviria, *supra* note 53 at 1024; see also Pettis, *supra* note 32 at 293;

[157] The usual case is that the exporting company ascertains the price in local currency, and converts it to the price in foreign currencies with certain exchange rates. If the local currency devalues, the exporting price in the foreign currency will decrease. After they sell the product, they obtain the same amount of local currency as they did before currency devaluation.

[158] The footnote says, "[i]n accordance with the provisions of Article XVI of GATT 1994 (Note to Article XVI) and the provisions of Annexes I through III of this Agreement, the exemption of an exported product from duties or taxes borne by the like product when destined for domestic consumption, or the remission of such duties or taxes in amounts not in excess of those which have accrued, shall not be deemed to be a subsidy." It addresses exemptions on tax regime.

[159] *SCM Agreement* art. 1.1(a)(1)(ii).

[160] See Caryl, *supra* note 52 at 196; Lima-Campos & Gaviria, *supra* note 53 at 1026.

[161] For example, in *United States - Tax Treatment for "Foreign Sales Corporations"*, the measure in dispute is the US's special tax arrangement for export companies; In *Canada - Certain Measures Affecting the Automotive Industry*, the measure in dispute is Canada's import duty exemption for imports of motor vehicles; In *US — Large Civil Aircraft* (2nd complaint), the measure in dispute is the State of Washington's tax deduction which influences aircraft industries. See WTO Analytical Index at paras 32 – 38, online: <www.wto.org/english/res_e/booksp_e/analytic_index_e/subsidies_01_e.htm#fntext52 >.

[162] Staiger & Sykes, *supra* note 68 at 610 - 1.

1.1 c. Government Providing Goods or Services or Purchasing Goods

Article 1.1(a)(iii) identifies two kinds of activities, the first of which is that a government provides goods or services other than general infrastructure to the producing companies, and the second is that a government purchases goods from the companies.[163] It is obvious that currency manipulation has nothing to do with the purchase of goods. Thus, the key issue here is whether the government's arrangement of a favorable exchange rate constitutes the providing of goods and services. The provision indicates a two-step examination on whether an activity falls within its category: 1) whether currency manipulation is a providing of goods or service, and if it is, 2) whether it is excluded from the scope of general infrastructure.

To start with, the definition of "goods" in Blacks Law Dictionary is "tangible or movable personal property other than money".[164] According to the definition, "goods" has at least to be a property, which obviously has nothing to do with currency policy arrangement.[165]

Hence, the core issue is whether the government's action adjusting exchange rate is a sort of "service" for the purpose of subparagraph (iii). According to the literature review, the majority viewpoint is that interpreting "service" to cover currency manipulation would overly expand the scope of the term.[166] The dictionary meaning of "service" includes "labor performed in the interest or under the direction of others; specif. the performance of some useful act or series of acts for the benefits of another, usu. for a fee".[167] This definition is quite broad and indicates two characters of service: the activity benefits others, and usually, it has *commercial* value ("for a fee"). By using

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[163] *SCM Agreement* art 1.1(a)(iii).
[164] *Black's Law Dictionary*,10th ed, *sub verbo* "goods". The dictionary has two definitions for the term "goods". The other definition is "things that have value, whether tangible or not". While it illustrates that in the phrase "goods and services", the meaning of "goods" should be the first one.
[165] Although it is required that text, context, object and purpose and other elements must be considered holistically when interpreting WTO agreements, it does not seem to be necessary here to consider other elements given that exchange rate arrangement is obviously nothing like "goods".
[166] See e.g. Leviton, *supra* note 48 at 257.
[167] *Black's Law Dictionary*,10th ed, *sub verbo* "service".

the word "usually", activities that do not have commercial value could also be included in the definition. An example is the service provided by some public entities, which cannot be purchased elsewhere and cannot be measured by a certain amount of money. However, whether the scope of the meaning of service contains this kind of activities must be examined together with the context of the provision. The word "service" is used together with the word "goods", and by saying "provides goods or services", the provision addresses not only the goods and services itself but the commercial value behind it. The service can only contribute to a subsidy if it has a potential to help the companies decrease cost. Taking article 1.1 holistically into account, providing goods and service is one of the four forms of *financial* contribution, and the phrase "financial contribution" itself consists the concept of commercial value. As pointed out by the AB in *US - Softwood Lumber IV*, the provision covers two types of transaction and they work differently: providing goods and services has the potential to *reduce the cost* of producing, and purchasing goods has the potential to increase the companies' revenue gained from selling the product.[168] Whichever types of transactions, financial values are transferred from the government to the companies. It confirms that "service" in this provision must contain commercial values.

In a broad scope, when the government intervenes in the exchange rate market and exercises its function to adjust the economy, it might be deemed to provide public service.[169] But it is certainly not the kind of service referred to in Article 1.1(a)(1)(iii) because it does not contain commercial values. If a service contains commercial value, people can obtain it by paying fees. For example, the government may provide free legal consultations to certain companies to lower

[168] *United States - Final Countervailing Duty Determination with respect to certain Softwood Lumber from Canada (Complaint by Canada)* (2004) WRO Doc WT/DS 257/AB/R at para 53 (Appellate Body Report), online: WTO<https://docs.wto.org/dol2fe/Pages/FE_Search/FE_S_S009-DP.aspx?language=E&CatalogueIdList=51335,75026&CurrentCatalogueIdIndex=1&FullTextHash=>.
[169] One definition of public service is "any work that serves the public good, including government work and public law". *Black's Law Dictionary*,10th ed, *sub verbo* "public service".

the companies' legal cost, otherwise, the companies have to pay fees to lawyers to get the service. Another example is the circumstance described in Annex I (j) of the SCM Agreement: "[t]he provision by governments … of export credit guarantee or insurance programs, of insurance or guarantee programs against increases in the cost of exported products or of exchange risk programs…".[170] In this circumstance, both export credit guarantee and insurance have commercial values, which have the potential to decrease the cost of the companies. By contrast, some activities for public purpose can never be measured with a certain amount of money, for example, legislation and macroeconomic policies in this case. Therefore, exchange rate policy arrangement, as a means to regulate a country's economy, is not a service covered by Article 1.1(a)(1)(iii). This interpretation conforms with the purpose and objective of this article. As mentioned above, the negotiators intended to limit the scope of financial contribution by explicitly listing the four kinds of activities. A broad interpretation will deviate from that purpose. Since currency manipulation does not fall within the scope of providing goods or services, there is no need to discuss the meaning of "general infrastructure" here.

1.1 d. Contribution through a Funding Mechanism or a Private Body

Article 1.1(a)(1)(iv) deals with circumstances where the government does not conduct the activities listed in (i)(ii)(iii) on its own but through a medium mechanism. It identifies two ways to accomplish this indirect financial contribution, the first of which is to make payments to a

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[170] *SCM Agreement* Annex I (j). While there is argument based on this provision that China, by maintaining its currency at a low value, saves the export companies from the cost of hedging against exchange rate fluctuations between Renminbi and the US Dollar, which provides the "service" in the sense of Article 1.1(a)(1)(iii). (Caryl, *supra* note 52 at 197, citing Stewart and Stewart, King & Spalding, *Petitions for the Imposition of Antidumping and Countervailing Duties on Certain Coated Paper from Indonesia and the People's Republic of China; Request for Proprietary Treatment and Accompanying Certifications,* C-570-959 (23 Sep. 2009) at 130.) However, this argument confuses the influence of currency devaluation with exchange rate stabilization. If the trading companies decide not to hedge, it is because they expect that the exchange rate is stable, but not that the currency is devalued. This logic would lead to the result that every action which aims at stabilizing the value of the currency would be a "service" in the article.

funding mechanism to conduct the functions in subparagraph (i)(ii)(iii), and the second is by entrusting or directing a private body.[171] As explained in section *a*, the destination of the government's fund is the exchange rate market and the fluctuation of exchange rate influences the profit of the companies. Therefore, the important issue, in this case, is whether the exchange market is a "funding mechanism" or "private body". The issue has not been widely addressed in previous research. While there is argument that some private banks in the exporting country may satisfy this provision, this will be discussed later.[172]

According to the provision, the first way of indirect contribution is through a funding mechanism. In Blacks Law Dictionary, there are five definitions of "funding", and the closest two are "[t]he provision or allocation of money for a specific purpose, such as for a pension plan, by putting the money into a reserve fund or investments",[173] and "[t]he provision of financial resources to finance a particular activity or project, such as a research study"[174]. The first definition clearly illustrates that the process of funding is accomplished through a reserve fund or investments, which does not include exchange rate market. One example of this sort of funding which is likely to be a financial contribution to a subsidy is that the government establishes a special fund to provide pension to certain export companies. The second definition indicates that the mechanism provides financial resources to certain activities or projects. And the term "provision" means that the flow of money is *unidirectional*, i.e. only from the funding mechanism to the companies. Exchange rate market, a place to *sell and buy* various currencies, does not satisfy this definition.[175]

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[171] *SCM Agreement* art 1.1(a)(1)(iv).
[172] See Lima-Campos & Gaviria, *supra* note 53 at 1027; Caryl, *supra* note 52 at 198.
[173] *Black's Law Dictionary*,10th ed, *sub verbo* "funding".
[174] *Ibid.* The first two definitions relate to specific process of financing such as refinancing debt, which are not related to this provision. The fifth definition is "[t]he transfer of property to a trust", which is also irrelevant to this case.
[175] Catharina E Koops holds similar idea that. with the financial contribution, there should be a "charge on the public account". When something is sold or brought in return to keep the account balanced, it is not a "charge". And consequently, not a financial contribution. See Koops, *supra* note 48 at 3.

The other type of indirect contribution is by directing or entrusting a private body. Previous interpretation of AB indicates that a private body must be an entity, such as a company or an individual.[176] Therefore, exchange rate market is also excluded from this category.[177]

However, there is also argument that some authorized foreign exchange banks could be the private bodies in article 1.1(a)(1)(iv) which are entrusted or directed by the government to carry out governmental activities in subparagraphs (i)(ii)(iii).[178] In fact, it is highly controversial whether the banks are still private bodies rather than public bodies when subsidy is concerned.[179] Even if they are private bodies, the activities they carried out do not meet the requirements of subparagraph (iv).

With regard to activities in subparagraph (i), when a bank exchanges currencies with an exporting company, there does exist direct transfer of money between the two entities. However, this transfer of currencies is not entrusted or directed by the government but is one kind of the bank's commercial services. The bank earns profits by selling a foreign currency at a higher price and buying at a lower price on the basis of the market exchange rate. During the whole process, the bank has no role to manipulate exchange rate but simply accepts the market exchange rate. For example, in China, the China Foreign Exchange Trade System is authorized by the central bank to ascertain the central parity exchange rate of the RMB against other major currencies according to

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[176] For example, in *US – AD/CVD (China)*, when interpreting the term "public body", the AB considered the meaning of "private body" in this provision to help understand the core characters of "public body". And they define private body as "any entity that is neither a government in the narrow sense nor a public body would be a private body". *US – AD/CVD (China), supra* note 124 at para 291.

[177] Koops, *supra* note 48 at 15.

[178] See, e.g. Caryl, *supra* note 52 at 198.

[179] For example, in *US – AD/CVD (China)*, the US argued that certain state-owned commercial banks were public bodies because they were controlled by the government. The AB disagreed with the reasoning and proposed a new standard to identify public bodies, i.e. "entities that possesses, exercise or are vested with governmental authority". While the banks were still found to be public bodies in some anti-subsidy investments. The Panel and AB also emphasized that the status of entities must be determined case by case. Therefore, in this case, it is uncertain whether the banks are private bodies.

prices quoted by all the market makers which are deemed to reflect market prices. After calculating the average exchange rates, the institution publishes them so that commercial banks can ascertain the selling prices and buying prices benchmarked against them.[180] When commercial banks transact with exporting companies, currency manipulation, if there is any, has already been conducted by the government and has influenced the exchange rate market. Therefore, even if commercial banks offer exchange rates which do not reflect the real value of the local currency, they are not directed by the government but by the exchange rate market.

The banks also do not conduct activities in subparagraphs (ii) and (iii). It is obvious that the banks do not give up any fiscal revenues in the sense of subparagraph (ii). On the contrary, they gain profits by exchanging currencies. With regard to subparagraph (iii), the banks do provide currency exchange services but the services are originally their own commercial services rather than a function vested in the government as required in subparagraph (iv).

1.2 Income or Price Support

Apart from financial contributions, the government's activity might be considered to be a subsidy if "there is any form of income or price support in the sense of Article XVI of GATT 1994".[181] However, according to the literature review, only a few articles and books interpret this provision. Most of them skip it over,[182] and others, although they mention it, do not give further explanations on the meaning of "income or price support"[183]. GATT Article XVI.1 states that:

> If any contracting party grants or maintains any subsidy, including any form of income or price support, which operates directly or indirectly to increase exports of any product from, or to reduce imports of any product into, its territory, it shall notify the CONTRACTING PARTIES …

[180] See China Foreign Exchange Trade System, "Trading Services", online:< http://www.chinamoney.com.cn/english/ausbas/>.
[181] *SCM Agreement* art 1.1(a)(2).
[182] See, e.g. Pettis, *supra* note 32; Koops, *supra* note 48; Marcus, *supra* note 82; Leviton, *supra* note 48.
[183] See, e.g. Jung, *supra* note 40.

Caryl suggested that a WTO panel could refer to previous cases on the Agreement of Agriculture and interpret "income or price support" as the circumstance where the government commits to buy the domestic product at a price higher than the world price.[184] Fudge described another circumstance: the government making payment to purchasers of the product or establishing export credit guarantee schemes.[185] Staiger and Sykes, and Zimmermann believe that the provision must be understood in a narrow way and be limited to certain specific programs on specific products.[186] But they did not give any explanation on the argument. It seems that most scholars agree that the provision should not be interpreted in a broad way.

The plain meaning of "income or price support" is so broad that it seems to cover all the four categories of activities of financial contribution. It also seems to cover any activities that are conducted to promote export, which includes currency manipulation.[187] The SCM Agreement has no explanation on the scope of the term and neither is there interpretation in previous WTO cases.[188] However, when looking at the intrinsic context, in the article, "financial contribution" and "income or price support" is connected with the conjunction "*or*", which indicates that they are describing two parallel circumstances.[189] Consequently, "income or price support" should not include the four types of financial contributions but has its own specific meaning. This also

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[184] Caryl, *supra* note 52 at 199.
[185] Fudge, *supra* note 17 at 355.
[186] Staiger & Sykes, *supra* note 68 at 610; Zimmermann, *supra* note 77 at 449.
[187] See *ibid* at 191.
[188] In *Canada - Renewable Energy*, Japan and EU tried to invoke the provision and argued that some government programs in Canada were subsidies to the export of energy products. However, the panel objected the argument and refused to make findings on "income or price support" on the grounds of judicial economy without interpreting the provision. The panel found that Japan and EU's argument was indeed concerning "benefit" in Article 1.1(a)(2) and should not be considered in Article 1.1(a)(1). See *Canada - Certain Measures Affecting the Renewable Energy Generation Sector (Complaint by Japan)* (2012) WTO Doc WT/ DS412/ R at 80 – 4 (Panel Report), online: WTO < docs.wto.org/dol2fe/Pages/FE_Search/FE_S_S009-DP.aspx?language=E&CatalogueIdList=113961,113962&CurrentCatalogueIdIndex=0&FullTextHash=>.
[189] Luca Rubini, *The Definition of Subsidy and State Aid: WTO and EC Law in Comparative Perspective*, (NewYork: Oxford University Press, 2009) at 123.

demonstrates that the term cannot be interpreted as broad to cover all government actions that confer a benefit to export.

This argument can be confirmed by the purpose of Article one. As explained above, in Article 1.1(a)(1), by making an exhaustive list on types of activities which should be deemed to be contributions to the subsidy, the negotiators intended to avoid an expanding understanding of the scope of subsidy. Imposing a too broad meaning of Article 1.1(a)(2) would severely conflict with this purpose.

A review of the evolution of the SCM Agreement might help understand the role of Article 1.1(a)(2). The regulation of subsidy and countervailing duties was first addressed in Article 25 – 28 of the *Havana Charter*.[190] It describes subsidy as "including any form of income or price support, which operates directly or indirectly to maintain or increase exports of any product from, or to reduce, or prevent an increase in, imports of any product into, its territory …".[191] Although the *Havana Charter* never came into force, its Chapter on Commercial Policy was converted to GATT 1947 and came into force,[192] which includes the subsidy section. During the negotiation period, the negotiators felt that it was not necessary and not feasible to agree upon a uniform and precise definition of subsidy, so they choose a quite general term "income or price support" without further explanation.[193] And this provision is kept in GATT 1994 in the Uruguay Round negotiation. However, before Uruguay Round, the members had already realized that a general term is not adequate to identify subsidy activities and some members concluded the *Tokyo Round Subsidies*

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[190] See *Havana Charter for the International Trade Organization* art. 25 – 8, online: WTO < https://www.wto.org/english/docs_e/legal_e/havana_e.pdf>.
[191] *Ibid* art 25.
[192] WTO, "Pre-WTO Legal Texts", online: WTO <https://www.wto.org/english/docs_e/legal_e/prewto_legal_e.htm>. The charter was also concluded in 1947, the same year as GATT 1947.
[193] WTO, *Analytical Index of GATT* at 445, online: WTO <https://www.wto.org/english/res_e/booksp_e/gatt_ai_e/art16_e.pdf>.

Code to elaborate the rules.[194] The code has more detailed rules, while it still has no provision on the definition of subsidy, which leads to the code's failure to deal with certain fundamental concepts in later disputes.[195] Therefore, in Uruguay Round, a new multilateral agreement based on GATT Article XVI, the SCM Agreement, was concluded to establish an effective regulatory framework for the application of subsidies and countervailing measures. It was the first time that there was a clear definition of subsidy.

The history explains why the drafters selected words as general as "income or price support": at the time GATT 1947 was negotiated, the negotiators did not intend to give subsidy a clear definition and used the term "income or price support". While decades later they found it necessary to clarify it and ratified Article 1 of the SCM Agreement. In the article, the scope of activities which constitute subsidy was clarified and narrowed to the four types of financial contributions. However, the drafters still chose to retain the term "income or price support", which reflects their concerns that the four types of "financial contributions" cannot cover other important circumstances which also grant subsidies. But it should not be interpreted as the drafters intend to enlarge the scope of subsidy significantly as covering every related government actions.

The Analytical Index of GATT published by the WTO includes a list of activities which can be an income or price support: 1) the government fixing the domestic prices of certain product above the world price level; 2) subsidies financed by a non-governmental levy; 3) export credit programmes; 4) granting of reduced internal transport charges on goods for export; 5) tax exemptions and 6) border tax adjustments and duty drawback.[196] There is also an explanation that

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[194] WTO E-Learning, "Detailed Presentation of Subsidies and Countervailing Measures in the WTO" at 4, online:< https://ecampus.wto.org/admin/files/Course_385/Module_1594/ModuleDocuments/SCM-L2-R1-E.pdf>. Only twenty-five members ratified the code.
[195] *Ibid.*
[196] *Analytical Index of GATT*, *supra* note 193 at 445-447.

the arrangement of multiple exchange rates that is consistent with the IMF rules should be excluded from the category of subsidy.[197] The list is concluded on the basis of the *Interpretative Note ad Article XVI*, the review reports, and commission meetings during the preparatory stage. Apparently, activities (3) (4) (5) (6) are already covered by the concept of “financial contribution” in the SCM Agreement Article 1. While activities (1) (2) might illustrate examples of “income or price support”. Activity (1) describes circumstances where the government’s price support system fixes domestic prices at a level higher than the world price level.[198] As to activity (2), an example is the French system of price supports in the pre-WTO case *French Assistance to Exports of Wheat and Wheat Flour*. In the case, a French institution (the Office National Interprofessionnel des Céréales) which monopolized the export of wheat and flour levied the delivery and disposal tax on cereal producers to defray its own losses in the world market, as a result of which its export price is lower than competitors from other countries. [199] A common character of these examples is that they are governmental programs which are established to adjust the prices of certain products in order to boost the export of that product. These programs directly target and influence domestic prices or export prices of that product. But they are not the same as general macroeconomic policies such as exchange rate arrangement.

However, the analysis above does not indicate that currency manipulation is categorically excluded from the scope of Article 1.1(a)(2) because the governments’ activities might be quite different and they must be analyzed case by case. If there is clear evidence that the currency intervention is designed and conducted to promote the export of a product or an industry rather than influencing the macro-economy, it may fall within the scope of this provision.

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[197] *Ibid* at 447.
[198] *Ibid* at 446.
[199] *French Assistance to Exports of Wheat and Wheat Flour (Complaint by Australia)* (21 November 1958), L/924 - 7S/46 (Panel Report), online:< https://www.wto.org/english/tratop_e/dispu_e/58wheflr.pdf>.

2) Benefit

The second criterion in the SCM Agreement to define a subsidy is that "a benefit is thereby conferred".[200] Although it has already been argued above that currency manipulation cannot be recognized to be a financial contribution or income or price support in Article 1.1(a) and consequently, cannot be a subsidy in the SCM Agreement, this subsection will still briefly analyze whether a benefit is conferred, presuming that, *arguendo*, currency manipulation constitutes a type of financial contribution.[201]

It is argued that after currency devaluation, the export companies receive a larger amount of local currency when they convert the foreign currency they earned from exporting.[202] While this argument is inconsistent with the trade practice because the companies usually price the products with the domestic currency first and then convert them into foreign currencies, which means that they are supposed to receive the same amount of local currency as it were without the devaluation.[203] The export companies gain trade advantages because the export price in the foreign currency is lower, which helps them expand the foreign market, and this is the reason why many scholars believe that a benefit is conferred.[204] However, the benefit granted by this advantage cannot be covered by the SCM Agreement.

It has been confirmed in a number of cases that a financial contribution can be deemed to confer a benefit if "it is provided to the recipient on terms more favorable than the recipient could

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[200] *SCM Agreement* art 1.1 (b).
[201] This is an approach frequently used by the WTO DSB. Even if they find that the measure at issue fails to meet the first criterion, they would continue analyzing the second criterion presuming that the first one is satisfied until all the criteria are examined instead of coming directly to the conclusion.
[202] See e.g. Caryl, *supra* note 52 at 201.
[203] It is possible that the exporting companies increase the export price to earn more local currency. But it should be their own market strategy.
[204] See e.g. Fudge, *supra* note 17 at 356.

have obtained from the market".[205] This interpretation requires a comparison between the condition of the companies after receiving financial contribution and their condition in the market without the contribution. In other words, the benchmark for comparison is what the company could have obtained from the market if there were not a subsidy.[206] The presumption for this finding is that there is an available market price which is not influenced by the subsidy, whether domestic or international, to be compared with. For example, in the case of government providing goods to certain producing companies, if the price offered by the government is lower than the price the companies would have to pay in the market, the gap between the two prices is the proof of benefit. However, the circumstance is different in the case of currency manipulation because when the government intervenes the exchange rate of its currency, it changes the whole market – the exchange rate to all the foreign currencies changes. In order to calculate how much benefit the exporting companies are granted with currency devaluation, the investigation authority may seek to find an exchange rate which is not influenced by the currency manipulation as a benchmark to compare with the manipulated exchange rate. However, it will inevitably fail because every exchange rate in the world has changed as a result of the government's intervention. In other words, there is no comparable "market price" of the currency in the exchange rate market.[207]

It is argued that if considered broadly, an estimated "equilibrium real effective exchange rate" could also be the benchmark.[208] That is to say, use IMF's method of calculating exchange rate to estimate the equilibrium market-based exchange rate if the government had not intervened in the market and compare it with the exchange rate after the intervention.[209] While it is quite doubtful

[205] WTO, "WTO Analytical Index: Subsidies and Countervailing Measures" at para 62, online: WTO < https://www.wto.org/english/res_e/booksp_e/analytic_index_e/subsidies_01_e.htm#article1>. This can be deemed as a well-established understanding. Hence there is no need to interpret the term here.
[206] *Ibid*.
[207] See e.g. Lima-Campos & Gaviria, *supra* note 53 at 1029.
[208] Caryl, *supra* note 52 at 205
[209] *Ibid.*

whether it is appropriate for the DSB to accept this approach since the result of econometric estimation is quite uncertain and not as precise as expected, especially when the object being estimated here is very complex.[210] Therefore, the "equilibrium real effective exchange rate" does not seem to be a reliable benchmark. The authority of the WTO dispute settlement mechanism will be seriously hindered if the DSB makes findings on the existence of benefit based on such estimated data.

3) Specific

The third criterion in Article 1 of the SCM Agreement is that the subsidy is specific to certain enterprises.[211] It has been explained at the beginning of section 2 that currency manipulation cannot be specific to certain enterprises or industries because it influences every entity exchanging currency. But it may be deemed to be specific if it satisfies the requirements in Article 3. Article 3 describes prohibited subsidies[212] (also called export subsidies). According to Article 3.1 (a), this kind of subsidy includes "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".[213] At first glance, since the benefit of currency devaluation is realized by granting the companies price advantages in export, *export* is a necessary condition of the subsidy. Thus, it seems reasonable to believe that currency manipulation satisfies the requirement of "contingent upon export performance".[214] The AB in *Canada – Aircraft* examined the ordinary meaning and intrinsic context of the word "contingent" and found that it means "conditional" or "dependent for its

[210] The fluctuation of exchange rate can be influenced by a great number of elements. It is highly possible that the value of the currency will still go down without the intervention of government. Besides, different econometric estimation models usually have quite diverse results and it is hard to tell which model is more precise.

[211] See *SCM Agreement* art 1.2 & art 2.

[212] The difference between prohibited subsidy and other kinds of subsidy is that for prohibited subsidy, the countervailing party do not need to prove that the subsidy cause injury to its domestic industry.

[213] *SCM Agreement* art 3.1 (a). Article 3.1 illustrates two types of subsidies. The other type is using domestic products over import ones. This type is irrelevant to currency manipulation.

[214] See Caryl, *supra* note 52 at 212; Lima-Campos & Gaviria, *supra* note 53 at 1033; Fudge, *supra* note 17 at 156.

existence on something else".[215] In this context, that "something else" refers to export performance.[216] This interpretation has been accepted and addressed in many cases. Thus, the analysis in this subsection will be based on this finding and discuss whether the grant of a more competitive exchange rate is conditional or dependent upon the companies' export performance.

According to Article 3.1 (a), the subsidy can be *de jure* export contingency or *de facto* export contingency. To prove that a subsidy is *de jure* export contingency, the countervailing party must demonstrate evidence from legal documents.[217] Since the analysis must be unfolded upon the evidence provided by the countervailing party, it will not be discussed in this subsection.

Even if there is no evidence in legal documents that the favorable exchange rate is granted contingent on export performance, it could still be an export subsidy if it is found to be *de facto* export contingent. Footnote 4 of the agreement further explained the meaning of *de facto* contingency:

> 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.[218]

The AB in *Canada – Aircraft* emphasized that "tied to" in this provision confirmed their interpretation of "contingency" to have a close relationship to "conditionality or dependence".[219] And it is not sufficient to merely demonstrate that the government *anticipated* that exports would

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[215] *Canada - Measures Affecting the Export of Civilian Aircraft (Complaint by Brazil)* (1999) WTO Doc WT/DS70/AB/R at para 166 (Appellate Body Report), online: WTO < https://docs.wto.org/dol2fe/Pages/FE_Search/FE_S_S009-DP.aspx?language=E&CatalogueIdList=28932,21419&CurrentCatalogueIdIndex=1&FullTextHash=>. [*Canada - Aircraft*]
[216] *Ibid* at para 167.
[217] *Ibid.*
[218] *SCM Agreement* art 3.1 (a) footnote 4.
[219] *Canada – Aircraft* at para 171.

result by granting the subsidy,[220] but that the exportation is the *condition* of the granting of subsidy. In other words, the subsidy has to be granted only for exporting activities.

According to this interpretation, currency manipulation is not contingent upon export. After a government devalues its currency, the exchange rate is available for everyone who plans to convert currency. It does not require the individuals or companies to export products in order to use the devalued exchange rate. In other words, exportation is not a condition for the granting of the devaluated exchange rate and consequently, not *de facto* export contingent.

It is argued that the fact that a subsidy is also applied to circumstances beyond exportation does not exclude the possibility that the subsidy is export contingent.[221] To be more specific, although people such as investors and tourists can also use the exchange rate, it does not exclude currency manipulation from export contingency.[222] The basis for this argument is the AB's finding in *US – FSC*, which states that "[o]ur conclusion that the ETI measure grants subsidies that are export contingent in the first set of circumstances is not affected by the fact that the subsidy can also be obtained in the second set of circumstances".[223] While it is important to note that the context for this finding is that the subsidy (tax exemption) is granted upon two *conditions* and one of them is exportation.[224] Hence, it is reasonable for the AB to draw the conclusion that the second condition should not influence the identification of the first one. However, in the context of currency manipulation, there is *no condition* on the availability of the devalued exchange rate and

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[220] *Ibid*.
[221] Caryl, *supra* note 52 at 212; Jung, *supra* note 40 at 191.
[222] *Ibid*.
[223] *United States – Tax Treatment for "Foreign Sales Corporations" (Complaint by European Communities)* (2002) WRO Doc WT/DS108/AB/RW at para 119 (Appellate Body Report), online: WTO <docs.wto.org/dol2fe/Pages/FE_Search/FE_S_S009-DP.aspx?language=E&CatalogueIdList=59984,90919,5673&CurrentCatalogueIdIndex=1&FullTextHash= >.
[224] See *ibid*. In *US – FSC*, the *United States FSC Replacement and Extraterritorial Income Exclusion Act* (the "ETI Act") grants tax exemption to exporting companies in two circumstances: 1) where property is produced within the United States and held for use outside the United States; and 2) where property is produced outside the United States and held for use outside the United States. The first circumstance was found by the AB to be export contingent.

neither is the exchange rate granted dependent on export performance. The argument only addresses the AB's words on circumstances beyond exportation but ignores the core concept - "condition".

To sum up, section 2 of this chapter goes through the three requirements in the definition of subsidy for the purpose of the SCM Agreement – financial contribution, benefit, and specificity. It finds that: 1) currency manipulation fails to fall within the fours types of financial contributions listed in Article 1.1(a)(1) or income or price support in Article 1.1(a)(2); 2) there is no reliable benchmark for the determination of benefit, and 3) it is not export contingent and consequently, not specific. Therefore, although the conductor and economic impact of currency manipulation are similar to a subsidy to a large extent, it does not satisfy the requirements of subsidy in the sense of the SCM Agreement.

3. GATT Article XV

Compared with the SCM Agreement, GATT Article XV, *Exchange Arrangements*, has a more explicit relationship with currency manipulation. The article mainly deals with the WTO's relationship with the IMF. There are nine paragraphs in the article and the one which it is possible for currency manipulation to violate is paragraph 4:

> "Contracting 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."

Generally, it is the IMF that regulates exchange actions and the WTO that regulates trade actions. And this provision requires that, if the measure at issue is an exchange action, it shall not frustrate the intent of the provisions of GATT; and if it is a trade action, it shall not frustrate the intent of the provisions of IMF. Since one main purpose of Article XV is to address the cooperation

between the WTO and IMF on exchange arrangements,[225] it can be conjectured that the aim of this provision is to realize the mutual respect of the two system: although exchange actions are under the jurisdiction of the IMF, they shall not violate WTO rules,[226] and it is the same for trade actions. Up to now, there is no interpretation of paragraph 4 in previous WTO cases. It is illustrated in the provision that a demonstration of a violation of the provision requires a two-step analysis: that currency manipulation fall within the scope of an exchange action/ trade action, and that currency manipulation frustrates the intent of the provisions in GATT/ the IMF Agreement.

1) exchange action/ trade action

The first step is to ascertain whether currency manipulation is an exchange action or/and trade action.[227] According to the literature review, there are two different understandings of the term "exchange action". The border understanding is that the scope of exchange action covers all exchange arrangements, including exchange convertibility restrictions and exchange rate adjustments. This is the interpretation accepted by the majority of scholars.[228] The narrower understanding is that "exchange action" in the context of GATT only refers to the actions regulating the convertibility of currency.[229] This understanding can be supported by the history background during the negation of GATT. When the countries were drafting the provisions, they were implementing the fixed-exchange-rate policy, which left little room for them to influence

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[225] See *GATT* art XV paras 1-3.

[226] See Thorstensen et al., *supra* note 72 at 128.

[227] A Special Sub-Group, after reviewing the GATT provisions, found that "in many instances it was difficult or impossible to define clearly whether a government measure is financial or trade in character and frequently it is both". This conclusion is quoted in the GATT Analytical Index published by the WTO. See WTO, "Analytical Index of the GATT: Article XV Exchange Arrangements" at 435, online: WTO<www.wto.org/english/res_e/booksp_e/gatt_ai_e/art15_e.pdf>.

[228] See Thorstensen et al, *supra* note 72 at 129; Pettis, *supra* note 32 at 288 – 90; Mercurio & Leung, *supra* note 67 at 1285.

[229] Fudge, *supra* note 17 at 359. However, the author argued that this history should not exclude currency manipulation from the aegis of this article given that the Bretton Wood system no longer exists.

exchange rates.[230] As a result, they could not have considered to regulate currency manipulation in the drafting of GATT.[231] However, on the other hand, a broader understanding could be that the negotiators intended to cover all exchange arrangement measures, including measures did not exist at the time of drafting but might happen in future, by using the general term “exchange action”.

The choice of word in paragraph 9 in the same article suggests a broader interpretation of “exchange action”. Paragraph 9 describes exceptional circumstances. The actions subject to its regulation is “the use by a contracting party of *exchange controls or exchange restrictions*”.[232] The drafters used specific words instead of “exchange actions”. If they had meant to narrow the scope of actions in paragraph 4, they could have use “exchange controls or exchange restrictions” like they did in paragraph 9. But they ended up choosing a broad term “exchange actions”. Therefore, the scope of “exchange actions” must be broader than “exchange controls or exchange restrictions” and should include currency manipulation.

The second type of action, “trade action”, also has a broad meaning. It includes measures such as tariff, export or import quota, subsidy, etc., but it should not include currency manipulation. Whether a measure is a trade action is supposed to be determined by the *nature* of that measure.[233] Currency manipulation is an exchange action because the *design* of it is to adjust exchange rate by a central bank’s buying foreign currency and selling local currency. In this process, the conductors of exchange rate manipulation actions (central banks), the objective of the actions (devaluate currency), and the approach applied to devaluate the domestic currency (transactions in exchange rate market) are all closely related to exchange rate. However, none of these elements have close

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[230] *Ibid* at 360.
[231] *Ibid*.
[232] *GATT* art XV paragraph 9.
[233] The Sub-Group also emphasized “the technical nature of government measures rather than on the effect of these measures” in the identification of “exchange action” and “trade action” after reviewing the practice of contracting parties and the IMF. See *supra* note 227.

relations to trade, despite the fact that currency manipulation eventually influences trade. If the drafters had intended to regulate activities that *affect* trade, they should have written it down instead of using a specific term "trade action".[234] Therefore, "trade action" is not broad enough to cover an activity like currency manipulation which merely affects trade but is not designed as a trade activity.

2) Frustrate the Intent of the Provisions of GATT

It has been argued in the last subsection that currency manipulation is an exchange action but not a trade action. Therefore, the only issue in this subsection is whether it frustrates the intent of the provisions of GATT. It is worth noting at the beginning of the analysis that, according to the legal texts, the provision addresses the intent of specific GATT provisions, instead of the intent of the entire GATT as discussed by some scholars.[235] The GATT provisions may have a same general intent, for example, to promote international trade. However, the intents of specific provisions vary from each other. For example, Article XVI aims to restrain the governments' subsidy activities, while Article VI regulates dumping activities. Equaling the specific intents of GATT articles to the general intent of GATT would unreasonably expand the scope of the provision.

There is specially a footnote in GATT explaining the meaning of "frustrate" in the provision:

> 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.[236]

There are also two examples in the footnote, both of which address that although some exchange actions seem to be inconsistent with the plain words of an article, they should not be deemed to violate that article if the purpose of those actions is not to infringe the intent of the

[234] Mercurio & Leung, *supra* note 67 at 1286.
[235] See e.g. *ibid* at 1288.
[236] *GATT* art. XV Interpretative Note Ad Article XV from Annex I.

article.[237] For example, a member may impose import fees on goods from one trading partner, which appears to violate GATT Article I (Most Favored Nation Treatment).[238] But if the purpose of the fee is not to introduce discrimination elements but to conduct exchange controls which are consistent with the IMF Agreement, it shall not be deemed to frustrate the two articles.[239] Despite this footnote, the scope of this provision is still ambiguous.

The first problem is, how general should this "intent" be. For example, it can be argued that the intent of GATT Article XVI (Subsidies) is to combat subsidy activities which cause injury in the trade partners' domestic industries, while it can also be argued in a quite general way that the intent is to defeat trade-distorting activities. The latter understanding is usually summarized from legal texts of a provision but not as accurate as the original words. And usually, it is too vague to reflect the intention of one specific provision because many other provisions in GATT have the same purpose (e.g. Article VI Anti-Dumping). As a result, one activity may frustrate the intent of many GATT articles at the same time. This unreasonably enlarges the scope of the intent of GATT Article XV. In GATT, every article has a specific title, which indicates that different articles target different legal problems, and they should have different intents. This problem will be further discussed in the analysis of Article II later.

[237] In order to further explain the meaning of "frustrate", the footnote stipulates that "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 licence the country from which the goods may be imported, for the purpose not of introducing any additional element of discrimination in its import licensing system but of enforcing permissible exchange controls".

[238] The article prohibits discriminative treatment among trade partners. If a WTO member imposes an import fee on only one trade partner, it makes that trade partner in a worse trade condition compared with others. Therefore, it might violate Article I.

[239] *Ibid.*

The second problem is that, whether it is possible that an action does not violate the legal texts of an article but still frustrates the "intent" of that article in the sense of GATT Article XV.[240] For example, there might be argument that, even if currency manipulation is not a kind of "income or price support" in GATT Article XVI (Subsidies), it still infringes the intent of the article because it operates to unfairly increase export. As a result, it is not consistent with GATT Article XV. The answer to the question should be no. If an action cannot even be covered by the legal texts, it is impossible for it to frustrate the intent of the provision. [241] For example, if it is determined by the DSB, after treaty interpretation, that currency manipulation is not an "income or price support" in Article XVI, it indicates that the Article does not intend to prohibit currency manipulation activities. In turn, it is not possible for currency manipulation to frustrate the intent of Article XVI. In other words, literal infringement of a GATT article is a "necessary but not sufficient condition" for the violation of Article XV paragraph 4.[242]

After explaining the meaning of "frustrate", the next issue is whether currency manipulation frustrates one or several provisions in GATT. There are thirty-eight articles in GATT and it is impossible and meaningless to examine all of them in this subsection. Among them, the most related one is Article XVI: Subsidies, which has been discussed in section 2 of this chapter. Since the conclusion of the interpretation in section 2 is that currency manipulation does not fall within the category of subsidy, it cannot even fulfill the literal requirements for the violation of Article XVI, letting alone frustrating the intent of Article XVI. Therefore, it cannot be the basis for arguing that currency manipulation violates Article XV.

[240] See e.g. Thorstensen et al., *supra* note 72 ("although there may not be a direct violation of the provisions of the General Agreement, the aims of such rules will be disrupted due to an exchange action" at 130).
[241] Please note that this argument is not the same as "textualism" in treaty interpretation. The meaning of the legal texts must be ascertained in consistent with rules of interpretation in *Vienna Convention*.
[242] Zimmermann, *supra* note 77 at 471.

There are also discussions on whether currency manipulation frustrates the intent of GATT Article II.[243] The article prohibits the members from imposing trade barriers in excess of the measures and rates they stipulate in the Schedules concessions:

> 1.(a) Each contracting party shall accord to the commerce of the other contracting parties treatment no less favorable than that provided for in the appropriate Part of the appropriate Schedule annexed to this Agreement.

There are different understandings on the intent of the article. The narrower one is that the article intends to limit the number and value of *tariffs* levied on imports.[244] The broader understanding is that it aims at providing the members greater market access in international trade, which means that all measures hindering free trade are possible to frustrate the intent of the article.[245] However, facilitating international trade is a general goal of the GATT and it is inappropriate to be identified as the intent of a specific provision. If Article II can be imposed with the broad intention for the purpose of Article XVI, most other GATT articles which combat trade barriers can also be deemed to have the same intention.[246] As a result, currency manipulation frustrates the intention of most GATT articles. The interpretation of the intention of Article II should primarily be unfolded on the basis of the legal text. The article explicitly requires that the members shall not provide less favorable treatment than what they promised in the Schedule. However, treatments they did not promise, such as avoiding currency manipulation, is not part of the intention of the article.

To conclude, although currency manipulation is an "exchange action" in Article XV paragraph 4, based on GATT articles and current DSB reports, it does not frustrate the intent of

[243] See e.g. Fudge, *supra* note 17 at 361; Pettis, *supra* note 32 at 290.
[244] Fudge, *ibid* at 361.The author argues that the intent of the article is to restrict the imposition of trade barriers which specifically influence import prices, rather than measures that influence economy as a whole (such as currency manipulation).
[245] Pettis, *supra* note 32 at 290.
[246] For example, Article XI of GATT prohibits non-tariff barriers, which also aims at facilitating free trade.

other GATT provisions. While this finding does not categorically exclude currency manipulation from the violation of paragraph 4 because there is still a possibility that currency manipulation infringes other provisions in a specific case, given that most provisions in GATT are supposed to be interpreted case by case.

The chapter has argued, by interpreting the provisions, that currency manipulation is not a subsidy for the purpose of the SCM Agreement, and neither does it violate Article XV of GATT. As the literature review in chapter one indicated, many scholars draw the same conclusion, although with different reasoning. Therefore, there are suggestions that a new agreement should be concluded to connect the IMF and the WTO to regulate the currency manipulation problem. The next chapter will analyze whether it is practical to conclude such an agreement. In addition to that, the chapter will also propose a new possible way for the WTO to combat currency manipulation: the anti-dumping mechanism.

III. POSSIBLE DEVELOPMENTS FOR WTO TO COMBAT CURRENCY MANIPULATION IN FUTURE

As the articles in the SCM Agreement and GATT cannot be interpreted to cover currency manipulation, there is little chance that a complaint against it will be supported by the WTO DSB. Therefore, many scholars are expecting the WTO to address the issue in future negotiations.[247] A straightforward solution to the problem is to change the current WTO legal system by concluding a new agreement to regulate the issue, which will make currency manipulation itself a violation of WTO rules and subject to the WTO dispute settlement mechanism, rather than being interpreted to be a subsidy or to be covered by GATT. It will make Article IV1(iii) of the IMF Agreement enforceable in practice. As will be introduced in detail in section one of this chapter, the agreement aims to cooperate the WTO and the IMF – WTO works as the dispute settlement body and the IMF contributes to technical analysis on whether there exists currency manipulation. This chapter will first examine the rationality and possibility of this cooperation mode under the current WTO and IMF agreements.

Apart from this widely proposed solution, section 2 of the chapter will present a new mechanism that has not been proposed before - to eliminate the unfair price advantage caused by currency manipulation through the anti-dumping mechanism. The section will first explain the relationship between currency devaluation and the calculation of anti-dumping duty. And then, it will analyze the legal basis, advantages, and disadvantages of the approach. Unlike chapter 2, the argument in this chapter will be based largely on facts, rather than theoretical analysis.

[247] See e.g. Mattoo & Subramanian, *supra* note 86; Jung, *supra* note 40 at 195.

1. Concluding a New Cooperation Agreement between the IMF and the WTO to Regulate Currency Manipulation

As reviewed in Chapter I, there has already been proposals on how to establish substantive and procedural rules on the two organization's cooperation.[248] For example, Mattoo and Subramanian suggest that the new rules must address two conditions for violation, the first of which is that undervaluation is found to exist, and the second is that the undervaluation is proved to be attributed to government actions.[249] Hufbauer and Schott also mention these two conditions in their proposal. In addition, they consider another two elements: the duration of actions and their impact on trade.[250] Since this chapter's task is to discuss the possibility to concluding the cooperation agreement, it will not analyze the substantive rules but will focus on the procedural design.

According to the literature review, the basic procedural structure is that one member complains to the WTO that another member violates the obligation of avoiding manipulating exchange rate. A panel will be established and make findings on whether the obligation is violated. In the decision-making process, the IMF will play an important role. It can give statistical advice on whether a currency is undervalued;[251] or it can directly provide a final determination on whether currency manipulation occurred;[252] or, it can even establish an independent panel and dispatch its experts to the panel.[253] After the panel report is issued, the rest of the procedure can follow the existing WTO enforcement mechanism. This procedural design seems to be an effective solution to the currency manipulation problem. However, as will be explained in subsection 2, it is not

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[248] See *supra* note 92 - 99.
[249] Mattoo & Subramanian, *supra* note 86 at 10.
[250] Hufbauer & Schott, *supra* note 86 at 12.
[251] Beckington & Amon, *supra* note 21 at 266.
[252] Jung, *supra* note 40 at 196.
[253] Hufbauer & Schott, *supra* note 86 at 12.

feasible in practice. Before subsection 2, subsection 1 will first examine the current cooperation mode of the WTO and the IMF and explain how the gap between the two organizations on the regulation of currency manipulation is generated.

1) The Gap between the WTO and the IMF on the Regulation of Currency Manipulation

In theory, the proposed cooperation mode does have its legal basis. GATT Article XV paragraph 1 requires that the members shall cooperate with the IMF and pursue a coordinated policy on exchange issues.[254] Paragraph 2 further addresses that the members shall "consult fully with" and "accept all findings of statistical and other facts presented by the Fund relating to foreign exchange" and accept its determination on whether an action violates the IMF Agreement.[255] These provisions leave adequate room for future cooperation between the WTO and IMF. It also indicates the WTO's attitude towards the cooperation: it believes that the IMF has more expertise on currency issues and will respect IMF's determinations on whether a measure violates the provisions of the IMF Agreement.

Based on the bilateral recognition of cooperation, the two organizations have already reached an agreement called the *Agreement between the International Monetary Fund and the World Trade Organization*. Paragraph 8 of the agreement mentions that the IMF shall inform the WTO (including the DSB) on whether the exchange actions within the IMF's jurisdiction is consistent with the IMF Agreement.[256] The *Agreed Commentary* on the article specifies that the paragraph applies to GATT Article XV and The General Agreement on Trade in Services (GATS) Article

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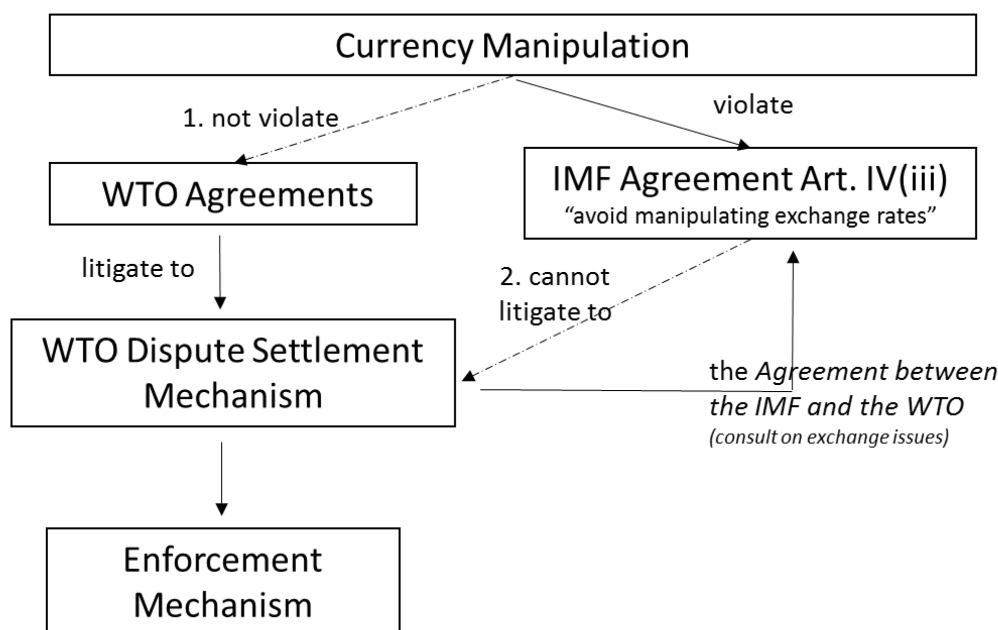
[254] *GATT* art XV paragraph 1.
[255] *GATT* art XV paragraph 2.
[256] *Agreement between the International Monetary Fund and the World Trade Organization*, 9 December 1996, Adopted by the IMF by Decision No. 11381-(96/105) (entered into force 25 November 1996) at para 8 in *WTO Agreements with the Fund and the Bank*, WT/L/195, 18 November 1996 ("The Fund shall inform in writing the relevant WTO body (including dispute settlement panels) considering exchange measures within the Fund's jurisdiction whether such measures are consistent with the Articles of Agreement of the Fund.").

XI,[257] both of which stipulate that the measures at issue shall not infringe the provisions of the IMF Agreement. In other words, the *Agreement between the IMF and the WTO* has already connected the IMF Agreement and the WTO dispute settlement mechanism with regard to the regulation of currency issues, while the premise is that the measure violates a *WTO obligation* and is addressed in a WTO case. However, as analyzed by section 3.2 of the last chapter, Article XV only requires *trade actions* to avoid frustrating the provisions in the IMF Agreement, which does not include currency manipulation.[258] And neither is currency manipulation related to the GATS. This creates a gap between the two organizations on the regulation of currency manipulation: since currency manipulation does not violate any WTO obligations, it cannot be complained to the DSB. Consequently, the IMF has no chance to inform the DSB whether the measure violates Article IV of the IMF Agreement and enforce the article. The relationship between the WTO Agreements, the IMF Agreement, and *the Agreement between the IMF and WTO* on the regulation of currency issues is illustrated in graph 1.

Graph 1 The Relationship between the Three Agreements on Currency Issues

[257] *Ibid* at Annex III "Agreed Commentary" para 8.
[258] *GATT* art XV.



In the graph, solid lines represent that the connection between the terms exists and dashed lines represent the opposite. There could have been two possible ways for currency manipulation to be complained to the WTO DSB, while both of them fail to work. Dashed line 1 describes that currency manipulation does not violate a WTO agreement, so it cannot be addressed by the WTO DSB; Dashed line 2 describes that although currency manipulation violates Article IV of the IMF Agreement, it cannot be litigated to the WTO DSB.

The graph indicates that although the existing agreement between the IMF and the WTO contributes to the cooperation between the two organizations, it fails to establish a regulatory framework for currency manipulation. Neither of the two gaps illustrated by the graph (the two dashed lines) is filled by the cooperation agreement. This explains why there are suggestions to conclude a new agreement against currency manipulation. These suggestions are either to transfer IMF Agreement Article IV 1 (iii) into a WTO obligation (path 1) or to make Article IV 1 (iii) litigable to the WTO DSB (path 2).

2) It Is Not Possible to Conclude a New Cooperation Agreement

Supposing that some countries, which are both WTO and IMF members, plan to initiate the negotiation of the new cooperation agreement to regulate currency manipulation, they will have to 1) get the *consensus* of the WTO members to add "avoiding to manipulation currency" to the WTO

legal system as a new obligation,[259] or 2) get no less than "three-fifths of the members, having eighty-five percent of the total voting power" to agree to subject IMF Agreement Article IV 1 (iii) to the jurisdiction of WTO dispute settlement mechanism.[260] In practice, neither ways will work because they cannot get adequate voting from the members to pass the proposal.

On one hand, it is obvious that countries who have been criticized for manipulating their currencies will not vote for the new agreement. These countries may include China, Japan, Korea, and Germany, which are all on the "Monitoring List" made by the US Department of the Treasury Office of International Affairs.[261] As long as one of them disagrees to include the regulation of currency manipulation in the WTO's jurisdiction, the agreement will not be concluded. Besides, the voting shares of the four countries in the IMF sums up to 19.39%,[262] which is large enough to veto the cooperation proposal in the IMF.[263]

On the other hand, neither are members who claim to be victims of currency manipulation seem to be willing to subject the issue to the joint regulation of IMF and WTO. For them, an important concern is that the IMF would be vested with too much regulatory power upon the members' currency arrangement, as a result of which their own sovereignty is hindered.[264] The

[259] See *Marrakesh Agreement Establishing the World Trade Organization,* 15 April 1994, 1867 UNTS 154 art IX (entered into force 1 January 1995). The article stipulates that "[t]he WTO shall continue the practice of decision-making by consensus followed under GATT 1947".
[260] *IMF Agreement* art X & art XXVIII. Article X stipulates that "[a]ny arrangements for such cooperation which would involve a modification of any provision of this Agreement may be effected only after amendment to this Agreement under Article XXVIII". And Article XXVIII stipulates that "[w]hen three-fifths of the members, having eighty-five percent of the total voting power, have accepted the proposed amendment, the Fund shall certify the fact by a formal communication addressed to all members".
[261] US Department of the Treasury Office of International Affairs, "Foreign Exchange Policies of Major Trading Partners of the United State" (29 April 2016) at 4-6, online:< www.treasury.gov/resource-center/international/exchange-rate-policies/Documents/2016-4-29%20(FX%20Pol%20of%20Major%20Trade%20Partner)_final.pdf > [*The US Exchange Policy Report*].
[262] In IMF, the voting shares of China, Japan, Korea, Germany are 6.12%, 6.18%, 1.74%, 5.35%. Taiwan is also on the list, while it does not have vote share in IMF since it is not recognized as a country in the United Nation. See IMF, "IMF Members' Quotas and Voting Power, and IMF Board of Governors", online: IMF<www.imf.org/external/np/sec/memdir/members.aspx>.
[263] While it does not exclude the possibility that some countries agree to accept the new agreement under certain political pressure.
[264] Howard, *supra* note 41 at 1230.

measure the US took against China's peg-to-dollar currency policy is evidence of this argument. Despite domestic petitions to impose trade sanctions on products from China, the US government insisted on imposing political pressure on Beijing.[265] This indicates that the US government is reluctant to bring currency issues to a legal level but preferring bilateral diplomatic discussion. The foreign exchange policy report published by the US treasury office also indicates the US's careful attitude on currency policies. The office determines three criteria to identify currency manipulation. And after examining its trade partners' exchange rate policy, it concludes that none of them satisfy all the criteria, even though it put five economies on the monitoring list.[266] The criteria are technically rather strict, with precise quantitative requirements on trade surplus and money flow. Besides, the criteria require that the intervention in exchange rate market be conducted *repeatedly*, as a result of which most countries are excluded from the scope of currency manipulators.[267] These high thresholds reflect the US's cautious attitude toward anti-currency-manipulation actions.

Besides, the recent trend of regional trade agreements can also shed light on the future of the cooperation agreement on currency manipulation because, compared with multilateral agreements, they usually go further in terms of facilitating fair trade. Regional trade agreements are concluded by a smaller number of members, which makes it easier to reach consensus on certain controversial issues. One example is the Trans-Pacific Partnership (TPP) Agreement, which has twelve members, including the US, Australia, Canada, Japan, etc. It has more advanced standards on fair trade and governmental regulation coordination than previous regional agreements. And in the US, during the negotiation stage, there were petitions from the congress, non-governmental groups, and

[265] See *HKTDC, supra* note 134.
[266] See *The US Exchange Policy Report, supra* note 261.
[267] *Ibid* at 1. Although the office blames the exchange rate intervention conducted by China in August 2015, it still does not identify China as a currency manipulator because China did not do it repeatedly.

economists to establish "strong and enforceable currency disciplines" in the TPP.[268] However, eventually, the agreement still fails to address exchange rate issues in its formal text. Instead, the issues are stipulated in a side agreement, *Joint Declaration of the Macroeconomic Policy Authorities of Trans-Pacific Partnership Countries*, which reiterates the obligation to avoid currency manipulation but has no enforcement mechanism.[269] This indicates that although the TPP members have concerns on exchange rate issues, they cannot reach consensus to, or are not willing to, make currency manipulation an enforceable violation of international obligation. Instead, bilateral discussions would be preferred by most countries.

One explanation for the countries' reluctance to make Article IV1(iii) of the IMF Agreement enforceable might be that, they attach vital importance to the freedom of arranging monetary policies. Even if the countries conclude an enforceable agreement to regulate currency issues, there is a high risk that they will violate it when there are no other effective tools to boost the economy. This has happened in the international monetary cooperation history. In 1944, the Bretton Wood System was established to build a new international monetary order after World War II, and the countries reached consensus to peg their currency values to the US. However, in 1971, when the US was facing a great depreciation pressure of the US dollar and failed to support the value of the US dollar after a series of measure, it unilaterally announced the suspension of the dollar's convertibility into gold and put an end to the Bretton Wood System.[270] And now, although the US has not directly interfered in the foreign exchange market, the three rounds QE it applied to boost its economy after the 2008 financial crisis has caused the US dollar to devaluate dramatically. If

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[268] Rep Sandy Levin, "The Need to Address Currency Manipulation in TPP, and Why U.S. Monetary Policy Is Not at Risk" (6 February 2016), *Huffpost Politics* (blog), online:< http://www.huffingtonpost.com/rep-sander-/the-need-to-address-curre_b_6631514.html>.
[269] Joseph E Gagnon, "More on TPP and Exchange Rates" (1 December 2015), *Peterson Institute for International Economics* (blog), online:< http://blogs.piie.com/trade/?p=525 >.
[270] The US Office of the Historian, "Nixon and the End of the Bretton Woods System, 1971–1973", online:< https://history.state.gov/milestones/1969-1976/nixon-shock>.

QE cannot work anymore, it is hard to predict what economic tools the US central bank can apply in the future.[271] The new agreement might deter its trade partner from intervening in exchange rate market, while it might also work against the US's monetary policies in future.[272] And the circumstance is similar in other major economies. Therefore, although some countries do not welcome currency manipulation, they are quite cautious on the independence of monetary policies, which makes it not likely for them to regulate it with an enforceable international agreement.

To conclude, this section has analyzed the rationality and the nature of the proposals to conclude a cooperation agreement between WTO and the IMF to effectively regulate currency manipulation: either by making currency manipulation a violation of the WTO obligations, or by connecting the IMF Agreement Article IV1(iii) and the WTO dispute settlement mechanism. In response to the proposals, the chapter has argued that it is not possible for the WTO members and IMF members, including members who are criticized as currency manipulators and members who claim to be harmed by currency manipulation, to conclude such agreements because most of them are reluctant to give up their sovereignty on currency policy arrangement. However, it does not mean that the WTO has no roles to play against currency manipulation. The next chapter will explain how some countries have already eliminated certain extent of injury caused by their trade partners' currency devaluation via the anti-dumping mechanism.

2. Indirect Participation through the Anti-Dumping Agreement

Chapter II and Section 1 of Chapter III has argued that currency manipulation does not violate current WTO agreements, including the SCM Agreement and GATT, and that it is not possible for

[271] In fact, the US central bank applies QE instead of general monetary policies because the latter have lost effect on economy. General monetary policy targets at decreasing short term interest. And when the short term interest is zero, the central bank has no choice but to interfere long term exchange rate to keep the inflation rate at the expected level. And when long term interest drops to zero, QE lost effect.
[272] Jeffrey Frankel, "The Top Ten Reasons Why Trade Agreements Should Not Cover Currency Manipulation" (16 June 2015), *Econbrowser* (blog), online:< http://econbrowser.com/archives/2015/06/the-top-ten-reasons-why-trade-agreements-should-not-cover-currency-manipulation>.

the WTO members to conclude a new agreement to cooperate with the IMF to regulate the issue. In other words, this paper disagrees with most previous proposals on regulating currency manipulation through the WTO mechanism. However, it does not mean that the WTO has no relationship with currency manipulation. As will be explained later, when a member is conducting anti-dumping investigation against a non-economic market member and using a surrogate country's price of like product to calculate dumping margin, the effect of currency undervaluation has already been involved in the process. This chapter will first explain how anti-dumping mechanism works in the WTO. And then it will analyze how exchange rate elements are considered in the calculation of dumping margin.

1) Anti-Dumping Mechanism in the WTO

Unlike subsidy, dumping does not resemble currency manipulation in many aspects. The most distinct difference is that dumping is usually considered to be conducted by private companies, rather than governments. However, dumping and currency manipulation lead to the same result: a lower export price which grants the export companies unfair advantages in international trade. What's more, since the anti-dumping investigation only focuses on whether there is a lower export price, rather than how the lower price is formed, it does not exclude circumstances where currency devaluation is also a causation of the low price. If an anti-dumping duty is imposed to offset the price advantage of the exporting company, it may also offset the impact of currency devaluation at the same time.[273]

According to GATT Article VI, when "products of one country are introduced into the commerce of another country at less than the normal value of the products", there is dumping.[274] The WTO does not categorically condemn dumping, but only dumping which "causes or threatens

[273] This will be explained in detail in sub-section (2).
[274] *GATT* art VI para 1.

material injury to an established industry in the territory of a contracting party or materially retards the establishment of a domestic industry".[275] If a member finds that, after the anti-dumping investigation, dumping exists with the import of one or several kinds of product from a country, and that the dumping causes material injury to its domestic industries, it can impose an anti-dumping duty on the product, but the duty must not be greater than the dumping margin, i.e. the price difference between *normal price* and *export price*.[276] This comparison determines whether there exist dumping and the maximum amount of anti-dumping duty the member can apply. Therefore, in order to analyze the relationship between currency manipulation and anti-dumping mechanism, the core issue in this section is how currency devaluation influences the calculation of dumping margin in anti-dumping investigations. Equation 1 explains the relationship between anti-dumping duty, dumping margin, export price, and normal price:

$$anti\ dumping\ duty\ \leq dumping\ margin\ = normal\ price\ - export\ price \quad \text{(equation 1)}$$

GATT Article VI has detailed instructions on how to ascertain the normal price of a product. Usually, normal price should be the price of like products for *domestic consumption* in the exporting country.[277] If such domestic price is not available, the investigating authority may consider the highest comparable price of like products exporting to a third country as substitution price, or constructs the normal price on its own based on the cost of producing and selling the product plus reasonable profits.[278] All of the three methods ascertain the normal price on the basis of the price of like products in the *exporting country*. Since this comparison can be deemed to be

[275] *Ibid.*
[276] *Ibid* para 2.
[277] *Ibid* para 1 (a).
[278] *Ibid* para 1 (b).

made between the same currency, i.e. the currency of the export country, currency devaluation does not influence the result of the calculation of anti-dumping duty.[279]

Apart from these normal methods of calculating dumping margin, there is also an exceptional method for countries which are identified as "non-market economy (NME)".[280] The logic behind a differential treatment to NMEs in anti-dumping investigations is that, in such economies, the price of goods is not determined by the demand and supply in the market, but is largely manipulated by the government, which makes the domestic price fail to reflect the real value of the goods. Therefore, the *ad* note to Article VI of the GATT determines that domestic price in NME is not appropriate to represent the normal price.[281] The methods used to ascertain the surrogate price is decided by the anti-dumping law of the members. A typical one is to choose a market-economy country which is in the similar development stage with the export country as the "surrogate country", and use the price for like product in that country as the normal price.[282] When there is not a like product in the surrogate country, the investigating party may consider the price of each factor input in producing the product in that country.[283] The detail of the methods may vary from case to case, but the methodology is the same: using the price in a surrogate country to ascertain the normal value.

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[279] It will be analyzed in detail in the next sub-section.

[280] An example of NME is China, which stipulates in its WTO Accession Protocol that it accepts NME status. While the period for the NME status is 15 years and it will end in December 2016.

[281] See *GATT ad* note 2 to Article VI Paragraph 1 ("… in the case of imports from a country which has a complete or substantially complete monopoly of its trade and where all domestic prices are fixed by the State, special difficulties may exist in determining price comparability for the purposes of paragraph 1, and in such cases importing contracting parties may find it necessary to take into account the possibility that a strict comparison with domestic prices in such a country may not always be appropriate.").

[282] See Jane M Smith, "U.S. Trade Remedy Laws and Nonmarket Economies: A Legal Overview" (31 January 2013) CRS Report for Congress at 2, online:<file:///C:/Users/Chen%20Yu/Desktop/project/us%20nme%20dumping.pdf>. This is the method adopted by the US since the 1960s.

[283] *Ibid* at 3.

In the WTO, the NME methodology is mainly used by the US and EU. For example, in *US – AD/CVD (China)*, the US initiated anti-dumping investigations on four products from China. For all of them, the US used surrogate prices instead of domestic prices in China because it believed that it should treat China as an NME.[284] The next subsection will use the trade between these two countries as an example to explain how the devaluation of currency influences the determination of dumping margin with different methods.

2) The Influence of Currency Devaluation on the Calculation of Dumping Margin

When trading with US companies, usually Chinese companies first ascertain a primary price based on the total cost of the product, including the cost of raw materials, producing, transportation, etc., plus the profit it expecting. Since most of the costs happen and are accounted in China, it is natural that the primary price is priced in the Chinese currency, yuan (hereby called export price in yuan). And then, when they quote the prices to US companies, they convert the prices to US dollars by dividing the price in yuan by the current exchange rate (hereby called export price in dollar).[285] Therefore, if the government intervenes in the exchange rate market to devaluate yuan, which means that one US dollar is worth more Chinese yuan, the price of the export product in dollars will be *lower* than the price without the currency devaluation. For example, assuming that an exporting company from China decides that it should sell the product at a price of 30 yuan each to a US company, and the exchange rate is 1 US Dollar: 6 Chinese yuan on the day of sale, the final price quoting to the US company will be 5 dollars. While at the same time, there is strong criticism that the exchange rate is a result of China's currency manipulation, and that the normal

[284] *US – AD/CVD (China), supra* note 124 (Panel Report) at 2-7. In the case, the US used NME methodology to calculate dumping margin and imposed anti-dumping duty concurrently with the countervailing duty against subsidy on the same product, which caused "double remedies" problem.

[285] It is possible that financial instruments such as Exchange Rate Agreements are used by the companies to avoid exchange rate fluctuation. While these circumstances are not discussed in this paper since they will make the analysis unnecessarily complicated.

exchange rate should be 1 US Dollar: 5 Chinese yuan, which means that the export price should have been 6 dollars. This devaluation of Chinese yuan causes a drop of export price in dollar.

The following paragraphs will discuss if, after an abnormal devaluation of Chinese yuan, which is believed by some countries to be manipulated by the government, the US finds that certain Chinese companies export products at prices lower than normal prices and conducts anti-dumping investigation on it, how this devaluation will influence the determination of dumping margin.

a. The Normal Methods

If the US does not treat China as an NME and uses the price of like product selling in China as the normal price, currency devaluation will not influence the calculation of dumping margin. The reason is that, since domestic like product is priced in Chinses yuan, the investigation group can simply use the export price in yuan recorded by the exporting company for comparison. If that price is not available, it can convert it back using the export price in dollar and with the same exchange rate applied on the date of sale.[286] In this process, the fluctuation of exchange rates does not affect the calculation of anti-dumping duty because the two prices for comparison, i.e., the normal price and the export price, are indeed not converted to prices in foreign currencies with the manipulated exchange rate.

Similar logic applies to the second method - using the highest export price to a third country as the normal value. In this scenario, the investigation group can directly compare the two export prices in yuan. The prices are recorded by the Chinese exporting companies and are before currency conversion. Currency devaluation has no role to play in the process.[287]

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[286] According to Article 2.4.1 of the Anti-Dumping Agreement, "[w]hen the comparison under paragraph 4 requires a conversion of currencies, such conversion should be made using the rate of exchange on the date of sale", and normally, "the date of sale would be the date of contract, purchase order, order confirmation, or invoice, whichever establishes the material terms of sale". *Anti-Dumping Agreement*, at art 2.4.1.

[287] Or, the investigation authority can compare the two export prices in dollar. Since the two prices decrease to the same degree as a result of currency devaluation, currency devaluation also does not influence the calculation of anti-dumping duty. For example, assuming that the highest export price for like product to a third country is 10 dollars.

With regard to the third method, the conclusion is the same. When the investigation group constitutes the normal price on this own, it has to consider the cost of materials for production, plus a reasonable amount for administrative, selling and general cost and profits.[288] Also, the data of cost and profits should be obtained from the records kept by the Chinese exporters and producers,[289] which means that they are priced in yuan. In terms of the influence on the calculation of anti-dumping duty, using this constructing normal price has no difference from using the domestic price because for both of them, the comparison is between the same currency, yuan. Therefore, in this scenario, the application of anti-dumping duty still cannot offset the effect of currency devaluation.

To conclude, anti-dumping duties calculated with all of the three normal methods fail to offset the lower export prices in dollar caused by currency devaluation because under the normal methods, exchange rate fluctuation does not influence the calculation of dumping margin.

b. The Surrogate Price/ NME Method

The US has been treating China as a non-market economy in the anti-dumping investigation for years. As explained above, this method uses the price in a third country as the normal price because it believes that the price in a non-market economy cannot reflect the true value of the goods. The following paragraphs will examine, under this method, the influence of currency devaluation on the calculation of dumping margin and anti-dumping duty based on the *assumption* that the value of the third country's currency is not manipulated.

This price is ascertained by the export companies after dividing 60 yuan by the exchange rate 1 dollar: 6 yuan. The export price for comparison is 5 dollars, which makes the dumping margin 5 dollars and the maximum of anti-dumping duty rate 100%. If the currency had not been devalued (1 dollar: 5 yuan), the highest export price will be 12 dollars (60/5), and the export price for comparison is 6 dollars, which make the maximum of anti-dumping duty rate still be 100%. It is important to note that this discussion assumes that the investigation group chooses the highest export price in transactions conducted *in the same time period* as the transaction being investigated so that the exchange rates used in the two transactions are very close.

[288] *Anti-Dumping Agreement* art 2.2.

[289] *Ibid* art 2.2.1.1.

In the anti-dumping investigation, the US will select a market economy which is in the same development stage as China and use the price of like product, or the price of the inputs to produce the product in that country as normal value (the surrogate price). In order to be compared with the export price, the surrogate price will be in US dollar and this price is not influenced by the devaluation of yuan.[290] While at the same time, the export price in dollar goes lower as a result of the devaluation of yuan, which means that the gap between normal price and export price, i.e. the dumping margin, become larger. In other words, the influence of currency devaluation is calculated in the dumping margin.[291] Therefore, if the US imposes an anti-dumping duty against certain products, the duty contributes to eliminating the price advantage caused by the devaluation of yuan.

In practice, the influence of currency devaluation may not be fully offset by the anti-dumping duty because dumping margin merely determines the maximum amount of the duty – the importing country may apply a lower duty rate. As a result, the influence of dumping is also not fully eliminated. However, this does not change the fact that the design of surrogate price method in the current WTO anti-dumping mechanism itself has already worked against currency devaluation.

3) Combating Currency Manipulation through the Anti-Dumping Mechanism

The analysis of the last section indicates that the choice of methods of calculating the dumping margin can determine whether the price advantage caused by currency devaluation can be eliminated by the anti-dumping duty: using the surrogate-price in a third country can eliminate the

[290] The surrogate price might be converted to US dollars by the investigation group in order to make comparison. However, as the discussion assumes that the third country does not manipulate its currency, the exchange rate used to covert currency can be deemed to be "fair".
[291] For example, assuming that the surrogate price ascertained by the US is 9 dollars, if yuan has not been devaluated, the exchange rate is 1 dollar: 5 yuan, then the export price is 6 dollars, and the dumping margin will be 3 dollars. After the devaluation of yuan to 1 dollar: 6 yuan, the export price is 5 dollars, and the dumping margin will be 4 dollars. The 1 dollar's drop of export price is calculated in the dumping margin. Therefore, if the US imposes anti-dumping duty on basis of this dumping margin, the influence of currency devaluation is eliminated.

influence while using the domestic price in the export country cannot. This finding provides a new angle for the WTO to work against currency manipulation: although the WTO cannot directly regulate the issue with the current WTO Agreements or concluding a new cooperation agreement with the IMF, it can indirectly eliminate the unfair trade advantage via the Anti-Dumping mechanism.

The basic idea is that the WTO permits the members to apply the surrogate price method in the anti-dumping investigations against dumping from countries which are identified as currency manipulators. This identification should be formally conducted by the IMF in accordance to Article IV1(III) of the IMF Agreement. For example, if, after exercising its authority to surveil the currency policies of the members, the IMF finds that Japan violates Article IV1 (iii) of the IMF Agreement by manipulating the exchange rate of Japanese yen against US dollar, the IMF shall inform the WTO. After that, the US is allowed by the WTO to use the surrogate price method in the following anti-dumping investigations against products from Japan until the IMF announces that the exchange rate has returned to the normal level. This may require the members to make amendments to the current Anti-Dumping Agreement. The following paragraphs will explain the legal basis, feasibility, advantages and disadvantages of this new proposal.

a. Legal Basis of the Approach

For an importing country, usually the most important concern is not the currency manipulation *per se* but the low export price currency manipulation causes, which may impact their own companies' market share and harm the domestic industries. This is exactly the principle of the anti-dumping mechanism – not to prohibit all dumping activities but only those that cause or threaten

material injury to the import country's domestic industry.[292] Therefore, it seems reasonable to solve the currency manipulation problem via the anti-dumping mechanism.

The current WTO legal system *de jure* supports this approach in two ways. The first has been discussed in Chapter III Section 1, which is the WTO's recognition of the IMF's findings on whether an exchange action violates the IMF Agreement.[293] Therefore, if the IMF finds that a member violates the obligation of avoiding currency manipulation, the WTO members and the DSB can directly use that result as the basis for further findings and actions. The second basis lies in footnote 2 to paragraphs 2 and 3 of GATT Article VI, which stipulates that multiple currency practices[294] can in certain circumstances "constitute a form of dumping by means of a partial depreciation of a country's currency which may be met by action under paragraph 2[295]".[296] Although "multiple exchange rate" is not the same as currency manipulation, it indicates that the anti-dumping mechanism in the WTO does take the influence of exchange rate into account, which leaves room for future negotiations on the coordination between exchange rate arrangements and the anti-dumping mechanism.

What's more, this proposal is *de facto* acceptable in the WTO legal system. Previous practice confirms that the anti-dumping mechanism only focuses on the price gap between normal price and export price, in spite of whether the price gap is caused by the export company's own low-pricing strategy or government actions or other social economic elements. For example, in *US – AD/CVD (China)*, the US levied anti-dumping duty and countervailing duty concurrently on the same product. This caused the "double remedies" problem because by using the NME method, the

[292] *GATT* art VI para 1.
[293] See *supra* note 255.
[294] There is not a definition of "multiple currency practices" in GATT or the IMF Agreement. It usually means that the government of a member applies different exchange rates in different circumstances.
[295] Paragraph 2 authorizes the WTO members' right to levy an anti-dumping duties on the dumped product which is not larger than the dumping margin.
[296] *GATT* Interpretative Note Ad Article VI at paras 2 and 3 (2).

drop of price caused by the government's subsidy has already been calculated into the dumping margin and consequently, levying a countervailing duty will offset the effect of subsidy twice.[297] The AB in the case recognized the "double remedies" problem but did not find the calculation of anti-dumping duty problematic.[298] Instead, it found that the imposition of the countervailing duty was not appropriate.[299]

A similar idea of combating currency manipulation through the anti-dumping mechanism, but with a different approach to calculating dumping margin, was proposed before in a congress bill in the US.[300] It was criticized by some scholars for the reason that "[d]umping is a matter of companies' product pricing decisions, which have nothing to do with the macro-level governmental measures that lead to exchange rate misalignment".[301] However, this argument lacks support from legal texts and practices. No text in the GATT or the Anti-Dumping Agreement suggests that the *conductors* of dumping must be private companies. Instead, the anti-dumping mechanism in the WTO merely focuses on the *price*. The nature of anti-dumping is "anti-price-discrimination"[302] and elements beyond the export company's activities can also contribute to the decrease of export price. Besides, as the last paragraph explains, the existence of NME method in

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[297] *US – AD/CVD (China)* (Appellate Body Report), *supra* note 124 at 199 - 202.
[298] *Ibid* at 218.
[299] *Ibid*.
[300] The bill was proposed in the 111th session of Congress (2009-10). Section 105 of the bill specifically requires the investigation authority to "[adjust] the price used to establish *export price* or constructed export price to reflect the fundamental misalignment of the currency of the exporting country". For example, assuming that a Japanese company sells a product for 200 yen domestically, and exports it for 1 US dollar. The current exchange rate is 1 dollar: 150 yen, while the investigation authority believes that the equilibrium exchange rate should be 1 dollar: 100 yen. In this circumstance, according to the proposal, the investigation authority should convert the export price (1 dollar) with the equilibrium exchange rate (1:100) instead of the exchange rate influenced by currency manipulation (1:150), and compares it with the normal price (200 yen). With this method, the dumping margin will be higher than normal method. However, the proposal does not explain how to determine the degree of the "misalignment of the currency of the exporting country". In general, this proposal is technically difficult to be implemented.
[301] Zimmermann, *supra* note 77 at 457. Robert W. Staiger and Alan O. Sykes hold the same opinion that dumping is a firm-level activity rather than government-level. See Staiger and Sykes, *supra* note 97 at 615.
[302] See WTO, "Technical Information on anti-dumping", online:< https://www.wto.org/english/tratop_e/adp_e/adp_info_e.htm >. Dumping can be deemed as a discrimination between domestic consumers and the import country's consumers.

the current anti-dumping mechanism reveals that the WTO does not prohibit the members from counting the influence of subsidies in the calculation of dumping margin, which also means that dumping is not necessary a purely company-level activity.

b. Feasibility of the Approach

In practice, this proposal is relatively feasible. To start with, there is no need for the WTO to develop new technical standards on the identification of currency manipulation. In this proposal, the WTO members simply accept the findings of the IMF on whether a member violates article IV of the IMF Agreement. Neither does it need to design new methods to calculate dumping margin which are especially for currency manipulators, as the members can keep using the current surrogate price method. The only change to the current Anti-Dumping Agreement is that a provision allowing the members to apply the surrogate price method in anti-dumping investigations against currency manipulators is added.

Secondly, it is possible for the WTO members to accept the amendment because no additional obligation is imposed as a result of the amendment. And there is no risk for them to be complained to the DSB for currency manipulation. As explained in section 1, the reason for the members' reluctance to regulate currency manipulation is that they attach importance on the independence to make monetary policy arrangements. In this proposal, since currency manipulation *per se* does not violate the WTO rules, a member cannot complain it to the WTO and require another member to stop the intervention activities or to take measures to bring the exchange rate to a normal level. Therefore, the members do not need to worry that its currency arrangement will be challenged under the WTO system. Meanwhile, there will not be extra pressure from the IMF in the currency policy reviews. The procedure and standards for the reviews will be the same as the previous ones, which are largely based on the IMF Agreement.

c. Advantages of the Approach

Compared with the proposals analyzed in chapter II and chapter III, this one has more advantages at both the legal level and the technical level.

To start with, the approach avoids impairing the coherence of the WTO legal system by focusing merely on whether there exists dumping, rather than the legality of the members' currency policies. The previous proposals, including the proposals to identify currency manipulation as a subsidy and to conclude a new cooperation agreement between the IMF and the WTO, all require the WTO to directly regulate currency manipulation, which unreasonably expands the regulatory scope of the WTO. The WTO, as its name indicates, is supposed to deal with trade relations between the members, such as trade in goods, service, trade-related intellectual property rights and trade-related investment measures. While currency manipulation, as a monetary issue, is under the regulation of IMF. In addition, GATT Article XV, which requires the WTO to consult the IMF on certain currency issues instead of making decisions independently, confirms this specialization of duty between the two organizations.[303] Although the WTO and the IMF shall cooperate with each other on currency issues, this division of responsibility should still be respected. Besides, it is well known that the Doha Round negotiation is facing a deadlock, which has caused worries about the development of the WTO system.[304] Expanding the responsibility of the WTO at this time will certainly worsen the situation. As the former chairman of the Appellate Body said, proposing the WTO to combat currency manipulation with punitive tariffs is pushing the WTO beyond its limits.[305] Counting the influence of currency manipulation in calculating dumping margin

[303] *GATT* art XV para 1.
[304] Beginda Pakpahan, "Deadlock in the WTO: What is next?" online: WTO < https://www.wto.org/english/forums_e/public_forum12_e/art_pf12_e/art19.htm>.
[305] Jim Bacchus, "Don't Push the WTO Beyond Its Limits", online: (2010) The Wall Street Journal at para 12 < http://www.wsj.com/articles/SB10001424052748703312504575141653709335366>.

prevents the WTO from bearing the responsibility to regulate currency manipulation. In nature, the WTO is still regulating anti-dumping measures but merely making adjustments to the method of dumping margin calculation. In the process, the authority of making findings on currency manipulation lies totally in the IMF.

Secondly, compared with directly regulating currency manipulation, this approach avoids the "double remedies" problem. As mentioned in subsection 1, if the investigation authority uses the surrogate price method to calculate dumping margin, the price decrease contributed by subsidy is also included. Therefore, levying an anti-dumping and a countervailing duty concurrently will cause the "double remedies" problem. The same logic applies to the circumstance where the members are allowed to impose import duty against currency manipulation. Under the surrogate price method, the influence of currency devaluation is also counted in the dumping margin. If the importing member launches an anti-dumping investigation and an anti-currency-manipulation investigation simultaneously, there is a large chance that the price drop caused by currency devaluation is offset twice. While counting currency devaluation only in anti-dumping investigations avoids the problem.

Thirdly, this approach avoids the technical difficulty in calculating the "devaluation margin". A core mechanism of proposals on regulating currency manipulation with the SCM Agreement, GATT, or a new cooperation agreement is that the members are allowed to levy punitive import duties against currency manipulation. But the investigation authorities must first ascertain how much the currency manipulation contributes to the decrease of price. For example, in the anti-subsidy mechanism, the investigation authority has to calculate the amount of subsidy granted by the government and then levy the countervailing duty based on that amount. Similarly, if a member intends to impose an "anti-currency-manipulation" duty, it firstly needs to calculate the degree of

currency devaluation caused by the government's intervention, which is the difference between the exchange rate after manipulation and the estimated market-equilibrium exchange rate, and then levy the duty accordingly. In practice, as explained in Chapter II section 2 above, it is quite difficult to estimate the real exchange rate level accurately.[306] By contrast, counting currency devaluation in anti-dumping investigations skips over this difficulty because there is no need to estimate the market-equilibrium exchange rate in order to know how much the currency is devalued. With the surrogate price method in anti-dumping investigations, the drop of export price caused by currency manipulation has been calculated in dumping margin. Therefore, the investigation authorities simply need to calculate the dumping margin, which is the gap between the exporting price and the normal price of the products in the surrogate country, and both of them are available from the companies' records.

Last but not least, compared with directly regulating currency manipulation, the approach works better in balancing the goal of promoting free trade and the goal of eliminating trade distortion. Unlike subsidy and dumping, currency manipulation does not occur to specific enterprises or industries but influence every cross-border transaction. Therefore, if an import duty is levied against currency manipulation, it does not have a specific target but may generally increase the level of tariff on all products from the exporting country, which excessively rectifies the trade distortion. Binding tariffs, which means that the members are obligated to keep the tariff level as committed and avoid increasing the tariff, is a core principle of the WTO, and anti-dumping and countervailing duties are merely *exceptions* to this principle.[307] The impact of "anti-currency-manipulation" duty as a trade barrier is much severer than anti-dumping and

[306] It has been discussed in footnote 210.
[307] See WTO, "Anti-dumping, subsidies, safeguards: contingencies, etc" online: WTO <https://www.wto.org/english/thewto_e/whatis_e/tif_e/agrm8_e.htm>. The third exception is the application of "safeguard" measures.

countervailing duties because it worsens the holistic trade condition between the export country and import country, which deviates too far from the principle of binding tariff and the goal of promoting free trade. By contrast, by counting the influence of currency manipulation in the anti-dumping investigation, the target of import duty is limited to specific enterprises or industries and to those that cause material injuries to the import country's industries.[308] In other words, it ensures that the punitive tariff is levied in an appropriate degree. For example, if after the currency devaluation, an exporting company decides not to adjust the export price with the new exchange rate and keeps the previous export price, it, in fact, does not gain price advantages from the devaluation. In this scenario, it will not be imposed with import tariff in anti-dumping investment as the dumping margin is zero. However, if the importing country levies a tariff against currency manipulation, this "innocent" company has to pay the extra tariff, which is certainly inconsistent with the goal of the WTO.

d. Disadvantages

Despite the legal and technical advantages, the approach has two critical deficiencies: there is a high risk that the amendment to the Anti-Dumping Agreement fails to get enough support to be conducted and even if it is conducted, the provision may be left unenforced.

To start with, although the feasibility analysis in sub-section 2 concludes that it is possible to make such amendment, there will inevitably be resistance to the approach. The oppositions will not only be against the WTO's involvement in currency issues, but also the surrogate-price method itself. China stipulates in its WTO Accession Protocol at Section 15 that it can be treated as an NME in anti-dumping investigations until 11 December 2016.[309] With the termination date

[308] Anti-dumping duty can only be levied when the import country's domestic industries are materially injured.
[309] See *Accession of the People's Republic of China* (23 November 2001) WTO Doc/WT/L/432 at provision15, online: WTO <https://www.wto.org/english/thewto_e/acc_e/completeacc_e.htm>. Provision 15(a)(ii) stipulates that the importing member is allowed to use the NME method if the company under investigation cannot market

approaching, there is an increasing debate over whether China can be automatically granted market economy status.[310] Since the surrogate-price method has caused the amount of dumping margin to be higher than normal methods in anti-dumping investigations, it is not surprising that China insists that it should be granted market economy status after the expiration of the provision.[311] However, members such as EU and the US argue that China's market condition still fails to meet the standard of market economy and that the NME treatment should remain.[312] If both sides insist on their position, it is possible that the issue will be litigated in the WTO. As there is already resistance from countries like China to the surrogate price method, it may be harder for them to agree on an expanded application of the method to include currency issues.

Secondly, even if the members reach consensus on amending the Anti-Dumping Agreement to permit the importing member to apply the surrogate price method, there is a significant chance that the provision cannot be enforced in practice as the IMF has not identified any countries as currency manipulators. Under this approach, a premise to use the method is that the exporting member is found by the IMF to manipulate the exchange rate. However, up to now, although the Executive Board of the IMF has conducted consultations on Article IV 1 (iii) of the IMF Agreement with a large number of members every year, it rarely criticizes a member's exchange rate arrangement[313] and it has never found that a member violates Article IV 1 (iii). With regard to the most criticized currency, Chinese *yuan*, the IMF has not found its value problematic. On the contrary, the IMF adds yuan to the basket of currencies that make up the Special Drawing Right

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economy conditions prevail in its industry. While Provision 15(d) addresses that paragraph (a) shall be terminated once China meets the import member's market economy criteria and that "[i]n any event, the provisions of subparagraph (a)(ii) shall expire 15 years after the date of accession".

[310] Laura Puccio, "Granting Market Economy Status to China" (2015) *European Parliamentary Research Service* at 1, online: European Parliament <http://www.europarl.europa.eu/RegData/etudes/IDAN/2015/571325/EPRS_IDA(2015)571325_EN.pdf>.

[311] *Ibid*.

[312] *Ibid*.

[313] In 2014, it criticized South Korea for devaluating the currency *won*. See *supra* note 22.

(SDR).[314] Although the standards for selecting the basket of currencies do not include the requirement that the value of the currency is not manipulated, this decision at least indicates that the IMF believes Chinese yuan to be reliable for conversion.[315] Therefore, as long as the IMF does not make findings on currency manipulation, this amendment to the Anti-Dumping Agreement will, in fact, change nothing.

To conclude, the approach proposed in this section is not a perfect solution to the currency manipulation problem, but it provides a new avenue on what endeavor the WTO can make to adjust the trade distortion caused by it, especially given that this approach does have more advantages compared with previous proposals.

[314] IMF, Press Release, No. 15/540, "IMF's Executive Board Completes Review of SDR Basket, Includes Chinese Renminbi" (30 November 2015), online: IMF < https://www.imf.org/external/np/sec/pr/2015/pr15540.htm>. SDR is one kind of international reserve asset. The value of one SDR is determined by a basket of currencies. Currently there are five currencies in the basket, namely the U.S. dollar, euro, Japanese yen, pound sterling and Chinese yuan.

[315] There are two standards to select the basket of currencies: 1) the member's exports have the largest value over a five-year period and 2) the currencies are determined by the IMF to be "freely usable". (IMF, "Review of the Special Drawing Right (SDR) Currency Basket" (6 April 2016), online: IMF <https://www.imf.org/external/np/exr/facts/sdrcb.htm>.)

CONCLUSION

This paper has discussed possible ways for the WTO to combat currency manipulation. The history of international monetary laws shows that the multilateral regulation of currency policies has evolved from no international rules to uniform fixed-exchange-rate scheme and now to the status that the IMF's surveillance is the dominant method of regulation. However, this surveillance lacks effective enforcement mechanism to sanction the members for manipulating currency.

In this background, an increasing number of scholars and politicians seek to solve the problem through the WTO system because the WTO has a sophisticated dispute resolution and enforcement mechanism. The most proposed solution is to identify currency manipulation as an export subsidy so that the importing members can levy a countervailing duty against it. However, Chapter II of this paper, after interpreting the provisions, finds that currency manipulation does not satisfy the definition of subsidy in Article I of the SCM Agreement because 1) it does not fall within the scope of "financial contribution"; 2) "benefit" may be granted in a general sense but it is not able to be measured with the method in the agreement, and 3) it is not "specific" for the purpose of Article 1 or Article 3. In addition to the SCM Agreement, Chapter II also finds that GATT Article XV cannot be interpreted to cover currency manipulation. It does fall into the scope of "exchange action", but it does not frustrate the intent of any provision in the GATT.

The analysis in Chapter II shows that the current WTO rules fail to contribute to the regulation of currency manipulation. Therefore, Chapter III focuses on what developments the WTO can make through future negotiations. One possible way is to cooperate with the IMF, in the process of which the IMF is responsible for making findings on whether a member manipulated its currency, and the WTO works as the dispute settlement and enforcement body. This new agreement will ensure that trade sanctions be imposed to currency manipulators. However, this

proposal is not feasible in practice because it lacks support from not only countries who are criticized for being currency manipulators, but also countries who claim to be victims of the manipulation. Hence, Section 2 of the Chapter seeks to explore a more feasible and more desirable approach for the WTO to combat currency manipulation, which is to amend the Anti-Dumping Agreement and apply the surrogate price method in anti-dumping investigations against countries who are found by the IMF to manipulate currency. By using the surrogate-price method, the price decrease caused by currency devaluation will be calculated in dumping margin so that the anti-dumping duty will eliminate this trade advantage. This approach has both advantages and disadvantages but it does provide a new perspective.

The WTO system is designed to regulate trade relations between the members. Therefore, it is not surprising that its agreements fail to cover currency issues. What's more, the problem of currency manipulation itself is fraught with complexities: on one hand, there is a strong protest against it; while, on the other hand, no country is taking actions to establish a regulatory framework because they also have concerns about their own freedom to make currency policy arrangements. Therefore, the role the WTO can play in the regulation of currency issues is quite limited, especially given the fact that the Doha Round Negotiation is facing a deadlock.

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